India

TAX LEGAL CONSULTING

Tax and Investment Facts

A Glimpse at Taxation and Investment in India

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Dhruva Advisors LLP India

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- Tax compliance
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1 Types of Business Structure / Legal Forms of Companies

The principal forms of doing business in India are the company (public company or private company, or one-person company), limited liability partnership (LLP), partnership firm, representative office / branch office / liaison office / project office or site office of a non-resident company.

Foreign investors may adopt any recognized form of business enterprise. A company is the most widely used form for a foreign direct investor.

2 Corporate Taxation

In India, income tax is levied on total income earned in each tax year, which is the financial year starting 1 April to 31 March. For the purpose of Indian income tax, the taxpayers are classified into different categories such as individual, company, firm including LLP, Hindu Undivided Family, association of persons, body of individuals and other artificial judicial persons.

The amount of income subject to tax in India is based on the residential status of the company.

2.1 Applicable Taxes / Tax Rates

a) Resident companies

For the tax year 2015-2016, a resident company is taxable at 30%.

The amount of income tax shall be increased by a surcharge at the rate of 7% of such tax where total income exceeds INR 10,000,000 and at the rate of 12% of such tax where total income exceeds INR 100,000,000.

The amount of income tax and the applicable surcharge is further increased by the education cess, calculated at the rate of 3% of the income tax and surcharge.

b) Non resident companies

For the tax year 2015-2016, a non resident company is taxable at 40%.

The amount of income tax is increased by a surcharge at the rate of 2% of such tax where total income exceeds INR 10,000,000 and at the rate of 5% of such tax where total income exceeds INR 100,000,000.

The amount of income tax and the applicable surcharge, shall be further increased by the education cess, calculated at the rate of 3% of the income tax and surcharge.

c) Minimum alternate tax (MAT) applicable to corporate assessees

The MAT is payable by a company if the regular tax payable (as mentioned above) is less than 18.5% of its book profits. MAT is levied at a rate of 18.5% of book profits, plus applicable surcharge and education cess.

Book profit means net profit as shown in the profit and loss account of the company for the relevant tax year as adjusted by the prescribed additions and deletions.

Tax paid under the MAT provisions may be carried forward for offset against regular income tax payable in the subsequent 10 tax years.

d) Partnership firms and LLPs

Partnership firms and LLPs are taxed at 30%. Further, a surcharge of 12% applies if income exceeds INR 10,000,000. The amount of tax and surcharge is increased by an education cess of 3%.

Interest, salary, bonuses, commissions or remuneration to any partner is allowed as a deduction subject to certain conditions.

e) Alternate minimum tax (AMT) applicable to non-corporate assessees

AMT is payable if the regular tax payable (as mentioned above) is less than 18.5% of the adjusted total income.

Adjusted total income is the total income as increased by certain items prescribed in this regard.

AMT provisions are imposed only on non-corporate assessees claiming prescribed investment-linked incentives. Further, except in case of partnership firms and LLPs, AMT is applicable only if the adjusted total income exceeds INR 2,000,000.

Tax paid under the AMT provisions may be carried forward for offset against income tax payable in the next 10 tax years, subject to certain conditions.

2.2 Resident Entities

Resident companies and resident partnership firms / LLPs are subject to tax on their worldwide income.

- A company is considered resident in India if it is incorporated in India or if its place of effective management in that tax year is in India. Place of effective management means a place where key managerial and commercial decisions that are necessary for conducting the business of the company as a whole are essentially made.
- A partnership firm or LLP is considered resident in India if any part of the control and management of its affairs is in India.

2.2.1 Computation of taxable income

The Indian tax law divides taxable income into various heads of income. A taxpayer's taxable income is determined by aggregating the income from the following heads:

- Income from business or profession
- Income from house property
- Capital gains
- Income from other sources

- **Income from business or profession**
  The Central Government has recently notified 10 income computation and disclosure standards for the purpose of computing income under the head business or profession.

The computation of business or professional income is based on the profits shown in the financial statements, after making adjustments for deductions and specific disallowances.

- Deductions available
  All expenses that are revenue in nature are allowed as deduction if they are:
  - Incurred exclusively for the business or profession
  - Not in the nature of personal expenses
  - Not in the nature of capital expenses

Illustrative examples of deductions include rent, rates, repairs and insurance for buildings and plants used for business, depreciation, interest on capital borrowed for business, bad debts, etc.

- Disallowances
  Examples of specific disallowances to be made while computing the income from business or profession include:
  - Certain expenses on which taxes are required to be withheld and required taxes have not been withheld and paid to the government.
  - Income tax and interest thereon
  - Payments made to related parties if they are excessive or unreasonable
  - Any expenditure for which payment is made in excess of INR 20,000 other than by way of account-payee cheque
  - Deductions for certain expenses are allowed only if payment is made on or before the due date for submitting returns for income / bonus to employees, interest on loans from banks / financial institutions, leave encashment to employees, contributions to provident funds, etc.

- **Income from house property**
  Income earned from leasing buildings or land appurtenant by the taxpayer is taxed under this head. In certain situations, income under this head is computed on deemed-to-be-leased basis.

  The tax under this head is computed on the annual value of the property, meaning the potential of the property to generate income (e.g. rent) for the taxpayer.

