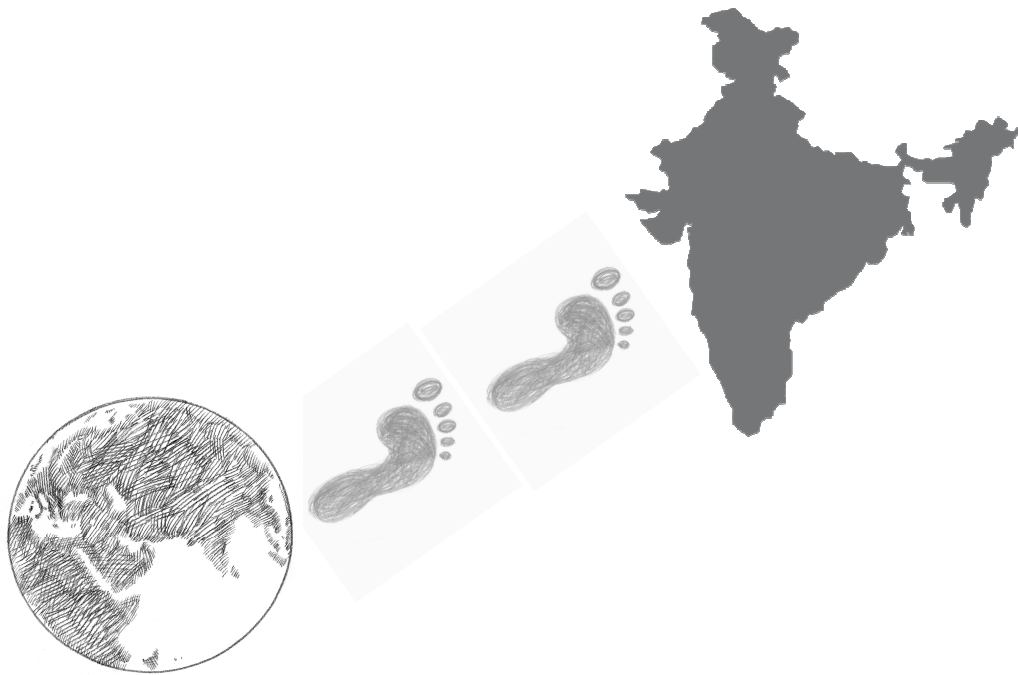


A guide to establishing presence in India

2011



“Grant Thornton combines the international reach, depth and expertise of the largest firms with the personal attention, value for money focus and relationship approach of the smaller firms, which has made us the leading firm in each of our chosen markets. This combination has made us the business advisers of choice to Indian businesses and their owners when they seek global expansion, global capital or global acquisitions.”

Vishesh Chandiok
National Managing Partner
Grant Thornton India



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India – fact file

India is emerging as a major market and investment destination and the U.S. Department of Commerce has identified India as one of the world's top ten “Big Emerging Markets”. Outlined below are some of the key facts and statistics that confirm this fact.

India is a Union of States with parliamentary system of Government

Capital: New Delhi

Land area: 3.29 million square kilometres. Slightly more than one-third the size of the United States

Climate: Mainly tropical with temperature ranging from 100 – 400 C in most parts

Time Zone: GMT +5½ hours

Population: 1,166,079,217 (July 2009 estimate.)

Internet users: 81 million (November 2008)

GDP: INR 3,609,425 crore at factor cost at constant prices (1999-2000)

GDP composition By (Economic Survey 2008-09):

- Agriculture: 18.5 per cent
- Industry: 22 per cent
- Services: 56 per cent

Currency: Indian Rupee (INR)

Exchange rate: INR 48.35/1US\$ (as on August 13, 2009)

Foreign exchange reserves: US\$ 271,641 million (as of July 31, 2009)

Exports: US\$ 168,704 million (Economic Survey 2008 09)¹

Imports: US\$ 287,759 million (Economic Survey 2008 09)¹

- the second largest English-speaking scientific, technical and executive manpower resource in the world
- an abundant supply of raw materials
- an extensive rail and road network
- a common law legal system, with English as a court language
- Goldman Sachs in its paper “Dreaming With BRICs: The Path to 2050” published in 2003 argues that the economic potential of Brazil, Russia, India and China (BRIC) is such that they may become among the four most dominant economies by the year 2050.

Major international airports: New Delhi, Mumbai, Chennai, Kolkata, Bangalore, Hyderabad, Thiruvananthapuram, Goa

Major ports of entry: Vizag, Kolkata, Haldia, Chennai, JLNehru, Kandla, Kochi, Momugao, Mumbai, New Managalore, Ennore, Paradip and Tuticorin.

¹ growth rate on provisional over revised basis and based on Department of Commerce methodology.

Business opportunities in India

Since 1991, India has undergone a sea change in its outlook towards foreign investment and global collaboration. Add to that the second largest English-speaking scientific, technical and executive resource for manpower in the world; it's no wonder that softwares and Information Technology enabled services have really led India's outward push.

The economic reform process has been stepped up since October 1999 and India's economy continues to progress on a higher growth path. The country is committed towards implementing economic reforms, encouraging investment and technology flows, and actively promoting and facilitating greater private sector participation in all sectors of the economy.

India is the fourth largest economy in the world, and has the second largest GDP among developing countries, based on purchasing power parity. Economic indicators are promising. It is the world's largest democracy, with a long established and robust democratic, federal system. India has a large market, and a growing middle class with substantial purchasing power. It has a long established legal and accounting system, an independent judiciary, a free and vibrant press, and a strong tradition of entrepreneurship. The use of English is widespread in business and commerce. Indian engineers, scientists, technicians, managers and skilled personnel are widely regarded as among the best in the world. The Information Technology sector continues to show growth. India's vast reservoir of knowledge workers has attracted many global companies to do business in India. Seldom mentioned is India's advance in biotechnology. India is today among the top five countries in the Asia Pacific region. India shows immense potential not only as a destination for new generation pharmaceuticals, biotech products and diagnostics but is also becoming an important hub for outsourcing of clinical trials and contract research. Also, education sector is amongst one of the sunrise sectors in India.

As India moves ahead with its economic reforms, opportunities wait to be exploited in sectors such as

energy, telecommunications, insurance and financial services, manufacturing, transportations, urban development, and other areas of infrastructure.

Procedures are being simplified and streamlined to help global companies like you to do business in India. Real Estate in India shows every sign of emerging as one of the fastest growing sectors, second only to agriculture in terms of employment generation. Currently, housing sector in India contributes to 5 per cent of GDP, which is expected to rise to 6 per cent in future. Indian real estate sector is expected to attract US\$ 12.11 billion in next five year period. In particular, the recent decision by the Government to allow 100 per cent FDI in the sector along with the easing up of bank finance for developers have acted as important catalysts for the sector.

We welcome you to India.

Country profile

History

India origins date back to the Indus Valley civilization, which is one of the oldest in the world, going back more than 5,000 years. Aryan tribes invaded India from the northwest, around 1500 B.C.; their integration with the earlier inhabitants created the classical Indian culture. Arab incursions started in the 8th century and Turkish in the 12th, followed by European traders in the late 15th century. By the 19th century, Britain had assumed political control of virtually the whole of India. Non-violent resistance to British colonialism under Mohandas Gandhi and Jawaharlal Nehru led to independence in 1947. The subcontinent was divided into the secular state of India and the smaller Islamic state of Pakistan. The third war between the two countries in 1971 resulted in East Pakistan becoming the separate nation of Bangladesh.

A predominantly agrarian economy, after independence India embarked on building a modern industrial base through a planned economy on the basis of the vast agricultural sector, with emphasis on self-reliance. This resulted in rapid industrialisation and substantial investment in the Government owned Public Sector Undertakings. However, the growth in the industrial sector and the economy was however, largely due to slow growth in the agricultural sector.

With the introduction of the New Economic Policy in 1991, India fundamentally altered its development strategy, from the planned and strictly regulated approach which isolated the country from the rest of the world, to that of structural reforms and opening up of the economy through liberalisation leading to globalisation.

Geography

The Republic of India forms a natural subcontinent with the Himalayan mountain range to the North and two sections of the Indian Ocean – the Arabian Sea and the Bay of Bengal lie to West and the East respectively. India borders Pakistan to the northwest, China, Bhutan and the Nepal to northeast and Bangladesh and Myanmar to the east. Near the country's southern tip across the Palk Strait is Sri Lanka.

It has a land frontier of over 15,000 kms, from the Himalayas in the north to the Palk Straits in the south and from the Arabian Sea in the west, to the Bay of Bengal in the east and a long coast line of over 7,000 kms. The climate varies from the tropical in the south to temperate in the north. India is a land of immense cultural, religious, linguistic and economic diversity and is the second most populated country with a population of around more than 1.15 billion. India is rich in natural resources having the fourth largest reserves in the world for coal. Other resources include iron ore, manganese, mica, bauxite, titanium ore, natural gas, diamonds, petroleum, limestone, etc.

With an ancient culture, rich tradition and history dating back several thousand years, India has a secular society where all religions of the world are respected and practiced. The Constitution of India has specified 18 languages, of which Hindi and English are the official languages. All these characteristics add to the vastness and diversity of India making it a large and growing market.

Standard of living

The burgeoning and yet untapped middle and upper middle class market, is the reason for India being considered as an attractive, high growth market, and more so as the market penetration levels in India are high. The post liberalisation era has led to an unprecedented consumer boom with tremendous rise in the demand for both consumer durables and non-durables.

Although two third of the population still resides in the semi-urban and rural areas, the standard of living in the metropolitan cities is comparable to the best in other developing countries.

