

Guide to Doing Business in **INDIA**



tax and regulatory aspects

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TABLE OF CONTENTS

Chapter I - Introduction to India - an overview	5
Demographic Features and Key Statistics	5
Applicable Laws for Doing Business in India	6
Chapter II - Foreign Investment Framework in India	11
Industrial Policy and Licensing	11
Foreign Investment Policy	11
Forex Regulations	17
Chapter III - Entry Vehicles – Forms of Entity	19
Liaison, Branch And Project Office.....	19
Liaison Office	19
Permissible activities and regulatory overview	19
Branch Office	19
Permitted activities and regulatory overview	19
Profit Repatriation.....	20
Project Office.....	20
Company	21
Chapter IV - Joint Ventures and Technology Transfer	23
Joint Venture Agreement	23
The need for joint ventures	23
Success of Joint Ventures	23
The stages of establishing a JV	24
Documentation.....	24
Technology Transfer Agreements	25
Nature of the contract.....	25
Typical provisions of a license agreement	25
Payment of Fees under the License Agreement.....	26
Procedure for Automatic Route.....	26
Chapter V - Overview of Corporate Laws	27
Types of companies.....	27
Private Limited Company.....	27
Public Limited Company	27
Other Companies	28

Common Requirements / Applicability of Provisions to all types of Companies..	28
Types of share capital	29
Meetings	30
Appointment of Directors / Secretary / Managing Director	30
Remuneration to Directors.....	31
Dividend.....	31
Utilization of General Reserve	32
Buyback.....	32
Director's report.....	32
AGM and Filing.....	32
Preservation of books of account	32
Other requirements	32
Cess	33
Competition laws	33
Chapter VI - Taxation in India	34
Direct Taxes particularly with reference to corporate assessee.....	34
Expatriate Taxation	38
Transfer Pricing and International Taxation	42
Quantum of penalty.....	43
Customs Duty Calculations.....	45
Chapter VII - Export Incentive Schemes	47
Export Oriented Units (EOU).....	47
Special economic zones (SEZ).....	48
Software Technology Parks of India (STPI).....	50
Chapter VIII - Funding Options	52
Equity Capital.....	52
Mobilization of Funds through Preference Shares.....	52
Foreign Currency Debt (External Commercial Borrowings (ECBs)):	52
Permissible Amount and Maturity under Automatic Route.....	53
Eligible Lenders	53
Chapter IX - Financial Reporting and Auditing Requirements	55
Accounting and Auditing Practices.....	55
Books of account.....	55

Choice of accounting year	55
Accounting and reporting requirements.....	55
Disclosure requirement	56
Standards prescribed by tax regulations	56
Auditing requirements.....	56
Statutory Audit	56
Tax Audit.....	57
Cost Audit.....	57
Internal Audit.....	57
Appointment of Auditor.....	57
Chapter X - Employee Regulations.....	58
Minimum Wages Act, 1948.....	58
Payment of Bonus Act, 1965.....	59
Payment of Gratuity Act, 1972	59
Employees' Provident Funds and Miscellaneous Provisions Act, 1952.....	59
Employees' State Insurance Act, 1948 (Esic Act):	60
Workmen Compensation Act, 1923	60
The Maternity Benefit Act, 1961	60
Industrial Disputes Act, 1947.....	61
The Contract Labour (Regulation and Abolition) Act, 1970.....	61
The Factories Act, 1948	61
The Industrial Employment (Standing Orders) Act, 1946.....	62
The Trade Unions Act, 1926	62
General	62
Chapter XI - Glossary of Terms	63
Disclaimer	64

Chapter I - Introduction to India - an overview

Demographic Features and Key Statistics

India at a Glance

- India is a Union of States with parliamentary system of Government. (29 States and 6 Union Territories). India is the largest democracy in the world.
- Land area: 3.29 million square kilometers (7th Largest in the World)
- Political Capital: New Delhi
- Commercial / Financial Capital: Mumbai
- Population: Appx. 1.10 billion
- Climate: mainly tropical with temperature ranging from 10° – 40° C in most parts
- Time zone: GMT + 5 1/2 hours
- Major airports: New Delhi, Mumbai, Chennai, Kolkata, Bangalore, Hyderabad, Thiruvananthapuram, Ahmedabad, Cochin
- Major ports: Chennai, Ennore, Haldia, Kolkata, Kandla, Kochi, Mormugao, Mumbai, Nhava Sheva (New Mumbai), Mangalore, Paradip, Tuticorin, Vishakhapatnam, Pipavav, Mundra, Dahej.