  The following deductions from the annual value are allowed:
  - Taxes paid to local authorities on such property
  - A sum equal to 30% of the annual value
  - Interest payable on capital borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of property

- **Capital gains**
  Income earned from the transfer of a capital asset (not being stock-in-trade or personal effects) is taxed under this head. Please refer our discussion in para **2.2.3** below.

- **Income from other sources**
  This is the residuary category under which income is taxable if not chargeable under any other specified head of income.

  The different types of incomes which generally get taxed under this head are dividends, interest, income from sub-letting of house property by a tenant, etc. Expenses which are wholly and exclusively incurred for the purpose of earning the income are deductible.

2.2.2 Taxation of dividends

→ **Tax on distribution of income through dividend**

Dividends paid by resident companies are subject to dividend distribution tax (DDT) on a grossed-up basis at the rate of 15%, plus applicable surcharge and education cess of the amount declared, distributed or paid as dividends. On a grossed-up basis the effective rate comes to 20.36%. Dividends subject to DDT are exempt for the recipient shareholder.

The dividend amount subject to DDT is reduced by the amount of dividend the resident company receives from its subsidiary company provided that the subsidiary company has already paid DDT on the dividend.

→ **Tax on buy-back of shares**

An unlisted resident company is liable to pay tax at the rate of 20%, plus applicable surcharge and education cess, on income distributed to a shareholder from buying back its shares. The distributed income is the amount of consideration paid by the company on the buy-back, reduced by the amount received by the company from the issue of the shares. The shareholder will not be charged tax on income arising from such buy-backs.

2.2.3 Capital gains and losses (including capital gains and losses from sales of shares)

Gains from the transfer of capital assets are subject to income tax under this head.

The term capital asset also encompasses shares or interest in a foreign entity if it derives its value substantially from the assets located in India.

Capital assets are either short-term capital assets or long-term capital assets. A short-term capital asset is defined as a capital asset that is held for less than 36 months immediately before the date of its transfer. This is reduced to 12 months or less for shares on a recognized stock exchange in India and other prescribed securities. Capital assets that do not qualify as short-term capital assets are considered long-term capital assets.

Capital gains are taxed as follows:

- Computation mechanism:
  Capital gain is the value of the consideration received for the transfer of the capital asset reduced by the following:
  - Cost of acquisition of the asset
  - Cost of improvement
  - Expenditure incurred in connection with the transfer of the asset

- Tax rates

Particulars	**Short-term capital gain**	**Long-term capital gain**
On sale of equity shares or equity-oriented unit funds, where the income is subject to securities transaction tax	15%	Exempt
Other capital assets	Applicable normal tax rates	20%

- Treatment of capital loss

Capital loss	**Set off against**		
	Short-term capital gain	**Long-term capital gain**	**Income other than capital gains**
Short-term capital loss	✓	✓	✗
Long-term capital loss	✗	✓	✗

The balance of capital losses, if any, may be carried forward to offset capital gains in the subsequent eight tax years provided that the tax return in year of incurring losses is filed by the due date.

2.2.4. Depreciation / Capital allowances

Depreciation is calculated using the declining-balance method and is allowed on classes of assets. Depreciation rates vary according to the class of assets.

Depreciation is also allowed on intangibles, such as know-how, patents, copyrights, trademarks, licenses, franchises or other similar commercial rights.

The depreciable base is based on actual cost, i.e. the purchase price plus capital additions, including certain installation expenses. If an asset is sold, discarded, demolished or destroyed, depreciation expense is reduced to the extent of the amount realized upon the disposition, if any.

Depreciation is calculated at 50% of the normal rates if an asset is used for less than 180 days in the first year.

The depreciation rates for certain fixed assets are as follows:

Assets	**Rate (%)**
Plant and machinery*	15
Buildings (other than used for residential purpose)	10
Furniture and fittings	10
Computers, including computer software	60
Motor cars (other than used for hiring business)	15
Airplanes	40

* Subject to the fulfilment of prescribed conditions, additional depreciation equal to 20% of the actual cost is allowed in the first year with respect to plant and machinery (other than ships or aircraft) acquired or installed after 31 March 2005

2.2.5 Loss carry over (including potential loss of tax loss carry forward in the event of restructuring)

Losses arising from business operations / professions in a tax year may be offset against income from any source in that year.

Balance losses, if any, may be carried forward to be set off against taxable income derived from a business or profession in the following eight tax years, provided the income tax return for the year of loss is filed on time. For closely held companies, a 51% continuity of ownership test must also be satisfied in order to carry losses forward.

Unabsorbed depreciation may be carried forward indefinitely.

→ **Treatment of losses on mergers and demergers**

Upon merger of a resident company owning an industrial undertaking or ship or hotel with another company, or a merger of a specified banking company with a specified bank, or a merger of one or more public sector companies engaged in the business of operation and maintenance of aircraft with another public-sector company, the accumulated losses and unabsorbed depreciation of the amalgamating company are regarded as losses and unabsorbed depreciation of the amalgamating company and are available for offset on fulfilment of certain conditions.