Education

The Indian educational system is widely recognised to maintain high standards and consists of public and private schools, universities and institutions of higher learning. These impart academic and vocational training besides encouraging participation in sports and extra-curricular activities. Education in the field of literature, computer engineering & programming, science & technology and business management & administration is considered to be of the highest global standards. India also has a well-developed accountancy, legal, actuarial and consultancy profession.

India, however, lags behind in primary education, overall literacy rate being around 65 per cent, even though several literacy campaigns have been undertaken by successive Governments.

The modern Indian Education System represents an intriguing fusion of the Eastern and Western values. Computer and Technical Education are emphasised at all levels, and the private investment in this field is substantial. Indian Institutes of Technology (IIT), Science (IISc) and Management (IIM) have assumed an international reputation for their international quality professional courses. The result of the gains of high quality technical education has been evident by the fact that India now has the third largest pool of technical manpower in the world, its scientists and engineers are sought after throughout the world and India's performance in software exports is doubling every three years India is now one of the largest exporters of computer software in the world, and it has the largest trained manpower in the field of computer technology. In this field of high technology and advanced learning, it is to the credit of the country that it has been able to produce world quality professionals. However, despite all these progress, illiteracy continues to be a major hindrance to development in India and even after 62 years of independence, India has not been able to mobilize the modest resources required to finish this fundamental job.

Legal and political environment

India is the largest multi-party democracy in the world and under its Federal Constitution has adopted a Parliamentary System of Government with two Legislative Houses. The country is a Union of 28 States and 7 Union Territories, each governed by governments comprising elected representatives of the public. The Central and State Governments comprise a Council of Ministers headed by a Prime Minister and a Chief Minister respectively. The Prime Minister and the Chief Minister is usually the head of the party, which has support of the majority members in the Parliament and the State Assembly respectively. Elections are usually held for the States, Union territories and the Centre once every five years

The Central Government is based in the National Capital Territory of New Delhi and has exclusive jurisdiction over all matters of national interest such as defence, communication; banking and currency, international trade and foreign affairs. The State Governments have primary responsibility for matters like law and order, education, health and agriculture.

Several regional and national parties – having different ideologies – are active players on the political front. In the decade of the 1990's, the country witnessed political instability, several governments and frequent elections, which had an unfavourable effect on economic reforms, the country's development and world outlook towards India, but not on economic growth.

All the States, Union territories and the Union Government, have their own legislation and laws, which are increasingly becoming investor friendly. Ever since the economic liberalisation process began in 1991, successive governments are striving to remove bureaucratic, legal and other structural bottlenecks to attract both local and foreign investment, especially foreign direct investment.

Judiciary and law

India has a well established, independent judicial system. The Supreme Court of India is based in New Delhi and is the highest court of appeal. The High Courts are based in the respective State Capitals, along with subsidiary District Courts. All these courts collectively enforce the rule of law and safeguard the fundamental rights of citizens which are guaranteed by the Constitution.

India's legal framework is mainly adopted from English law. Based on the principles of equality and secularism, Indian laws are aimed at the protection and promotion of business entities and healthy industrial and social environment and labour protection. Until 1991, the home-grown industry was protected by law against global competition; since then, the laws have been gradually amended to open up several sectors to foreign investors in keeping with the requirements of World Trade Organisation.

The laws governing the business environment can be categorised into:

- labour laws
- corporate and other allied laws
- taxation laws

The most important piece of financial legislation is the Union Budget, which is generally presented on the last day of February every year, and passed by the Parliament.

Economy

India's economic policies are designed to attract significant capital inflows into India on a sustained basis and to encourage technology collaboration agreements between Indian and foreign firms. Policy initiatives taken over the past few years have resulted in significant inflows of foreign investment in all areas of the economy, except those reserved for the public sector.

Today, India is one of the most exciting emerging markets in the world. Skilled managerial and technical manpower that match the best available in the world and a middle class whose size exceeds the population of the USA or the European Union, provide India the distinct cutting edge in global competition.

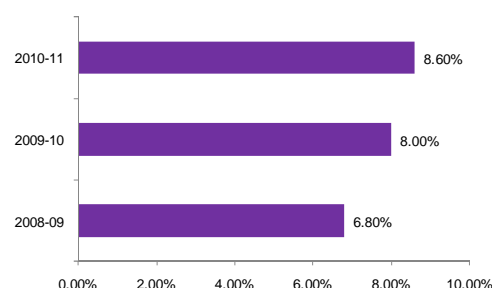
Indian economic profile

GDP and key fiscal indicators:

- GDP (Gross Domestic Product) growth rate registered at 8.6% during FY 2010-11 as compared to 8% of 2009-10
- Gross fiscal deficit at 4.8% of the GDP in 2010-11, lower than provisional actuals of 6.3% estimated for 2009-10
- Revenue deficit recorded at 3.5% of the GDP in 2010-11, lesser than provisional actuals of 5.1% estimated for the preceding year
- Primary deficit at 1.7% of the GDP in 2010-11, down from provisional actuals of 3.1% estimated for 2009-10

Sources: Economic Survey, 2010-11
Fiscal indicators for 2009-10 are based on the provisional actuals for 2009-10

GDP (factor cost 2004-05 prices)



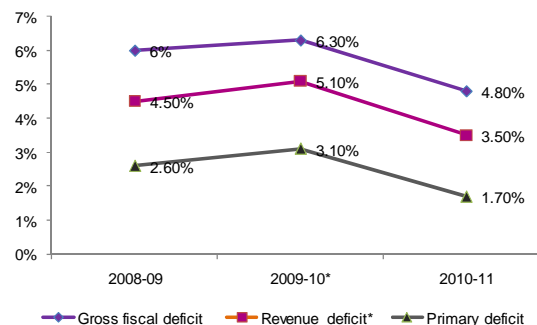
External sector and per capita net national income

- Robust growth in exports: 29.5% in 2010-11 from -3.5% registered in 2009-10
- **Imports registered at 19%** in 2010-11 from -5% being recorded in the previous year
- Per capita net national income (factor cost at current prices): INR 54527 in 2010-11, which is more than 17% higher than INR 46492 of the preceding year

Money and credit

- Scheduled commercial bank credit growth estimated at 24.4% in 2010-11, from 16.9% of the preceding fiscal year

Key fiscal indicators (% of GDP)

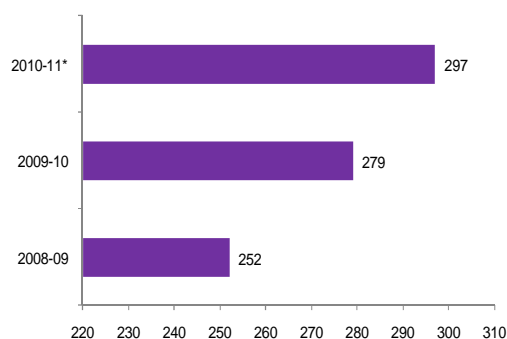


Other key economic indicators

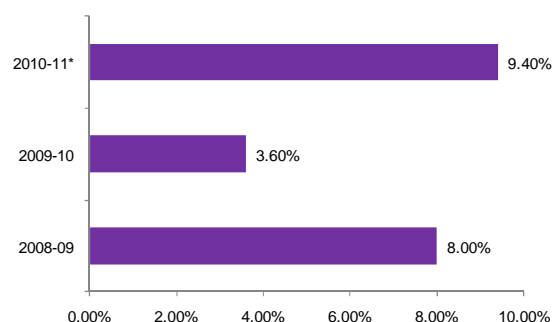
- External debt stock at US\$262.3 billion at end of March 2010, recording an increase of US\$37.8 billion over end of March 2009
- Current account deficit of 2.8% of GDP in 2009-10 vis-à-vis 2.3% in 2008-09
- Foreign exchange reserves of US\$297 billion as of 31 December 2010
- Gross Fixed Capital Formation estimated at 8.4% in 2010-11, from 7.3% of 2009-10 and 1.5% of 2008-09
- Gross Domestic Saving estimated at 33.7% in 2009-10
- Net capital flows increased to 3.8% of GDP in 2009-10 from 0.5% of 2008-09
- Gross capital inflows pegged at US\$345.7 billion during 2009-10, which is 10.2% higher than US\$313.6 billion of 2008-09
- Net inflows from Foreign Institutional Investors (FIIs) marked at US\$22.3 billion during April-September 2010 as compared to US\$15.3 billion of the preceding year
- Inflation, in April-December 2010, recorded at staggering 9.4%, which is substantially higher than 3.60% of 2009-10

Foreign Exchange Reserves (US\$ billion)

*As of 31 December 2010



Inflation (WPI)



Source: Economic Survey 2010-11

*Apr-Dec 2010

Manpower availability and labour relations

India has a very large pool of unskilled and semi-skilled workforce and its labour cost is one of the cheapest in the world. India also possesses abundant skilled manpower, highly efficient professional managers and competent professionals in several other fields whose services are available at reasonable costs.

There is comprehensive legislation, which protects employees from arbitrary dismissal and requires payment of retrenchment compensation on termination of services.

Trade Unions play a powerful role in businesses over a certain size and legislation requires the recognition of trade unions. However, there is no requirement for employees' representation on the Board of Directors

There is considerable legislation on relations between employers and employees for:

- regulating working conditions and terms of employment
- providing employee benefits, collective bargains and settlements of disputes through agencies constituted by law.

Facilities and infrastructure

Although, a lot of thrust was laid on infrastructure development, pre-1991 the progress in the infrastructure sector was poor. It was then recognized that specialisation and 'gains from trade' are a key source of improved resource utilisation and hence contribute to India's growth strategy. In order to harness these gains from trade, the transaction costs involved in trading needed to be low, for trading within the country and for international trade. Hence the problems of transportation and communications, roads, railways, airports, telecom, ports, the postal system, electricity transmission and distribution became a prominent focus of economic policy in the 1990's.