Economic indicators

- GDP: Approximately USD 900 billions, growing at approximately 9.2% p.a. (Expected to grow at 10% over next 5 years)
- Exchange rate: Rs.40.60/ US \$
- Foreign Exchange Reserves: Approx US\$ 200 billion (March, 2006)
- FDI Inflow: 2006-07: Approximately US\$ 16 billion
- Exports: 2006-07: US \$ 124.60 billion
- Imports: 2006-07: US \$ 181.36 billion
- Robust banking and financial sector with all the major international Banks operating in India for a number of years.
- Strong and transparent legal and accounting system.
- Pro-active and independent judiciary.
- Vibrant capital market with screen based, paperless trading.
- India's biggest strength is the trained and motivated human resource which looks forward to more and more challenges.

Applicable Laws for Doing Business in India

Following is a list of some important Central Laws applicable in India:

Sr. No.	Name of the Act	Purpose
1.	Arbitration and Conciliation Act, 1996	Law for faster settlement of civil disputes between the Parties
2.	Central Excise Act, 1944	Law for levying of duty on Manufacture deemed Manufacture of goods in India. Duty is payable as per the Central Excise Tariff Act
3.	Central Sales Tax Act, 1956	Deals with levy of Sales Tax on Inter State Sales Transactions. (Will be Phased out in 3 / 4 years)
4.	Contract Act, 1872	Governs the basic principles of Contract.
5.	Companies Act, 1956	Deals with incorporation and other routine matters for Companies.
6.	Competition Act, 2002	Law for ensuring free and fair competition
7.	Consumer Protection Act, 1986	Law for faster grievance redressal of consumers who buy or avail any service for a consideration.
8.	Customs Act, 1962	Deals with importation of goods and duties payable on the same as per the Customs Tariff Act.
9.	Environment Protection Act (Including the Water And Air Pollution Prevention and Control Acts)	For protecting the environment, water and Air from Pollution and procedure for obtaining environmental Clearances.
10.	Employees Provident Fund and Miscellaneous Provisions Act, 1952	Labour Welfare Law
11.	Employees State Insurance Act, 1948	Labour Welfare Law
12.	Factories Act, 1948	Deals with facilities to be provided to the Workmen in Factories
13.	Foreign Exchange Management Act, 1999	Governs the transactions in which foreign exchange is involved. It applies to Current and Capital Account transactions of Residents and Non-Residents
14.	Payment of Gratuity Act, 1972	Labour Welfare Law
15.	Income Tax Act, 1961	Direct Tax Law related to the income of a person (Including Companies)
16.	Industrial Disputes Act, 1947	Settlement of disputes between the Employer and the Trade unions
17.	Industries (Development & Regulation) Act, 1951	Applicable for certain type of Industries and also defines SSI and other units
18.	Information Technology Act, 2000	Gives legal recognition to electronic transactions and paves the way for e-commerce related transactions
19.	Negotiable Instruments Act, 1881	Deals with Negotiable Instruments such as Cheques, Bills of Exchange etc
20.	Partnership Act, 1932	Deals with the formation and routine aspects of a Partnership firm
21.	Patents, Copyrights, Trade Mark and Designs related Laws	Deals with registration and other matters governing Intellectual Property Laws
22.	Prevention of Money Laundering Act, 2002	Deals with confiscation of property derived from money laundering
23.	Research and Development Cess	Deals with levy of Cess on import of

Sr. No.	Name of the Act	Purpose
	Act, 1986	technology from abroad
24.	Sale of goods Act, 1930	Deals with when the property in goods pass and rights and duties of buyer and seller
25.	Securitisation and Reconstruction of financial Assets and Enforcement of Security Interest Act, 2002	Deals with establishment of Asset Reconstruction Companies and procedure for speedy recovery of Bank Loans.
26.	Special Economic Zones Act, 2005	Deals with the Developers and Units in Special Economic Zones and procedures for availing fiscal benefits
27.	Wealth Tax Act, 1957	Deals with the types of assets on which Wealth Tax is leviable
28	Chapter V of Finance Act, 1994	Deals with the applicability of Service Tax

Apart from the aforesaid laws each State has its own Laws applicable in that particular State.

Regulatory Authorities

There are various regulatory bodies with whom the investors have to liaise with for various approvals, permissions, etc. A broad outline of the functions of some of the important regulators is as under:

Registrar of Companies (ROC)

The ROC plays an important role in the governance of the Indian Companies Act, 1956. The ROC is primarily responsible for:

- Ensuring adherence to the filing and registration requirements and for incorporation of Companies;
- Collecting information on companies within its jurisdiction and making it available to the public;
- Initiating action against non-compliant companies and officers.

Securities and Exchange Board of India (SEBI)

SEBI was set up primarily for the purpose of protecting the interests of investors in securities, promoting the development of, and regulating, the securities market and matters connected therewith. Its primary functions include:

- Promoting fair dealing in issue of securities;
- Ensuring that the capital markets function efficiently, transparently and economically in the better interests of both the issuers and the investors;
- Safeguarding the interests of investors from unethical practices;
- Coordinating and monitoring the working of all stock exchanges and intermediation with stock brokers.