In the case of a demerger, the accumulated losses and unabsorbed depreciation of the demerged company is available to the resultant company for offset and carry-forward if such loss or unabsorbed depreciation is

- directly relatable to the undertaking transferred: whole of the loss or unabsorbed depreciation of the undertaking.
- not directly relatable to the undertaking transferred: proportionate loss or unabsorbed depreciation based on the proportion of assets transferred.

2.2.6 Group taxation

India does not have group taxation concept. Each entity is taxed separately.

2.2.7 Relief from double taxation (tax credit / tax exemption)

- **Unilateral relief**

  A resident deriving income from a non-tax treaty country is eligible for a credit (lower of tax on such income or tax paid in foreign country on such income) for the foreign income taxes paid.

- **Tax treaties**

  To avoid the hardship of double taxation, the Government of India has entered into double taxation avoidance agreements (DTAA) with various countries.

2.2.8 Incentives

Profit and investment linked incentives are available to various activities / sectors such as:

- Infrastructure sector
- Oil and gas sector
- Research and development activities
- Carrying on activities in specified geographical areas

Incentives available upon meeting key conditions include:

- Set up of a unit in special economic zone
- In-house scientific research expenditure
- Investment in new plant and machinery in notified rural areas
- Expenditure on certain types of business
- Profits and gains from industrial undertakings or enterprises engaged in infrastructure developments
- Profits and gains from the business of collecting and processing of bio-degradable waste
- Income of offshore banking units and international financial service centres

2.3 Non-resident Companies

Non-resident companies, i.e. companies incorporated outside of India, and non-resident partnership firms / LLPs are subject to tax only on Indian-sourced income.

Non-residents may also be taxed on the following income:
- Income accruing outside India through a business connection in India;
- Income through or from any asset or source of income in India;
- Income through transfers of capital assets situated in India, including shares in a company incorporated in India (i.e. indirect transfers).

2.3.1 Concept of permanent establishment / doing business

Indian tax law uses the concept of business connection, which is similar to the concept of permanent establishment (PE). The concept of business connection is broader than that of PE.

Based on the nature of business activities carried out by a non-resident entity in the source country, different types of PEs emerge and the taxability of income also differs based on the nature of PE. The following types of PEs have been considered in international double taxation model conventions, namely the United State Model Convention, Organisation for Economic Co-operation and Development Model Convention and United Nations Model Convention:
- **Fixed-base PE:** A fixed-base PE refers to a fixed place of business through which the business of an enterprise is wholly or partly carried on.
- **Service PE:** The furnishing of services through employees or other personnel by a foreign enterprise results in a service PE subject to certain conditions.
- **Construction PE:** Any construction, installation, assembly project or any supervisory activities in relation to the same

which continue for more than the period specified in the relevant tax treaty shall be deemed to be a construction PE.

- **Agency PE:** An entity / individual in the source country is deemed to be an agency PE of the foreign entity if it is a dependent agent of the latter and fulfils any of the prescribed conditions laid down in this regard.

2.3.2 Withholding taxes

- There is an obligation on the payer of income (either resident or non-resident) to withhold tax at the following rates when making certain specified payments to residents:

Nature of Payment	Withholding rate (%)
Interest	10
Payment to contractors	2
Rent	2 / 10
Professional fees	10
Royalties or fees for technical services	10
Commission or brokerage	10
Payment of consideration for transfer of immovable property	1

- Resident companies or non-corporate assessees must withhold tax at the following rates when making payments to non-residents:

Nature of Payment	Withholding rate (%)
Interest on foreign currency loans	5* / 20
Royalties and fees for technical services	10

* 5% rate is imposed if interest relates to specified borrowings in foreign currency and the money is borrowed under a loan agreement or by issue of a long-term bond, including a long-term infrastructure bond as approved by the central government, and the funds are borrowed between 1 July 2012 and 31 July 2017. Further 5% rate applies on interest paid between 1 June 2013 and 30 June 2017 on a rupee-denominated bond of a resident company, or a government security subscribed by a foreign institutional investor or a qualified foreign investor.

- The resident companies / non-corporate assessees, when making payment to any resident / non-resident, are required to withhold tax at the rate of 20% or the higher rate prescribed in the tax act / relevant treaty if the recipient fails to furnish the permanent account number (PAN).

2.3.3 Capital gains

Refer to section **2.2.3**.

In addition to section, **2.2.3**, non-residents pay capital gains tax on the sale of shares and debentures issued by an Indian company based on gains determined in the foreign currency used for the purpose of acquiring such securities. The capital gains so computed are reconverted into rupees and taxed; no cost inflation index is applied for computing such gains.

2.4 Tax Compliance

Furnishing of Tax Returns

- **Tax authority**
  The Central Board of Direct Taxes is the primary revenue body responsible for providing essential input for policy and planning of direct taxes in India and for administration of direct tax laws through subordinate income tax authorities.

- **Tax year (financial year)**
  In India, the tax year is a financial year starting from 1 April and ending on 31 March.

→ Assessment year

Assessment year is the year immediately following the financial year wherein the income of the financial year is assessed to tax. For example, if the financial year is 2014-2015 then the assessment year is 2015-2016.