The thrust of the current infrastructure policy has been to create a sound regulatory framework. The role of regulation is to protect the interests of consumers, obtain conditions of competition and foster the institutional framework. The ultimate goal of infrastructure policy is to effectively deliver infrastructure services of high quality at low prices.

All segments of the Infrastructure sector showed good growth during 2008-09. India's total installed capacity of electricity generation has expanded from 105,045.96 MW at the end of 2001-02 to 145,554.97 MW at the end of September 2008. In fact, India ranks sixth globally in terms of total electricity generation. The Indian Civil Aviation market grew at a compound annual growth rate (CAGR) of 18 per cent, and was worth US\$ 5.6 billion in 2008. India has jumped to 9th position in world's aviation market from 12th in 2006. Freight traffic carried by railways grew by 13 per cent during April 2008 – January 2009, cargo traffic at major ports by 11.94 per cent in 2007-08. Prices for long distance telephony and cellular phone services have fallen sharply. In the roads sector, India has the world's second largest road network, aggregating over 3.34 million kilometres.

In the last 30 years, roads have grown in prominence as a mechanism for moving goods and people in the country. This has partly reflected the

greater innate flexibility of road transportation. India has an extensive road network of more than 3.3 million kms, making it one of the largest in the world. National Highways are the prime arterial routes having a span of 70,548 kms throughout the country. The Indian Railways is one of the largest railway systems in the world. It has an extensive network, which is spread over 86,526 kms broad gauge, 18,529 kms meter gauge and 3,651 kms narrow gauge. Of the total route of 63,028 kms, 16,001 kms are electrified.

The telecom sector has seen a revolution. The sector has been opened to private and international players who are providing both basic and advanced telecommunication services and facilities. This sector has witnessed continued progress on policies in telecom, resulting in a growth of new telephone connections and reduction in tariffs of national long distance and international long distance calls. A major shift towards mobile telephony is also apparent.

Policy makers in India have worked on problems of infrastructure policy for over a decade. There has been substantial progress over the years. The key principles seem to involve new institutional arrangements well-enforced user charges, exploiting new technologies, private sector production, and a regulatory framework that fosters competition.



Foreign investment

Investment structure

In recognition of the important role of Foreign Direct Investment (FDI) in the accelerated economic growth of the country, the Government of India initiated a slew of economic and financial reforms in 1991. India is now ushering in the second generation reforms aimed at further and faster integration of the Indian economy with the global economy.

FDI is freely allowed in almost all sectors including the services sector. However, in a few sectors the existing and notified sectoral policy does not permit FDI beyond a ceiling. FDI for virtually all items/activities can be brought in through the 'Automatic Route' under powers delegated to the central bank known as Reserve Bank of India (RBI) and for the remaining items/activities after obtaining Government approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board ("FIPB").

Application for all restricted FDI cases, except Non-Resident Indian (NRI) investments, 100 per cent Export Oriented Units (EOUs), and for FDI in retail trading (single branded product) should be submitted to the FIPB Unit, Department of Economic Affairs (DEA), Ministry of Finance. Application for NRI, 100 per cent EOUs and for FDI in retail trading (single branded product) cases should be presented to Secretariat for Industrial Assistance (SIA) in Department of Industrial Policy & Promotion (DIPP). Applications can also be submitted with Indian Missions abroad who forward them to the Department of Economic Affairs for further processing.

FDI inflows during April 2009-January 2010 stood at US\$ 22,963 million. The cumulative amount of FDI inflows from August 1991 to January 2010 amounted to US\$ 129,503 million. India achieved a stunning 85.1 per cent increase in foreign direct investment flows in 2008. As per an UNCTAD study, this is the highest

increase across all countries, even at a time when the global flows declined by 14.5 per cent.

FDI in India is permitted under the following forms of investments:

- financial collaborations
- joint ventures and technical collaborations
- capital markets
- private placements or preferential allotments.

FDI up to 100 per cent is allowed under the automatic route in all activities/sectors except the following which require prior approval of the Government:

- activities/items that require an Industrial Licence
- proposals for acquisition of shares in an existing Indian company in:
 - financial services sector
 - where Securities & Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 is attracted
- all proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted.

FDI is not permitted in the following sectors:

- retail trading (except for retail of "single brand")
- atomic energy
- lottery business
- gambling and betting
- agriculture (including plantations other than tea plantations)
- activities/sectors not opened to private sector investment
- business of chit fund
- nidhi company
- trading in Transferable Development Rights (TDRs)
- real estate business, or construction of farm houses (subject to certain exception).
- Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes

To make investment in India attractive, all profits, dividends, royalty, know how payments as per the FDI policy are freely repatriable, except where the approval has been granted subject to specific conditions.

Exchange controls

The Foreign Exchange Management Act, 1999 (FEMA) has replaced The Foreign Exchange Regulation Act, 1973 with the objective of facilitating external trade and payments and for promoting orderly development and maintenance of foreign exchange market in India. This is a welcome move from the regulatory mode. Broadly India offers full convertibility on Revenue Account and limited convertibility in Capital Account.

The exchange rate of the rupee is broadly market determined. The exchange rate management policy of the government focuses on smoothening excessive volatilities on exchange rate with no fixed target, while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly manner. Toward this end, the Reserve Bank of India, closely monitors the developments in the financial markets at home and abroad and carefully coordinates its market operations with suitable monetary, regulatory and other measures, as considered necessary from time to time.

The surge in the supply of foreign currency in the domestic market led inevitably to a rise in the price of the rupee. The rupee gradually appreciated from INR 46.54 per US\$ in August 2006 to INR 39.37 in January 2008. The global financial crisis however reversed the rupee appreciation and after the end of positive shock around January 2008, rupee began a slow decline. With signs of recovery and return of FII flows after March 2009, rupee has again been strengthening against US\$. Currently rupee trades at approximately INR 44.75 to US\$ 1.

Import/export controls

Over the years, Indian trade policy has undergone fundamental shifts to correct the earlier anti import bias through the withdrawal of quantitative restrictions, reduction and rationalisation of tariffs, liberalization in the trade and payments regime and improved access to export incentives, besides a realistic and market based exchange rate.

A policy was introduced on 1.4.2000 for setting up of Special Economic Zones (SEZ) in the country with a view to provide an internationally competitive and hassle free environment for exports. Units may be set up in SEZ for manufacture of goods and rendering of services. All the import/export operations of the SEZ units will be on self-certification basis. The units in the Zone have to be a net foreign exchange earner but they shall not be subjected to any pre-determined value addition or minimum export performance requirements. Sales in the Domestic Tariff Area by SEZ units shall be subject to payment of full Custom Duty and import policy in force. Further Offshore banking units may be set up in the SEZs.

The new Foreign Trade Policy framed for the period 2004-09 seeks to usher in an environment free of restrictions and controls. The policy measures announced include a comprehensive package for development of Special Economic Zones including entitlement by these zones to procure duty free equipment, raw materials, components etc. whether imported or purchased locally. Recently, the Government of India has announced a comprehensive legislation providing incentives and regulating development of SEZ as well as units in SEZs. Salient features of SEZs are:

- a designated duty free enclave and to be treated as a foreign territory for trade operations and duties and tariff
- no license required for import
- manufacturing, trading or service activity allowed

- no fixed wastage norms. Full freedom for subcontracting including subcontracting abroad.
- job work on behalf of domestic exporters for direct exports
- contract farming allowed agriculture/ horticulture units
- no separate documentation required for customs and EXIM Policy. In house customs clearance
- support services like banking, post office, clearing agents etc. provided in Zone complex
- developed plots and ready to use built up space.

Apart from the units set up in SEZ , other units are also entitled to various concessions/ incentives like exports of goods/ services without payment of any duty or taxes. Import of goods without payment of customs duty etc. The basic principle is not to levy indirect tax to goods or services exported.

- In addition to above capital goods, required for export of goods or services, are allowed to be imported at concessional rate of duty.
- Further, under the special scheme of STPI and EOU goods can be procured without payment of any duty within India as well as from outside India.

It also emphasises on further decontrol and deregulation of agricultural sector to encourage higher exports of farm products, de-reservation from small scale industry provisions for over 50 items, to facilitate higher investment, technology upgradation and exports from these sectors and fiscal measures for strengthening key industries for improving their competitiveness and exports.



Setting up in India

The typical stages of any global company wishing to setup operations in India are:

Stage 1: Strategizing

To be able to enter and establish successfully in India, a firm strategy based on research and findings is necessary. Typically companies take the following steps prior to their entry into India:

- market study/industry assessment
- competition scan
- feasibility assessment
- market positioning
- investment strategy and structure
- location assessment
- entry strategy for India.

Stage 2: Design phase

After finalizing the entry strategy, the global company will need to incorporate an Indian business vehicle, usually a branch or a subsidiary or acquire an existing Indian business. The Incorporation process in India is fairly tedious and usually requires government approvals, and takes between 4-6 weeks after the incorporation documents are ready.