→ Advance payment of tax

If the income tax liability of a corporate taxpayer is more than INR 10,000 in a tax year, it is liable to pay advance tax. Such tax has to be paid on 15 June, 15 September, 15 December and 15 March of the relevant tax year. Any balance of tax due must be paid on or before the date of filing the return.

→ Filing of tax returns

A company must file a final tax return, reporting income of the tax year, by 30 September immediately following the end of the tax year, stating its income, expenses, taxes paid and taxes due for the preceding tax year. A non-corporate taxpayer that is required to have its accounts audited also must file a return by 30 September. The due date for filing returns and transfer pricing accountants' reports is extended to 30 November for taxpayers with international and specified domestic transactions during the year. All other taxpayers must submit a return by 31 July. A tax return will be treated defective if the tax liability along with interest is not paid on or before the date of submission of the tax return.

Quarterly statement of taxes withheld are to be filed electronically with the tax authorities on or before 15 July, 15 October and 15 January for the first three calendar quarters of the tax year and on or before 15 May following the last calendar quarter of the tax year.

All taxpayers are required to apply for a PAN for purposes of identification. The PAN must be quoted on all tax returns and correspondence with the tax authorities and on all documents relating to certain transactions. Every recipient (whether resident or non-resident) of India-sourced income that is subject to withholding tax must furnish a PAN to the Indian payer before the payment is made.

Tax Assessment Proceedings

→ Regular assessments

Although income disclosed in valid tax returns is generally accepted subject to prima facie adjustments, the tax officer may scrutinize selected cases. The tax officer may require the taxpayer either to attend his office or to produce such evidence as he may wish to produce in support of his return and such further evidence that the tax officer may require on specific points.

The time limit for completion of a regular assessment is 2 years from the end of the relevant assessment year (transfer pricing cases get additional time of 1 year).

→ Reassessment

A completed assessment may be reopened by the tax officer if there is reason to believe that income has escaped assessment.

The time limit for initiating reassessment proceedings is 6 years from the end of the relevant assessment year. The said time limit is increased to 16 years when taxable income related to an asset (including a financial interest in any entity) located outside India has escaped assessment.

→ Rectification

All assessment orders are subject to modification by the tax officers if there is any mistake apparent from the record. The time limit for filing rectification application is 4 years from the end of the tax year in which the order to be amended is passed.

Appeals

All assessment / reassessment orders passed by the tax officer are subject to appeal by the taxpayer before the Commissioner of Income-tax (Appeals). The time limit for filing the appeal is 30 days from the date on which the relevant order was communicated.

The decision of the Commissioner of Income-tax (Appeals) may be brought for a second appeal to the Income Tax Appellate Tribunal (ITAT). The appeal to the ITAT should be filed within 60 days of the date on which the relevant order was communicated. An appeal may be filed by either the taxpayer or the tax authorities.

An appeal may be made to the High Court in respect of any order of the Appellate Tribunal, provided that the High Court is satisfied that the case involves a substantial question of law. An appeal must be filed within 120 days from the date of communication of the order of the ITAT.

An appeal may be made to the Supreme Court against any judgment of the High Court. The law declared by the Supreme Court becomes the law of the land, and is binding on all courts and tribunals.

Authority for Advance Rulings

The Authority for Advance Rulings (AAR) issues rulings on the tax consequences of transactions which have been undertaken or proposed transactions of non-residents. An advanced ruling can be obtained by any person, resident or non-resident, to decide whether or not a proposed arrangement constitutes an impermissible avoidance arrangement subject to general anti-avoidance rules (GAAR). From 1 October 2014, the AAR also may issue rulings in relation to the tax liability of residents in prescribed cases. Rulings are binding on the applicant and the tax authorities for the specific transaction(s).

3 Double Taxation Agreements

To obtain relief under the DTAA, a non-resident taxpayer is required to furnish a tax residence certificate from the authorities in its country of residence and other documents and information as may be prescribed under the Indian Income-tax Act and rules.

Indian Tax Treaties		
Albania	Israel	Romania
Armenia	Italy	Russia
Australia	Japan	Saudi Arabia
Austria	Jordan	Serbia & Montenegro
Bangladesh	Kazakhstan	Singapore
Belarus	Kenya	Slovak Republic
Belgium	Korea	Slovenia
Bhutan	Kuwait	South Africa
Botswana	Kyrgyz Republic	Spain
Brazil	Latvia	Sri Lanka
Bulgaria	Libya	Sudan
Canada	Lithuania	Sweden
China	Luxembourg	Switzerland
Croatia	Malaysia	Syria
Colombia	Malta	Tajikistan
Cyprus	Mauritius	Tanzania
Czech Republic	Mexico	Thailand
Denmark	Mongolia	Trinidad & Tobago
Egypt	Morocco	Turkey
Estonia	Mozambique	Turkmenistan
Ethiopia	Myanmar	Uganda
Fiji	Namibia	Ukraine
Finland	Nepal	United Arab Emirates
France	Netherlands	United Kingdom
Georgia	New Zealand	United States

Germany	Norway	Uruguay
Greece	Oman	Uzbekistan
Hungary	Philippines	Vietnam
Iceland	Poland	Zambia
Indonesia	Portugal	
Ireland	Qatar	

International transfer pricing

As an anti-avoidance measure, India introduced comprehensive transfer pricing regulations into its tax laws in 2001. India's transfer pricing regulations are broadly based on the OECD guidelines, with some differences (and more stringent penalties). The regulations explicitly define the relations and the types of transactions that are covered for the purposes of transfer pricing.