Stage 3: Implement & operationalise

People resources are the most critical in today's knowledge economy and as such there is a definitive need to have systems, policies and procedures in place to attract, manage and motivate talent once they join the new company. Some of the elements that are necessary to ensure smooth business operations from a people's perspective are:

- organisation structure
- performance architecture
- recruitment strategy
- policy & manual
- performance management system
- rewards & recognition programs

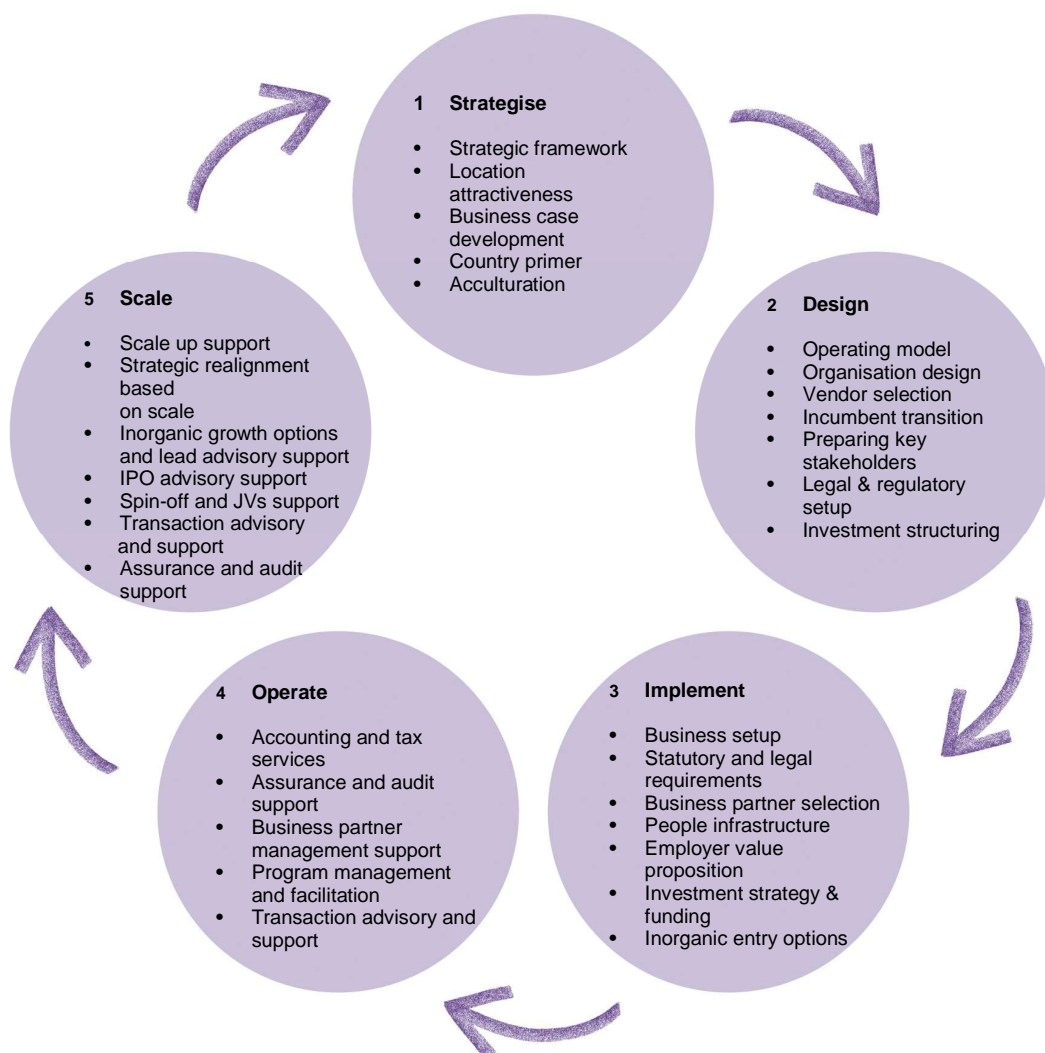
- long term/short term incentive programs (ESOP's/variable pay/incentives)
- measuring employee satisfaction.

Additionally, the company would be required to comply with local and international audit and accounting norms and legal & statutory requirements. Also, the company would need to replicate/design operational processes and systems to take care of operating nuances in India while ensuring productive output.

Specifically for a company entering India to setup their back-office support or backend research & development, apart from the 3 stages described above, additional activities may be required in order to successfully enter India as well as scale up operations.

As described on Page 1, India Inbound Investment is one of Grant Thornton India's Six Key market focuses. In this market, Grant Thornton India has helped several hundred global corporations with the steps defined above, whether in relation to acquiring an Indian entity or setting up from scratch.

A typical cycle of events that need to be taken care of are summarized below:



Finance

Banking

India has one of the largest banking networks in the world, with a large number of nationalised, co-operative, private and foreign banks providing a wide variety of services. The Reserve Bank of India is the central bank of the country that closely monitors developments in the entire financial sector through instruments such as the monetary and fiscal policies, directives, notices and regulations.

The banking sector is dominated by Scheduled Commercial Banks. Most nationalised banks have branches in semi-urban and rural areas of the country. Commercial banks transact all types of commercial banking business including cash management system, ATMs, credit cards, term and working capital loans, housing and consumer finance, purchase and sale of foreign currencies, providing forward cover relating to foreign exchange, funded and non funded guarantees and many other facilities. Most banks are also offering advanced facilities like debit cards, internet banking, tele-banking, etc. Banks have also set up separate divisions for merchant banking, mutual funds and subsidiaries for lease financing, venture capital, factoring, investment consultancy, asset management and the like.

The State Bank of India is still the largest bank in India. Indian banks, particularly private banks, are riding high on the retail business. ICICI Bank and HDFC Bank have witnessed a significant year-on-year growth in retail loan assets over period of time. All India Financial Institutions and several State level Financial Institutions provide long-term project finance to corporates. Lately, their focus has shifted to provide easy finance to infrastructure projects and other key sectors. Financial Institutions are now becoming more dynamic by forging alliances with commercial banks and by entering new areas in finance like retail banking, credit cards, car finance etc.

Retail Banking is the new mantra in the banking sector. The home loans alone account for nearly two – thirds of the total retail portfolio of the bank. According to one estimate, the retail segment is expected to grow at 30 per cent to 40 per cent in the coming years

With the credibility of the Indian banking system on a high, a number of Indian banks are now leveraging it to expand overseas. To meet the challenges of going global, the Indian banking sector is implementing internationally followed prudential accounting norms for classification of assets, income recognition and loan loss provisioning. The scope of disclosure and transparency has also been raised in accordance with international practices. India has complied with almost all the Core Principles of Effective Banking Supervision of the Basel Committee.

Capital markets

Capital markets in India comprise equity, debt, and foreign exchange and derivatives markets, including futures markets in commodities. These markets are key components of the financial sector because of their transparency in disseminating price information. Markets help in discovery of price of the assets and price of the risk in the economy. They help to shape the behaviour of owners of capital in making decisions about which firms and industries to allocate scarce capital to.

The equity market has experienced profound changes in recent years, with the introduction of rolling settlement and equity derivatives. The market has successfully absorbed these changes.

The major stock exchanges are the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The business in stock exchanges and other securities, primary market issues, etc. is regulated by the Securities and Exchange Board of India. Since 1991, there has been significant development in the capital markets both directionally and dimensionally. Indian

Business entities

capital markets have now grown into one of the leading capital markets in the developing countries, and are highly responsive to world developments. Corporates are raising funds not only through equity issues and private placements, but also through Global Depository Receipts, American Depository Receipts, Foreign Currency Commercial Bonds (FCCBs) and External Commercial Borrowings (ECB). Trading in derivatives (Futures and Options) forms substantial part of trading volumes. Apart from derivatives trading, debt instruments, bonds, government securities and mutual funds have now become an important part of the capital markets. Foreign Institutional Investors have become one of the most important players in Indian capital markets, major Foreign Institutional Investors (FIIs) continue to be bullish on investment in India. Small investors are also becoming an important part of the market. The government has also eased ECB norms. Several regulations have been introduced by the Securities and Exchange Board of India, to protect small investor interest. The emergence of credit rating agencies and the growing importance and acceptance of credit rating is another development. Indian securities have moved towards 'dematerialisation' of securities.

BSE is the world's number one exchange in terms of the number of listed companies and the world's fifth in transaction numbers. It is not just foreign fund flows which are driving markets up, even domestic investors are pouring money into equities. India's benchmark share index reached nearly 21,000 points for the first time in January, 2008, on the back of robust foreign fund inflows and a move by the government toward greater capital account convertibility which has seen a lower base of around 8,000 points due to the global financial crisis. The Indian markets have also outperformed most of the other major regional markets like South Korea, Taiwan, Thailand and Singapore. Currently, it is trading in the range of 15,000 – 16,000 points

Financial assistance available from the government

Specialised investment institutions are mainly in the public sector, which invest in shares, debentures, and gilts and grant loans.

Capital subsidy is available from the Central and State governments for setting up certain specified industries in backward areas. In certain backward states, subsidy is made available by the Government, based on investments made on fixed assets. Cash subsidies, Sales tax holidays, deferment of sales tax payment, tax holidays, exemption from local entry taxes i.e. octroi, power subsidy and electricity duty exemption are allowed for a certain period. Besides, the government and the RBI have eased several norms, in case of infrastructure industries for entering the debt market.

Forms of business entities

- liaison office
- branch office
- project office
- partnership firms
- limited Liability Partnership firms (LLP)
- limited company (public or private).

Liaison office

A foreign company needs prior approval of the Reserve Bank of India to establish its liaison office (LO) in India. An LO is suitable for a foreign company, which wishes to set up a representative office as a first step to explore and understand the business and investment climate in the country. The LO acts as a communication channel between the parent company overseas and its present/ prospective customers in India. The LO can also be set up to establish business contacts or gather market intelligence to promote the products or services of the overseas parent company.

The LO cannot undertake any business activity in India nor earn any income in India.

Branch office

A foreign company needs prior approval of the RBI to establish its branch office (BO) in India. The RBI does not permit a BO to undertake any manufacturing activity in India. The range of activities to be undertaken by a BO is also very restricted and permission has to be obtained from the RBI, each time any new activity is to be undertaken. The BO will not expand its activities or undertake any new trading, commercial or industrial activity other than that expressly approved by the RBI.