The basic definition of the term "associated enterprise" is similar to that of the OECD model and is based on the generally accepted criterion of participation in control, management or capital. However, its scope is extended by including situations such as complete dependence on intellectual property, substantial participation in debt, extensive sourcing of raw materials by one enterprise from another enterprise, common control by any individual, etc.

Similarly, the definition of "international transaction" has been defined broadly, and includes, among others, any transaction that has a bearing on the profits, income, losses or assets of other associated enterprises. Transactions relating to cost contribution and cost allocation also are specifically covered, as are transactions in tangible and intangible property, capital financing including guarantees, and business restructurings or reorganizations with an associated enterprise, among others. Transactions between unrelated parties may be deemed to be international transactions under certain circumstances.

Taxpayers are also required to maintain a comprehensive set of prescribed information and documents relating to international transactions that are undertaken between associated enterprises, on an annual basis, within the prescribed timelines (due date of filing income tax returns). Further, taxpayers are required to obtain an Accountant's

Report from an independent accountant certifying the nature and amount of international transactions. The certificate needs to be filed along with the income tax return. The burden of proving the arm's-length character of the transaction is primarily on the taxpayer.

The following are the specified methods for determining the arm's-length price:

- Comparable uncontrolled price method
- Resale price method
- Cost-plus method
- Profit split method
- Transactional net margin method
- Any other method that takes into account the price that has been charged or paid or would have been charged or paid, in the same or a similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

The tax officer may make adjustments with respect to an international transaction, if the officer determines that certain conditions exist, including any of the following:

- The price is not at arm's length.
- The prescribed documents and information have not been maintained.
- The information or data on the basis of which the price was determined is not reliable.
- Information or documents requested by the tax officer have not been furnished.

Stringent penalties are prescribed in case of failure to comply with the provisions of the Indian transfer pricing regulations, which can be levied at the rate of 2% of the transaction value.

Domestic transfer pricing

In addition to cross-border related party transactions, the transfer pricing regulations have been extended inter alia to cover the following domestic transactions:

- Expenditures (for which a deduction is allowable when calculating business income) where payment has been made to specified persons, and
- Transfers of goods or services from a unit claiming a tax holiday to another unit that may not be eligible for the tax holiday, and vice versa.

Only those cases where the aggregate of such transactions entered into by the assessee in the tax year exceed INR 50,000,000 (the limit has been increased to INR 200,000,000 from 1 April 2015) are covered. The regulations also contain deeming provisions that may cover transactions with unrelated parties, whether resident or non-resident, in certain circumstances.

Safe harbour rules

According to the rules, the transfer price declared by an eligible taxpayer shall be accepted by the tax authorities for the below mentioned international transactions subject to the prescribed ceilings / circumstances:

- Provision of software development services
- Provision of information technology-enabled services
- Provision of knowledge process outsourcing services
- Advance of intra-group loans
- Provision of corporate guarantees
- Provision of contract research and development services wholly or partly relating to software development
- Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs
- Manufacture and export of core auto components
- Manufacture and export of non-core auto components

→ Advance pricing agreements (APA)

An APA is an arrangement between the taxpayer and the tax authority covering future transactions, with a view to solve potential transfer pricing disputes in a cooperative manner. The APA has been made effective since 1 July 2012, and the rules have been notified providing procedures and necessary forms for application / administration of APA.

In line with the expectations, the rules have been provided for both unilateral and bilateral / multilateral APAs. The salient features of the procedure laid down for APAs are the pre-filing consultation, application for APA, withdrawal of APA, defective application, procedure, compliances post APA, cancellations of APA, and revisions and renewal of APA.

An APA is valid for five years and is legally binding on the taxpayer and on the tax authorities in respect of the international transaction for which it has been entered into, except where there is a change in law having a bearing on the APA. From 1 October 2014, an APA can be rolled back to cover up to four past years prior to the first year otherwise covered under the APA.

The application for APA has to be filed before the start of the 1st financial year for which APA is sought. For example, if the tax payer desires to file an APA for the financial years 2016-17 to 2020-21, it has to file the APA application on or before 31 March 2016.

The APAs filed by 31 March 2015 have been mainly unilateral APAs. Bilateral APAs have been filed covering countries such as the USA, Japan, Germany UK, etc. As per the recent news report in July 2015, approximately 550 APA applications are pending with the Government.

5 Anti-avoidance Measures

5.1 General Anti-avoidance Rule

General anti-avoidance rules (GAAR), have recently been notified which will be effective from 1 April 2017. The GAAR are broad rules designed to deal with aggressive tax planning. Wide discretion is provided to the tax authorities to invalidate an arrangement, including disregarding of the application of tax treaties, if an arrangement is treated as an impermissible avoidance arrangement.

The GAAR provisions will be applied in accordance with rules and guidelines notified by the government. The GAAR do not apply to arrangements with an aggregate tax benefit of below INR 30,000,000.