Project office

A foreign Company may open a project office in India without prior approval from RBI provided it has met with prescribed conditions. The project office is generally opened to execute a specific project in India. Once the project execution is complete as per the terms of the contracts awarded, project office would need to be closed.

Partnership firms

Under the present Foreign Direct Investment policy of the Government of India and the Foreign Exchange Management law foreign investment into Indian partnership firms requires permission of the Reserve Bank of India. A partnership is an association of two or more persons to carry on as co-owners of a business for profit. Each partner of a partnership has unlimited liability.

Limited Liability Partnership (LLP) firms

A limited liability entity is a hybrid of existing partnership firms and full-fledged companies. It is a separate legal entity, liable to the full extent of its assets with the liability of the partners being limited to their agreed contribution in LLP. The act would facilitate

creation of another business model which would enable growth of the economy. While there is no formal clarification, it appears that infusion of Foreign Direct Investment into a LLP requires prior approval of the RBI.

Limited company

As mentioned above, foreign investment into India is governed by the Foreign Direct Investment policy of the Government of India and the Foreign Exchange Management law.

Under the present policy, all companies in India have to be incorporated under the Companies Act, 1956. The following are the requirements of the Companies Act, 1956.

Types of companies

Public Limited or Private Limited.

Capital requirements

Minimum capital requirement is INR 500,000 in case of public companies and INR 100,000 in case of private companies. Equity Shares and Preference Shares can be issued by Indian Companies. Although all equity shares have voting rights, the law allows issuance of equity shares with differential rights with respect to voting, dividend sharing, etc. There are specific rules and conditions to be complied with for issue of shares with differential rights in case of Public Companies.

Minimum number of subscribers, shareholders and directors required

The main features of public and private companies are as follows:

	Public	Private
Minimum numbers of subscribers/ shareholders/members	7	2
Maximum number of subscribers/ shareholders/members	No limit	50
Minimum number of directors	3	2

Equity restrictions

There are no debt/equity restrictions under the Company Law. However, limits are prescribed for acceptance of deposits by companies. There are no specific 'thin capitalisation' rules in India. However, there are certain restrictions under the Foreign Exchange which try to capture such transactions.

External commercial borrowings

External Commercial Borrowings (ECB) are permitted by the Government for providing an additional source of funds to Indian corporates. There are end-use restrictions to utilization of ECB such as financing expansion of existing capacity as well as for fresh investment. Subject to complying with specific conditions and limits, ECB are permitted under automatic route. Otherwise prior approval of the RBI is required. External Commercial Borrowings are approved by the Reserve Bank of India within an overall annual ceiling.

Corporates are free to raise ECB from any internationally recognized source such as banks, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity holders, international capital markets etc. Offers from unrecognized sources are not entertained. Certain sectors are not permitted to avail of ECB.

Requirements for contribution in kind

There are no specific requirements as to contributions in kind except that the shares issued for consideration other than cash require disclosure in the annual accounts. However, FIPB approval is required for receiving FDI as contribution in kind except in few cases such as pre-incorporation/pre-operative expenses

Value of shares

The shares of a company whether preference or equity must have a nominal/par value.

Management of the company

Company is managed by the Board of Directors who may delegate powers, except where any transaction requires approval of Board of Directors under the Companies Act, to any director or managing director.

Citizenship of directors

There is no requirement for any director to be a citizen of India.

Requirements as to appointment of a company secretary

The law provides for compulsory appointment of a full time Company Secretary, where the paid up capital of a company exceeds the prescribed limit, (presently INR 50 million). Where the paid up capital is INR 1 million up to 50 million a compliance certificate from a practicing company secretary is required every year.

Procedure for registration and incorporation

The promoters of the company have to apply to the Registrar of Companies for availability of the proposed name of the company. After obtaining approval, the Memorandum and Articles of Association of the proposed company are filed with the Registrar of Companies for registration. On registration, a Certificate of Incorporation is issued which is conclusive evidence of the company having been incorporated.

Commencement of business

A Certificate to commence business is required in case of a public limited company whereas in the case of a private limited company business can be started immediately after incorporation.

Labour

Costs associated with incorporation

The costs associated with incorporation of a company relate to drafting and printing of the Memorandum and Articles of Association, stamp duty, registration and filing fees, in addition to professional fees of advisors who assist in the process.

Time taken for incorporation of a company

With the introduction of mandatory e-filing procedures, it usually takes 4-6 weeks to incorporate a company in India.

Permission and notification to commence business

Where a company has issued a prospectus inviting the public to subscribe to its shares, the company cannot commence business until the amount of minimum subscription stated therein has been received.

Restriction on distribution

A company can distribute its profits as dividend after transferring certain percentage of its profits to the general reserve (subject to certain conditions). However, capital profits are not allowed to be distributed.

Employment legislation

India is a member of the International Labour Organization. Employment legislation covers a wide spectrum and the employment conditions are determined under the Factories Act, Minimum wages Act, Industrial Disputes Act, Payment of Bonus Act, Employees Provident Fund and Miscellaneous Provisions Act, Payment of Gratuity Act, Employees State Insurance Act, Workmen Compensation Act, Trade Union Act, Maternity Benefit Act etc.

Customary working hours and holidays

The normal working hours in a factory are 8 hours per shift and in offices, 7 hours per day, six days a week.

Indian subsidiaries of multinational corporations usually follow a five day – eight hour per day week. Normally 10 days casual leave and 20-30 days privilege leave is allowed in a year.

Compensation for redundancy

Compensation on retrenchment is payable as per the terms of employment or as per mutual agreement/negotiation to the workers under statute.

Labour organisation

As a member of the International Labour Organisation, India has to comply with its recommendations and accordingly provide for harmonious working environment and social security benefits to the labour force.

Working conditions

The working conditions are controlled as per the various labour laws and other statutory requirements as to safety, hygienic conditions and labour welfare measures.

Work permits for foreign workers

Once a Business Visa or an Entry Visa has been issued, a foreign national is free to work in India. However, the registration with Foreign Regional Registration Office (FRRO) is essential for all foreigners having visas for a period exceeding 6 months. Such registration has to be within 14 days of his arrival in the country.

Government of India has also recently decided to grant Overseas Citizenship of India (OCI) status commonly known as 'Dual Citizenship'. Persons of Indian Origin (PIOs) of certain category as has been specified who migrated from India and acquired citizenship of a foreign country other than Pakistan and Bangladesh, are eligible for grant of OCI as long as their home countries allow dual citizenship in some form or the other under their local laws.

Persons registered as OCI have not been given any voting rights, election to public/government offices etc. Registered OCIs shall be entitled to following benefits:

- multiple entry, multi-purpose lifelong visa to visit India
- exemption from reporting to Police authorities for any length of stay in India
- parity with NRIs in financial, economic and educational fields, except in the acquisition of agricultural or plantation properties.

A person registered as OCI is eligible to apply for grant of Indian citizenship if he/she is registered as OCI for five years and has been residing in India for one year out of the five years before making the application.

Sickness and pension arrangements

It is compulsory for an employer to make available medical facilities to its work force by contributing towards Employees' State Insurance Scheme or otherwise providing medical benefits to its employees and their family members.

The employer contributes towards a Provident Fund Scheme and a certain portion of the contribution is appropriated towards a Pension Scheme, which provides for pension benefits to employees and their family members. Workers are also entitled to gratuity on completion of five years of continuous service. However, contribution towards a Provident Fund Scheme is not required if the number of employees in that organisation do not exceed 20.



Accounting and reporting requirements

Records to be maintained

Companies registered in India are governed by the Companies Act, 1956 and are required to maintain statutory books as prescribed under the Act. There is no provision as to the form of the books of accounts. However, it is incumbent on the companies to maintain accounts on accrual basis and the books of account must be retained for a minimum of eight years.

Preparation of financial statements

Financial statements are normally prepared once in a year under the Companies Act. However, a listed company is also required to publish quarterly results reviewed by auditors. For tax purposes, financial statements as at 31st March each year must be prepared.

Contents of financial statements

Financial statements of a company are prepared in the form prescribed under the Companies Act.

Audit of financial statements

Every company in India, irrespective of its size, must have its financial statements audited, by a member of "The Institute of Chartered Accountants of India. Companies or other entities, which have exceeded the prescribed limit of turnover (presently INR 4 million if engaged in business and INR 1 million if engaged in profession), also have to get their accounts audited under the Income tax Act.

Inspection of records

The books of accounts and other records are open to inspection by any director, Registrar of Companies and other government agencies such as excise, sales tax, etc.

Accounting year

The accounting year of an organisation must end on 31st March every year for income tax purposes. However, for financial reporting purposes a company may have a different year-end of its choice.

Language in which business records are required to be maintained

There is no prescribed language for maintenance of books and business records. It can be maintained in any Indian language. Companies generally maintain their accounts in English.

Maintenance of accounting records in a foreign currency and presentation of financial statements

The financial statements have to be presented in Indian currency i.e. the Rupee. However, in addition the foreign currency amounts may also be disclosed.

The accounting records, whether electronic or manual, have to be kept in Indian currency. However, corresponding figures may be given in foreign currency also

Direct tax

Income tax

Income tax is chargeable on taxable income computed in accordance with the provisions of the Income-tax Act, 1961 (the Act). All taxpayers are required to follow a uniform accounting year from April 01 to March 31 for tax purposes called as “previous year”, irrespective of the financial year followed for accounting purposes. Income earned during the financial year is assessed to income-tax in the next year, called the “assessment year”.

All taxpayers are required to file a Return of Income for the previous year within prescribed due dates in the assessment year. Different due dates have been prescribed for this purpose under the Act which are as in the table opposite.-

Initial compliances

Permanent Account Number (PAN)

All taxpayers are required to make an application for the allotment of tax registration number which is called the Permanent Account Number (PAN). The application is to be made in Form 49A on or before 31 May of the assessment year for which the income is assessable to tax.

This number is to be quoted on all tax returns, correspondence with the tax authorities and on all documents relating to prescribed categories of transactions.

Tax Deduction Account Number (TAN)

Every person responsible for withholding tax in accordance with the provisions of the Act is required to make an application for the allotment of withholding tax registration number which is called as Tax Deduction Account Number (TAN). The application is to be made in Form 49B, within 1 month from the end of the month in which tax is deducted.

In case of

<ul style="list-style-type: none"> a company; or a person (other than a company) whose accounts are required to be audited under this Act or under any other law for the time being in force; or a working partner of a firm whose accounts are required to be audited under this Act or under any other law for the time being in force 	30th day of September of the assessment year
<ul style="list-style-type: none"> in the case of a company which is required to file an accountant's report under transfer pricing regulations 	30 th day of November of the assessment year
<ul style="list-style-type: none"> in the case of any other assessee 	31st day of July of the assessment year

Computation of business income

There are certain permissible deductions in computing the taxable income and there are certain disallowances in respect of expenditure incurred by the company. In arriving at taxable income, expenses on revenue account, incurred wholly and exclusively for business purposes are deductible. Certain expenses are specifically disallowed or the quantum of deduction is restricted. These include:

- interest, royalties, technical service fees or any other chargeable amounts paid to non-residents without the withholding of applicable tax. However, such expenditure is deductible in the year in which the tax is paid/deducted at source
- specified payments such as interest, contractual payments, rent, royalty, professional/technical

service fees, etc paid to a person resident in India without withholding of applicable tax. However, such expenditure is deductible in the year in which the tax is paid/deducted at source

- income-tax/wealth tax paid
- provisions for taxes, duties, interest on loans from public financial institutions or on term loans from a scheduled bank and certain contributions to statutory funds on behalf of employees, not actually paid. However, such expenditure is deductible in the year in which it is actually paid
- security transaction tax paid, etc. unless the assessee is into the business of trading in securities.

Depreciation is normally calculated on the basis of declining balance method using varying rates depending on the nature of assets. All similar type of assets eligible for the same rate of depreciation are clubbed together in a block and depreciation is charged on the value of the block. Depreciation is available for a full year, irrespective of the actual period of use of the asset. However, in the year of acquisition of the asset, depreciation is allowed at half the normal rates, if the asset is used for less than 180 days in that year. No depreciation is available in the year of sale of the asset. Depreciation on intangible assets such as know-how, patents, copyrights, trademarks, licences, franchises or other similar business or commercial rights, is also available.

The rates of depreciation for different blocks of assets are as follows:

Block of assets	Rates (per cent)
Residential buildings except hotels and boarding houses	5
Non residential purposes including hotels and boarding houses	10
Furniture and fittings	10
General plant and machinery	15
Intangible assets	25
Computers	60

In addition to above, additional depreciation at the rate of 20 per cent (over and above normal depreciation) is available for Plant and Machinery (other than ships and aircrafts) upon fulfilment of prescribed conditions.

The following are some of the other important deductions that are available to arrive at the taxable income:

- certain preliminary expenses over a five-year period commencing from the year in which the business commences
- capital expenditure on scientific research related to the business of the taxpayer
- 200 per cent of the amounts paid to National laboratory, university, Indian Institute of Technology or a specified person
- 200 per cent of the amount of expenditure incurred by companies engaged in the business of manufacture or production of certain specified article or thing on in-house research and development facilities.

Tax holidays

Tax holidays are available in respect of profits derived from export of manufactured items/goods or services, including computer software and information technology (IT) enabled services, from units in specified locations, industrial undertakings or enterprises engaged in generation/transmission/distribution of power, developing/operating/maintaining infrastructure facility, or SEZ developers and units located in SEZ. Investment based deductions are also available for the following sectors subject to certain conditions:

- laying & operating cross-country natural gas distribution
- building and operating two star or above hotel
- building and operating new hospitals
- affordable housing

- slum rehabilitation
- production of fertilizers

Business loss & unabsorbed depreciation

Business losses, other than from speculation business, are permitted to be set off against income from any other source (except income from employment i.e. salary income) in the same year. Business losses not so set off are permitted to be carried forward for set off against business profits arising in the subsequent eight years. Unabsorbed depreciation is permitted to be carried forward for an unlimited period.

Corporate tax rate

The corporate tax rates for the financial year 2010-11 are as follows:

Type of company
Domestic company
Rates (per cent)
32.45 per cent (30 per cent plus surcharge ² at the rate of 5 per cent and education cess @ 3 per cent on tax and surcharge)

Type of company
Foreign company
Rates (per cent)
42.02 per cent (40 per cent plus surcharge ² at the rate of 2 per cent and education cess @ 3 per cent on tax and surcharge)

Minimum Alternate Tax (MAT)

MAT is payable by a company at following rates on the “book profits” of the company computed as specified where the income-tax liability determined under the normal tax provisions is lower than tax on “book profits”.

Type of company
Domestic company
Rates (per cent)
20.01 per cent (18.5 per cent plus surcharge ² at the rate of 5 per cent and education cess @ 3 per cent on tax and surcharge)

Type of company
Foreign company
Rates (per cent)
19.44 per cent (18.5 per cent plus surcharge ² at the rate of 2 per cent and education cess ³ @ 3 per cent on tax and surcharge)

Tax credit for the difference between MAT and tax under normal provisions is allowed against tax liability in subsequent ten years, where tax becomes payable under normal provisions of the Act. From previous year 2006-07, long term capital gain on listed securities, which otherwise may be exempt, will have to be considered for calculation of “book profits” for MAT purposes. Similarly from previous year 2011-12, MAT provisions are applicable even to SEZ developers and units located in SEZ.

² Surcharge is applicable only if the company's total income exceeds INR 10 million

Dividend distribution tax (DDT)

Dividends distributed by an Indian company are not taxable in the hands of the shareholders. The Company distributing the dividends is liable to pay a dividend distribution tax of 16.22 per cent (including surcharge @ 5 per cent and education cess @ 3 per cent). With effect from 1 June 2011, SEZ developers will also be liable to pay dividend distribution tax.

Further, to avoid double taxation of dividends received from subsidiary company, which has been already taxed in the hands of subsidiary company, it has been provided that dividend received from such subsidiary company should be reduced from the amount of dividend liable to DDT for the purpose of calculating tax on dividend distributed, provided such Indian company is not a subsidiary of any other company

The tax on distributed profits is payable within 14 days from the date of declaration, distribution or payment of any dividend, whichever is the earliest.

The additional income tax so paid by the company is treated as the final payment of tax in respect of the amount distributed and no further credit for such tax can be claimed either by the company or by any other persons (unless permitted, under the domestic laws of foreign recipients or under the tax treaty as underlying tax credit).

Withholding tax

The Indian tax law casts an obligation on each taxpayer to withhold tax on specified payments, among others on the following:

- salaries
- interest
- rent
- commission or brokerage
- payments to contractors
- professional/technical fees/Royalty
- payments to non-residents.

Further, disclosure of PAN is mandatory requirement for any person whose receipts are subject to tax withholding i.e. the deductee, failing which withholding tax rate would be higher of the following rates:

- the rate prescribed in the Act
- at the rate in force i.e., the rate mentioned in the Finance Act
- at the rate of 20 per cent.

Personal income tax

Income (INR)	Rates (per cent) [*]
0 – 1,60,000*	0
1,60,001 – 5,00,000	10.30
5,00,001 – 8,00,000	20.60
8,00,001 – and above	30.90

* Basic exemption limit for women is INR 190,000 and for senior citizen is INR 240,000. Finance (No. 2) Act 2009 has abolished surcharge on individuals.

Fringe benefits tax (FBT)

Finance (No. 2) Act, 2009 has abolished FBT. However fringe benefits provided to employees will now be taxed in the hands of employees as perquisites.

Capital gains tax

Tax on capital transaction is levied in the form of capital gains tax on transfer of a capital asset. Short term capital gains (other than those discussed in the paragraph below) are charged at normal rates applicable for personal or corporate taxation. Long term capital gains are taxed @ 20 per cent (plus applicable surcharge and education cess @ 3 per cent). However, a long term capital gain arising from transfer of listed securities, on which Security Transaction Tax has been paid, is exempt from tax whereas short term capital gain arising from transfer of above securities is charged to tax @ 15 per cent (plus applicable surcharge and education cess as 3 per cent).

On disposal of depreciable capital assets held as business assets, any excess realized over the written down value of the block of assets is treated as a short

term capital gain and is taxed at normal rates applicable to business profits.

Advance tax

Every tax payer is required to pay its tax liability, for the year during the previous year itself in instalments prescribed. The tax liability is to be worked out on the basis of an estimate of current income and income-tax thereon shall be calculated at the rates in force in the relevant previous year. Advance tax would be payable only if advance tax liability is expected to be more than prescribed amount (INR10, 000 for the previous year 2010-11)

Non payment of advance tax at prescribed rates and within the prescribed period shall attract levy of penal interest.

Self assessment tax

Every tax payer is liable to make payment of tax payable (if any) on the basis of actual income after considering the insert payable as aforesaid and the credit for the advance tax paid, taxes deducted at source. Self assessment tax is payable after the completion of the previous year but before filing of the return of income.

Wealth tax

Wealth-tax is levied @ 1 per cent on the aggregate market value in excess of INR 3 million of specified assets (only certain non-productive assets), which includes vacant urban land, guest house, residential house, motor cars, yachts, air craft, jewellery, etc to the extent the value is in excess of any debts incurred in relation to such assets.