5.2 Thin Capitalization Rules

India does not have specific thin capitalization rules. However, under GAAR, the revenue authorities have wide powers to re-characterize transactions (including treating debt transaction as equity).

5.3 Controlled Foreign Company Provisions

India does not have CFC rules.

6 Taxation of Individuals / Social Security Contributions

6.1 Residency Rules

Individuals are considered as resident if they meet either of the following criteria:

a. They are present in India for 182 days or more during the tax year
   or
b. They are present in India for 60 days or more during the tax year and for at least 365 days in aggregate during the preceding four tax years.

   The 60 days condition is increased to 182 days in the case of a citizen of India who leaves India in any tax year as a member of the crew of an Indian ship or for the purposes of employment outside India or in the case of a citizen of India or a person of Indian origin who comes for a visit to India in a tax year. When calculating the number of days present in India, the entire period mentioned in the Continuous Discharge Document shall be excluded.

Individuals who do not meet the above criteria are considered to be non-residents.

A resident individual will be treated as resident and not ordinarily resident in India during the tax year if he satisfies following conditions:

a. He is non-resident in India in 9 out of the 10 preceding tax years;
   or
b. He is present in India is for 729 days or less during 7 preceding tax years.

6.2 Income Liable to Tax

As discussed in section **2.2.1**, the amount of income subject to tax in India is based on the residential status of the individual.

→ **Resident**

An individual can either be resident or resident but not ordinarily resident.

- Ordinary residents individuals are subject to tax on their global income i.e. whether income is received or deemed to be received or accruing in India or outside India.
- Resident but not ordinarily resident individuals are subject to tax on Indian-sourced income and income accruing outside India if it is derived from a business controlled / profession set up in India.

→ **Non-resident**

Non-resident individuals are subject to tax only on Indian-sourced income. Further, they may also be taxed on the following income:

- Income accruing outside India through a business connection in India;
- Through or from any asset or source of income in India;
- Through transfer of a capital asset situated in India, including shares in a company incorporated in India (i.e. indirect transfers).

→ **Taxability of income of expatriates**

All salary income relating to services rendered in India is deemed to accrue in India irrespective of where it is received or the residential status of the recipient.

An exception to the above rule is that salary income earned by an individual will be exempt if all the following conditions are satisfied:

- The individual is not a citizen of India and is non-resident for the tax year.
- Salary is earned by him in connection with the employment on a foreign ship
  or
  Salary is earned by him in connection with the employment of a foreign enterprise during his stay in India provided the foreign enterprise is not engaged in any trade or business in India.
- His stay in India does not exceed in aggregate for a period of 90 days in the tax year.

→ Taxable benefits of individuals

In general, most elements of compensation are taxable in India. However, the following benefits may receive preferential tax treatment, subject to certain conditions. Further, the government has laid down valuation rules for determining the taxable value of the benefits provided to an employee:

- Rent-free accommodation: Specified percentage (ranging from 7.5% to 15%) of the employee's salary, depending on the city where the accommodation is located.
- Accommodation in a hotel (other than provided for a period not exceeding 15 days on relocation): 24% of salary or actual hotel charges as reduced by rent actually paid by employee.
- Use of movable assets of the employer: 10% per annum of the actual cost of the assets, or the amount of rent paid by the employer if the assets are leased (the use of computers and laptops is not treated as a perquisite).
- Interest-free / concessional loans exceeding INR 20,000: Interest computed at the annual rate charged by the State Bank of India.

- Approved superannuation fund: a contribution in excess of INR 100,000 is taxable.
- Other benefits: other taxable perquisites will be computed as per the prescribed valuation rules.

6.3 Allowable Deductions

- For individuals, a deduction of up to INR 150,000 may be claimed annually for prescribed contributions such as life insurance premiums paid, provident funds and other specified savings instruments.
- Interest paid on loans obtained for pursuing higher education is fully deductible. However, no deduction is available for repayment of the principal amount.
- Interest up to INR 200,000 may be claimed annually on home loans obtained on or after 1 April 1999, if the borrower resides in the home.
- A deduction of up to INR 10,000 may be claimed by individuals with respect to interest earned on deposits in a savings account with a banking company, specified co-operative society or post office.
- A deduction up to INR 25,000 is allowed for health insurance premiums. Additionally, INR 25,000 (INR 30,000 for senior citizens) is allowed for health insurance premiums paid for dependent parents. The aggregate deduction available to any individual in respect of health insurance premium incurred would however be limited to INR 30,000.

6.4 Tax Rates

For the tax year 2015-2016, income tax rates are progressive (refer to table below) up to 30%. Further, a surcharge of 12% applies if income exceeds INR 10,000,000. Amount of tax and surcharge is increased by an education cess of 3%.

Income (INR)	Rates (%)
Up to 250,000#	0
Above 250,000 to 500,000	10
Above 500,000 to 1,000,000	20
Above 1,000,000	30

To be read as INR 300,000 for individuals of the age of 60 years or more but less than 80 years.
Additional relief available for individuals of age 80 years or more.

A tax rebate up to INR 2,000 is allowed for individuals with taxable income of up to INR 500,000.

AMT provisions shall be applicable to individuals only if the adjusted total income exceeds INR 2,000,000.

6.5 Tax Compliance

Refer to section **2.4**.