Security Transaction Tax (STT)

STT is levied in the following type of security transactions that are transacted through a recognised stock exchange in India:

Type of transaction	Rates
Delivery based equity shares & units of equity oriented fund – both buyer and seller	0.125 per cent
Non Delivery based equity shares & units of equity oriented fund – only seller	0.025 per cent
Derivative trades – seller	0.017 per cent
Sale of equity oriented mutual fund to the mutual fund – only seller	0.25 per cent

Gift tax

Aggregate sum of money received as gifts from unrelated persons on or after 1 April 2006, above the threshold limit of INR 50,000 will be taxed as income. Finance Act (No. 2) 2009, with effect from October 1 2009 , has further provided that if aggregate value of any kind of moveable or immoveable property received as gift from any unrelated person exceeds INR 50,000 then it will be taxed as income as per the prescribed valuation methodology. Gifts received from specified blood relation, lineal ascendants/descendants and gifts received on certain occasions like marriage, inheritance, etc are exempt. Further, in case a firm or a closely held company receives shares of a closely held company, for a consideration lesser than the fair market value, the difference in excess of INR 50,000 will be taxed in the hands of the recipient.

Estate duty

No estate or death duty is charged.

All the provisions of Direct tax mentioned above takes into consideration the amendments proposed in Finance Act 2011.

New direct tax code

The Direct Tax Code (DTC) has been recently introduced as a bill in Parliament and is proposed to will replace the Act with effect from April 1, 2012. The DTC proposes sweeping changes to the Income Tax Laws in India.

Companies Bill, 2009

The Government of India introduced Companies Bill, 2009 on 3rd August, 2009. The bill proposes to allow formation of one-person company along with other major proposals. It also proposes to simplify the formation of companies in India. The said bill on its enactment, would allow the country to have a modern legislation for growth and regulation of corporate sector in India.



Indirect tax

Service tax

The levy was introduced for the first time in the year 1994 through Chapter V of the Finance Act, 1994 (Act). The service tax law does not envisage taxation of all services. Only those services that are specified as taxable will be subject to service tax levy. Presently, more than 100 services are specified as taxable services on which service tax is required to be paid. Service tax is currently levied at the rate of 10 per cent of the value of taxable services. Also, a cess @ 3 per cent (2 per cent Education Cess and 1 per cent Secondary and Higher Education Cess) on the service tax is applicable, thereby making the effective rate of service tax equal to 10.30 per cent.

Further, an Indian resident shall be liable to pay service tax under the reverse charge method if he receives any taxable service from a service provider situated outside India.

Moreover, services provided outside India are not subject to service tax under the export of services provisions if the service provider satisfies prescribed conditions. Service providers are entitled to avail CENVAT credit of duty paid on inputs and capital goods and service tax paid on input services used in rendering output services.

Value Added Tax (VAT)

VAT is levied on sale or purchase of goods effected within a particular state, the same would qualify as an intra-state sale, and VAT would be levied under the relevant State VAT tax legislation.

The rate of local VAT depends on the description of the goods, the rate of tax mentioned in the applicable state VAT tax legislation, various VAT tax concessions/exemptions as may be available in such state etc. However, the VAT regime envisages five rates of tax viz 0 per cent, 1 per cent, 5 per cent, 13.5 per cent and 20 per cent.

Central sales tax

Where goods move from one state to another pursuant to a contract of sale, or a sale is effected by the transfer of documents of title during the movement of goods from one State to another, such a sale is known as an inter-state sale and is subject to Central Sales Tax ('CST').

Presently, the rate of CST on sales to registered dealers against Form C is 2 per cent. Under the CST Act, import from outside India and export of goods from India are not liable to VAT or CST.

Customs duty

Customs duty is leviable on imports/exports of goods into/from India at the rate defined under Customs Tariff Act, 1975 ('Customs Tariff'). The procedure relating to customs duty is governed by the Customs Act, 1962 ('Customs Act') and the rules/regulations made there-under. The customs duty is payable by the importer/exporter and consists of:

- Basic Customs Duty (BCD) @ 10 per cent
- Additional Customs Duty (CVD) @ 10.30% per cent (Equal to the duty of excise leviable on the same products if manufactured in India)
- customs Education Cess @ 3 per cent
- additional CVD (in lieu of VAT) @ 4 per cent.

General effective Customs duty rate – 26.85 per cent (at basic customs duty of 10 per cent)

Generally, no customs duty is leviable on export of goods from India except certain items as defined under second schedule of the Customs Tariff (iron & steel and other items which are essential for a nation's growth).

Customs duty rates are subject to various exemptions and concessions as may be notified from time to time. These exemptions and concessions depend on the government policy, the nature and end use of the goods, the nature of the projects, the status of the importer and various other factors.

The various duties of customs leviable under Indian Customs laws are as follows:

BCD is levied on all imported items which are specified under the Customs Tariff Act, 1975. The peak rate of BCD is 10 per cent unless the imported item is subject to any exemption/concession.

CVD is levied on imported items if the imported article is such, as if produced in India and is liable to excise duty. The rate of CVD is 10 per cent plus cess @ 3 per cent. CVD is available for set off to the manufacturer/service provider towards payment of excise duty of manufactured products/service tax on services provided in India.

Special CVD is levied on imported goods to counter balance various internal taxes like sales tax and VAT and to provide a level playing field to indigenous goods which have to bear these taxes. The rate of special CVD is 4 per cent. Generally refund/set off of special CVD is available to manufacturers/traders selling/reselling goods in India.

The total of all the above duties shall be the effective rate of import duty and such effective rate shall be calculated after taking into account all the exemptions, concessions as may be available at the time of importation.

Goods imported for the purpose of export are either exempt from duties or refund of duties, paid at the time of import, are allowed to exporter.

Excise duty

Excise duty is levied on goods manufactured in India. The manufacturer is liable to pay excise duty at the time of clearance of goods from the factory. The rate of duty to be paid depends upon the classification of goods as per the Excise Tariff Act, 1985 ('Excise Tariff'). The procedure relating to Excise duty is governed by the Central Excise Act, 1944 ('Excise Act').

General Excise duty structure is India:

- generic rate @ 10 per cent
- Education Cess @ 2 per cent
- secondary and Higher Education Cess @ 1 per cent.

General effective Excise duty rate – 10.30 per cent (at basic Excise duty of 10 per cent)

However, this rate is subject to exemptions and concessions as may be notified from time to time.

For the purpose of levying excise duty, manufacture has been interpreted to mean any process, which brings into existence a new commodity having a distinct name, character, use and marketability. However, the Central Government is empowered to declare any process, e.g. labelling, relabeling, packing, repacking etc. as manufacturing process.

Excise duty is generally charged on transaction value. However, in certain cases it is chargeable to maximum retail price printed under any law, after allowing certain abatement towards post manufacturing expenses.

Manufacturers are entitled to avail CENVAT credit of duty paid on inputs and capital goods and service tax paid on input services used in the manufacturing process. Certain duty exemptions are also available to manufacturers having units in backward areas such as Kutch, Himachal Pradesh, Uttaranchal etc.

Export of excisable goods is generally exempt from Excise duty.

Octroi/entry tax

Octroi/entry tax is a levy on the entry of goods into a particular municipal/state jurisdiction for use, consumption or sale. Depending on the municipal/state jurisdiction where the goods are proposed to be used, consumed or sold, either octroi or entry tax may be levied.

As already noted above, octroi is predominantly a municipal specific levy. Within the state there may be several jurisdictions where octroi/entry tax may be levied depending on the specific rules thereof.

Other taxes

The other taxes that are levied are expenditure tax, luxury interest tax, stamp duty and research & development cess.

Goods and services tax

Goods and Services tax (GST): Introduced for the first time by France in 1954 is a comprehensive value added system of levying tax, operational in more than 140 countries today.

India is working towards introduction of a dual GST which, most probably, would be introduced w.e.f. 1 April 2012 whereby the myriad of existing indirect taxes would be progressively merged into a common central tax (CSGT) and a state tax (SSGT).

GST would ideally be collected on the value added on goods and services at each stage of production via a tax credit mechanism. It would be similar to a last point retail tax, as the consumers being the last node in the supply chain have to bear this tax.

Primarily GST proposes to embody the following principles:

- uniform rate of taxation within a given jurisdiction
- sale of goods and services would be taxed under the destination principle
- low costs of compliance and administration
- each level of government to set its own tax rate subject to agreed ceilings and/or floors

- a substantively common tax base for Central and State governments
- substantial co-operation in tax administration between all levels of government
- Simplification of statutes in order to reduce litigation and facilitate an easy interpretation.

The introduction of GST is a welcome change as it will do away with many distortions that exist under the current indirect tax legislations. Further with the advent of a common tax base for goods and services a service provider shall be entitled to avail credit on his purchase of goods and vice versa. This would substantially reduce tax cost and enhance competitiveness both in the domestic as well as International markets.

While the introduction of GST is much awaited, its implementation could be a difficult task. Further indirect taxes, such as excise duty, customs, and service tax are levied by the Central Government, whereas the state and local governments levy VAT, octroi, entry tax, entertainment tax, etc. Consequently the States could lose their authority to levy and collect taxes and would have to depend on the Central Government for the same. Tax experts believe that the solution lies in a dual structure wherein the Centre and states divide items on which each can impose the uniform levy of GST and there is no double taxation.

Transfer pricing in India

The Finance Act 2001 introduced transfer pricing regime in India. The transfer pricing legislation is contained in Section 92 through Section 92F of the Income Tax Act, 1961 (‘the Act’) and Rules 10A to 10E of the Indian Income Tax Rules, 1962 (‘the Rules’). The new legislation became effective for all accounting periods ending on or after March 31, 2002.