6.6 Social Security Contributions

Both the employer and the employee are required to contribute to social security. The employee contributes 12% of his / her salary to the employee provident fund.

India has entered in to social service agreements (SSA) with 13 countries, whereby foreign employees who obtain a certificate of coverage under the SSA are exempt from contributing to the provident fund.

Foreign employees coming from an SSA country can withdraw their provident fund balance on cessation of employment in India. However, foreign employees coming from a non-SSA country can withdraw provident fund balances on retirement from service.

7 Indirect Taxes

Indirect tax	Taxing Authority	Taxing Event	General Effective Rate of Tax (%)
Customs Duty	Central Government	Import of goods from outside India	29.44 / 26.42 / 23.42
Excise Duty	Central Government	Manufacture of goods in India	12.5
Service Tax	Central Government	Provision of a service	14
Value Added tax (VAT)	State Governments	Sale of goods within the state	1 to 15
Central Sales tax (CST)	Central Government	Inter-state sale of goods	2 to 15
Entry Tax	State Governments	Entry of goods into a state for use, consumption or sale therein	0 to 15
Octroi / Local Body Tax (LBT)	Local Authorities	Entry of goods into a municipality for use, consumption or sale therein	0 to 7
Research & Development Cess (R&D Cess)	Central Government	Import of technology into India under foreign collaboration	5

7.1 Customs Duty

- Customs duty is levied by the Central Government on goods imported in India or exported from India under the Customs Act, 1962 as read with the Customs Tariff Act, 1975.
- Customs duty is payable by the importer on 'transaction value' at the time of clearance of such goods.
- Customs duty comprises:
  - Basic customs duty (BCD) is generally 10%. However, lower rate of BCD may be provided for capital goods or specified goods at 7.5% / 5%.
  - Countervailing duty (CVD) is generally 12.5%, levied in lieu of central excise duty to counterbalance impact of excise duty on indigenous manufacturers.
  - Additional duties of customs (ADC) is 4%, levied in lieu of VAT / CST payable on the goods imported.
  - Education cess (EC) and secondary and higher education cess (SHEC) is 3% (i.e. 2% plus 1%, respectively).
  - Anti-dumping duty / Safeguard duty is levied on specified goods at varying prescribed rates for protecting the domestic industry.
  - Other duties like NCCD, etc. are also imposed on certain specified products
- The classification of imported goods is based on universally accepted Harmonized System of Nomenclature (HSN) assigned to such goods for determining the applicable rate of Customs duty.
- The general effective rate of customs duty is 29.44%. The effective rates of customs duties may vary pursuant to general and / or specific exemption or concession notifications issued by the Government.

7.2 Central Excise Duty

- Central excise duty is levied on goods manufactured and produced in India under the Central Excise Act, 1944 (CEA) as read with Central Excise Tariff Act, 1985 (CETA).
- The applicable rate of Excise duty on the manufacture of goods is based on HSN code assigned to the said goods under the CETA.
- The duty is levied on the basis of "transaction value" of the excisable goods.
- The general effective rate of central excise duty is 12.5%. The effective rates may be lower pursuant to general / specific exemption notifications issued by the Government granting whole or partial exemption from duty.
- The manufacturer of goods would be entitled to claim CENVAT credit of duties paid on inputs, capital goods and input services against its output tax liability payable on such finished goods manufactured, subject to satisfaction of prescribed conditions under the CENVAT Credit Rules, 2004.
- Registered manufacturers are required to file periodical returns and make payment of central excise duty.

7.3 Service Tax

- Service tax can be levied under Chapter V of the Finance Act, 1994 ('the service tax law'), as amended from time to time.
- Service tax can be levied on provision of all services, except services specified in the Negative List and exemption notifications.
- The current prevailing rate of service tax is 14%.
- Generally, service tax is payable by the person providing services, by charging the same to the service receiver. However, in certain cases, the service recipient is also made liable to pay service tax liability such as services from a non-

resident service provider, sponsorship services, legal services, goods transport agency services, etc. Further, the law also prescribes a partial reverse charge mechanism for certain services like renting of motor vehicles and works contract service.

- The service provider would be entitled to claim CENVAT credit of duties paid on inputs, capital goods and input services against its output tax liability payable on rendition of taxable service, subject to satisfaction of prescribed conditions under the CENVAT Credit Rules, 2004.
- Registered service providers are required to file the periodic (i.e., currently, six-monthly) returns and make payment of service tax.

7.4 Value Added Tax (VAT) / Central Sales Tax (CST)

- India has both central- and state-level indirect tax levies on the sale or purchase of goods.
- Sale transactions which involve movement of goods within the same state are subject to the levy of state VAT, whereas inter-state movement of goods are subjected to levy of CST under the Central Sales Tax Act, 1956 (CST Act).
- Typically, the general rate of state VAT is 12.5% to 15%. Some goods like capital goods, industrial inputs etc. have a lower rate of 5% and precious metals, diamonds, etc. have a still lower rate of 1%. These rates are based on the schedules prescribed by the respective states in their statutes.
- The applicable rate of CST would be equivalent to the state VAT rate in the selling dealer's state at the time of sale. However, the purchasing dealer is entitled to procure goods at concessional rate of CST of 2 percent against issuance of declaration in Form C and subject to certain conditions being satisfied. The CST paid on purchase of goods is not available as credit and hence is a cost to the business.

- The registered dealer selling the goods is required to file periodic returns (monthly / quarterly / six-monthly, as applicable) along with payment of tax and are also subject to VAT audit, based on their state-specific audit provisions.

7.5 Entry Tax

- Entry tax is levied on entry of specified goods in certain states / local areas (municipal jurisdictions) within the state for sale, consumption or use therein.
- Entry tax payments may generally be offset against the state VAT / CST payable on sales.
- The rate of entry tax on different products varies from state to state and generally ranges between 0% and 15%.
- The levy of entry tax in many states is currently declared unconstitutional due to the levy not being compensatory in nature. Further, matters pertaining to constitutional validity, compensatory nature of levy etc. are in many cases currently pending before the Supreme Court.

7.6 Octroi / Local Body Tax (LBT)

- Octroi is levied only on the entry of goods in certain specified municipal limits / local areas in the State of Maharashtra.
- Currently, LBT is levied in the State of Maharashtra, in lieu of Octroi or cess, on the entry of specified goods into a specified municipal limit / local area (for example, Kolhapur, Solapur, Vasai-Virar) for use or consumption therein.
- LBT rate varies from 0% to 7%. No offset of such LBT is available.
- Only dealers whose turnover of sales or turnover of purchases, during any year, is INR 500 or more million would be liable for registration and payment of LBT (effective 1 August 2015).

7.7 Foreign Trade Policy 2015-2020 (FTP)

- The Ministry of Commerce (MoC), Government of India has introduced FTP to provide a stable and sustainable policy environment for foreign trade in merchandise and services.
- The focus of the new policy is to support both the manufacturing and services sectors, with a special emphasis on improving the 'ease of doing business'.
- The policy is closely integrated to various initiatives of the government such as 'Make in India', 'Digital India' and 'Skills India'. The various schemes introduced are as follows:

  - **Merchandise Export from India Scheme (MEIS):** Export of the specified goods such as dairy products, vegetables, confectionary, pharmaceutical products, capital goods, etc. to specified markets / countries are granted benefits (scrip) ranging from 2% to 5% of the FOB value. Such scrip can be used for payment of additional customs duty, central excise duty and service tax. The payment of basic customs duty through cash or scrip would be available as a drawback.
  - **Services Exports from India Scheme (SEIS):** Service provider with a minimum net foreign exchange earning of USD 15,000 in the preceding financial year, are eligible for SEIS. The service provider would be entitled to scrip of 5% or 3% (based on the category of service) of the net foreign exchange earned. The benefits under this scheme are similar to the benefits of MEIS.
  - **Export Promotion Capital Goods (EPCG):** The capital goods (including second hand capital goods) can be imported at a concessional customs duty rate of 0% and 3%, based on the goods imported. This concession is available subject to fulfilment of the export obligation of 6 times the duty saved over a period of 6 years.

- **Other Schemes**
  - Advance Authorization Scheme helps exporters import raw material for manufacture of export goods without payment of customs duty, subject various conditions such as actual user condition, fulfilment of export obligation, value addition norms, etc.
  - Duty Free Import Authorization (DFIA) scheme grants exemption from payment of basic customs duty against import of raw materials for manufacture of goods meant for exports.
  - Export Oriented Unit (EOU) / Software Technology Park Scheme

7.8 Goods and Services Tax (GST)

- India is proposing to introduce a dual system of GST, with taxes imposed by Central Government and State Government in form of Central GST (CGST) and State GST (SGST) or Integrated GST (IGST), on the supply of goods and services.
- This would mainly subsume central excise duties, customs duties (CVD/SAD), service tax, state VAT, entry tax, purchase tax, entertainment tax, luxury tax etc. into a single levy.
- The model contemplates concurrent taxation by the central government and states through parallel levies of CGST and SGST on local supply of goods and services and IGST on inter-state supply of goods and services. Further, IGST would be levied on import of goods and services. It is also proposed to levy 1 percent additional tax on inter-state sale of goods for the first two years. The said tax would be assigned to state from where the supply originates.
- GST aims to create a common national market for goods and services and would also eliminate cascading effect of taxes (i.e. tax on tax).

- The contours of GST such as tax rate, tax base, exemption limits, place of supply rules for services etc. are evolving. For levying CGST, SGST and IGST, a set of three laws would be enacted by Parliament / state legislatures.
- The proposed GST bill was passed by the Lower House of Parliament (Lok Sabha) on 6 May 2015 and will soon be raised for discussion in the Upper House of Parliament (Rajya Sabha).
- The Government of India has proposed a deadline of 1 April 2016 to be the date of implementation of GST in India.

7.9 Transfer Tax

Various instruments / transfers are subject to stamp duty. The rate of stamp duty varies from state to state and nature of instrument executed.

8 Inheritance and Gift Tax

India does not have an inheritance tax law. While certain gifts / sums of money received from donors is taxable for the recipient as income (subject to specifed expemptions), there is no separate gift tax levy / legislation.

9 Wealth Tax

India has abolished the levy of tax on wealth.

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