When examining transfer pricing issues, Indian transfer pricing regulation (‘TPR’) follows the arm’s length principle in determining the price of transactions between related parties.

Arm’s length price

The arm’s-length price, as defined under Section 92F (ii), means “a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions”.

Under the regulations, an “uncontrolled transaction” is defined as a transaction between enterprises other than associated enterprises, whether resident or non-resident.

The legislation provides that where more than one arm’s length price is determined by the most appropriate method, the arm’s length price is taken to be the arithmetical mean of such prices.

Further the tax payer may choose a price which may vary from the arm’s length price. The variation allowed is 5% from the transfer price. If the difference between the arm’s length price and the transfer price does not exceed this variation, the transfer price would be deemed to be the arm’s length price. Effective from 1st April, 2012 the prescribed variation of 5% shall be substituted by different percentages which may be prescribed by the Central Government for different industries.

Associated enterprises

The definition of associated enterprises (‘AEs’)¹ in the Indian TPR is broadly similar to the definition in the OECD TP Guidelines. Associated enterprise (‘AE’) in relation to another enterprise means an enterprise:

- which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise
- in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

However the peculiarity of the Indian TPR lies in the insertion of the deeming fiction in the definition of ‘AE’ and in this respect it differs from the definition in the OECD Model Tax Convention. Section 92A(2) contains certain situations where two enterprises are considered as associated enterprises viz. shareholding of 26 per cent or more by one entity in the other or common shareholding of 26 per cent or more, dependence on the finance provided by one enterprise to the other, or raw material supplied or technology provided by the other enterprise etc.

Deemed Associated Enterprise

The Finance Bill, 2011 has proposed to introduce anti-avoidance provision with the objective of discouraging transactions with persons located in notified jurisdiction which do not effectively exchange information with India.

Where one of the parties to the transaction is located in the notified jurisdiction, all parties to the transaction shall be deemed to be associated enterprises and any transaction which has a bearing on the income of the tax payer shall be deemed to be an international

¹ Section 92B

transaction and would be subject to provisions of the TPR. However the benefit of the permissible variation of transaction price would not be available.

International transaction

Transaction between two or more AEs, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, financing or any other transaction having a bearing on the profits, income, losses or assets of such enterprises or any cost contribution agreement shall be considered as an international transaction.

Section 92B (2) further expands the scope of the definition of international transaction by including in its fold the concept of 'Deemed International Transaction'. The aforesaid section provides that a transaction entered into by an enterprise with a person other than an AE shall be deemed to be an international transaction, if:

- there exists a prior agreement between such other person and the associated enterprise or
- the terms of such a transaction are in substance determined between such other person and the associated enterprise.

Documentation requirements

The burden of demonstrating the arm's length nature of the international transactions rests on the taxpayer. Rule 10D of the Indian TPR prescribes thirteen mandatory documents in this regard and requires the taxpayer to maintain documentation contemporaneously. Some of the requirements are general in nature while others are more specific to the relevant international transactions. Some of the requirements are as follows:

- business and group's overview (description of the ownership structure, business of the group etc.)
- description of international transactions
- Functional Asset and Risk analysis ("FAR analysis")

- selection and application of the most appropriate method
- benchmarking and identification of comparables
- other supporting details/documents which help in demonstrating the arms length nature of transaction.

The arm's length price in relation to an international transaction is required to be determined by any of the following methods:

- comparable uncontrolled price method
- resale price method
- cost plus method
- profit split method
- transactional net margin method.

Whilst the rigors of the documentation are applicable in each case where the taxpayer has entered into international transaction with its AE irrespective of the factors like volume, complexity etc., the Indian TPR provides a partial relief to the taxpayers from maintenance of extensive documentation, in case the value of the international transactions does not exceed INR 10 million. However, the taxpayer is still required to maintain sufficient information and appropriate documentation, to substantiate the arm's length nature of the international transaction, in case the audit process is initiated.

The rules provide that the documentation is to be prepared and maintained by the due date for filing the annual income-tax return. Further it is obligatory for the taxpayer to maintain the documents for 9 years from the end of the relevant Financial Year.

The taxpayer is also required to file an Accountant's Report in Form 3CEB with the Income Tax Department within the due date of filing of return of income which, presently, is 30th November following the end of the financial year, for taxpayers subject to transfer pricing. In this Form the accountant is required to give his independent opinion regarding the

maintenance of transfer pricing documentation and discloses the nature and volume of international transactions along with the details of AEs with whom the international transaction has taken place, the arm's length value under best method.

Transfer pricing audit by revenue authorities

The transfer pricing audit is conducted by the Transfer pricing officers ("TPO"), a specialised officer from the revenue authorities. As per section 92CA (1), "Where any person, being the assessee, has entered into an international transaction in any previous year, and the Assessing Officer ('AO') considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction under section 92C to the Transfer Pricing Officer".

The TPO will now have the jurisdiction to determine the arm's length price of international transactions which he may identify during the course of audit proceedings before him, and not referred by the Assessing officer. Further, TPO has been empowered to conduct survey for enquiries and collection of information. This amendment is effective from 1st June, 2011.

Penalties

Indian TPR prescribes onerous penal consequences in the event of non-compliance with documentation and other obligations set out there under. The penal provisions are summarized below:

Default	Penalty	Section of TPR
Failure in maintaining documentation	2 per cent of the value of each international transaction	271AA

Failure in producing the relevant documents to the TPO	2 per cent of the value of each transaction for which documents cannot be furnished	271G
Failure to file accountant's report within the due date (Form 3CEB)	INR 100,000	271BA
Concealment of income in the event of wilful manipulation of price	100 per cent – 300 per cent of amount of tax sought to be evaded	271(1)(c)(iii) read along with Explanation 7

It is important to note that each of these aforementioned penalties are independent and can be levied by the tax authorities concurrently.

Introduction of safe harbour norms

With a view to ease out the administrative burden of transfer pricing documentation, in certain circumstances, an amendment, effective April 1, 2009 was introduced by inserting Section 92CB. Considering the humungous transfer pricing litigations pending before the Appellate Authorities and the Courts in respect of a large number of cross-border transactions, the Central Board of Direct Taxes ("CBDT") has been given the powers to formulate 'safe harbour rules' i.e. to provide the circumstances in which the Income-tax authorities shall accept the transfer price declared by the tax payer.

Alternate dispute resolution panel

Dispute resolution panels have been set up with a view to achieve speedy and efficient disposal of transfer pricing cases. The AO before passing the final assessment order, which is prejudicial to the interest of the tax payer, issues a draft order to the tax payer. The tax payer files his acceptance to the AO or objection to the Alternate Dispute Resolution Panel ("ADP") along

Investment risks in India

with the AO, in regard to the said draft order, within thirty days from the date of receipt of the draft order. The ADP provides the directions to the AO within 9 months of such filing. The direction of ADP is binding on the AO. Such an order of AO which is passed as per the instructions of ADP is appealable to ITAT directly. The ADP is primarily an alternative to the Commissioner Appeals and will positively reduce the total time spent by the tax payer in the appellate procedures involved in the transfer pricing disputes.

If the taxpayer does not opt for ADP, he may go through the normal appellate procedure i.e. file an appeal before Commissioner of Income Tax (Appeals).

Advance Pricing Arrangement ('APA')

DTC, effective from 1st April, 2012, provides that the CBDT may frame a scheme for the functioning of the APA programme. An APA is an agreement between a taxpayer and the tax authorities for the upfront determination of the arm's length price and pricing methodology in relation to an international transaction.

Further, it provides that APA shall not exceed 5 consecutive Financial Years and that APA is not binding in case of change in code having bearing on the agreement. Also, APA shall be binding only:

- on the person in whose case the agreement has been entered into;
- in respect of the transaction in relation to which the agreement has been entered into;
- on the jurisdictional authority.

Sovereign risk

India is a vibrant parliamentary democracy and has been one since its political independence from British rule more than 55 years ago. There is no serious revolutionary movement in India; hence there is no conceivable possibility of the state collapsing. Sovereign Risk in India is therefore zero for both "foreign direct investment" and "foreign portfolio investment."

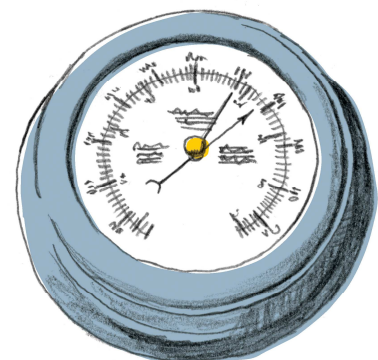
Political risk

India suffered political instability for a few years due to the failure of any party to win an absolute majority in Parliament. However, political stability has returned since the general elections in 1999. However, political instability did not change India's economic course though it delayed certain decisions relating to economic liberalisation.

Thus, political instability in India in practical terms has posed no risk to foreign direct investors because no policy framed by a past government has been reversed by any successive government so far. You can find a comparison in Italy which has had some 45 governments in 50 years, yet overall economic policy remains unchanged. Even if political instability is to return in the future, chances of a reversal in economic policy are next to nil. Hence, political risk in India is practically non-existent.

Commercial risk

Commercial risk exists in business in any country. Not each and every product or service can be readily sold; hence it is necessary to study the demand/supply situation for a particular product or service before making any major investment. There is a large number of market research & advisory firms in India (including Grant Thornton) which will study demand/supply situation for any product/service and advise the potential investor accordingly in exchange of a professional fee.



Grant Thornton India

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Other services

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- government and infrastructure advisory.

Fast figures

	India	Global
*Revenue US\$	N/A	3.7 billion
Partners	41	Over 2,500
Personnel	922	Approx 30,000
Offices	9	Approx 500

*As on 01 April 2011

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