Central Board of Excise and Customs (CBEC)

CBEC is a part of Department of Revenue under the Ministry of Finance, Government of India. It is responsible for:

- Formulation of policy concerning levy and collection of Customs, Central Excise and Service Tax;
- Prevention of smuggling;
- Administrative matters relating thereto.

The Board is the administrative authority for its subordinate organizations like Custom Houses, Central Excise Commissionerates, etc.

Central Board of Direct Taxes (CBDT)

The CBDT has been charged with all matters relating to various direct taxes in India and it derives its authority from the Central Board of Revenue Act, 1963. The CBDT is a part of Department of Revenue in the Ministry of Finance. CBDT is responsible for:

- providing necessary inputs for policy and planning of direct taxes in India;
- for administration of direct tax laws through the Income Tax Department.

Directorate General of Foreign Trade (DGFT)

DGFT operates under the Ministry of Commerce to facilitate international trade and thereby stimulate sustained national economic growth, through the coordinated efforts of the Union and the State Governments, by providing a trade environment that is transparent, equitable, proactive, based on consultation that enhances the user's confidence in the organization. Applications such as that for Importer Exporter Code no. (IEC), Import Licence, etc. are to be made to DGFT.

Ministry of Corporate Affairs (MCA)

The Ministry is primarily concerned with administration of the Companies Act, 1956; other allied Corporate Acts and rules & regulations framed there under mainly for regulating the functioning of the corporate sector. The Ministry exercises supervision over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and the Institute of Cost and Works Accountants of India (ICWAI) which are constituted under three separate Acts of the Parliament for proper and orderly growth of those professions. The Ministry also has the responsibility of carrying out the functions of the Central Government relating to administration of Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980.

Department of Industrial Policy & Promotion (DIPP)

The Department of Industrial Policy & Promotion, established in 1995, is responsible for the formulation and administration of the overall Industrial Policy. With the progressive liberalization of the Indian economy, initiated in July 1991, there has been a consistent expansion in the role and functions of this Department. From regulation and administration of the industrial sector, the role of this Department has been transformed into facilitation of technology and investment flows and promotion of industrial development in the liberalized environment.

The Secretariat for Industrial Assistance (SIA) and Foreign Investment Implementation Authority (FIIA) are the important bodies within DIPP

The SIA provides a Single Window for entrepreneurial assistance, investor facilitation and processing of applications, which require government approval.

FIIA was established to facilitate quick translation of Foreign Direct Investment (FDI) approvals into implementation by helping the foreign investors in obtaining necessary clearances, sorting out their operational problems and meeting with various Government agencies to find solutions to their problems. FIIA conducts regular interactions with investors of specific regions or countries.

Foreign Investment Promotion Board (FIPB)

The FIPB is a part of Department of Economic Affairs, Ministry of Finance (MoF). It is a specifically empowered board whose approval is required when FDI in India is not allowed automatically. Proposals for FDI are to be sent to the FIPB. Approval is generally granted within six weeks of receipt of application. Some factors considered by the FIPB are employment generation, other benefits expected from the proposed foreign Direct Investment, etc. The FIPB follows certain guidelines while disposing of the applications for FDI in India. Usually the FIPB meets weekly but of late as most of the sectors are covered under automatic route, the FIPB meets when there is sufficient number of proposals.

Competition Commission of India (CCI)

The objectives of the Competition Act, 2002 are sought to be achieved through the instrumentality of the Competition Commission of India (CCI), which was established by the Central Government with effect from 14th October 2003.

Main Functions of CCI are as follows

CCI shall prohibit anti-competitive agreements and abuse of dominance, and regulate combinations (merger or amalgamation or acquisition) through a process of enquiry. It shall give opinion on competition issues on a reference received from an authority established under any law (statutory authority)/Central Government. CCI is also mandated to undertake competition advocacy, create public awareness and impart training on competition issues.

Company Law Board (CLB)

The Central Government constituted Company Law Board (CLB) in 1991 in terms of Section 10(E) of the Companies Act, 1956. The Board is a quasi-judicial body, which exercises some of the judicial and quasi-judicial powers, which were earlier being exercised by the High Court or the Central Government. The Board is not subject to the control of the Central Government and has powers to regulate its own procedures and act in its own discretion. The Board has four Regional Benches located at Delhi, Mumbai, Kolkata and Chennai.

Note: In due course of time the powers of CLB will be transferred to National Company Law Tribunal (NCLT).

Reserve Bank of India (RBI)

The Reserve Bank of India (RBI), India's Central Bank, was established in 1935. The Central Office of the Reserve Bank has been in Mumbai since inception where the RBI Governor sits and where financial policies are formulated. Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

Main Functions of Reserve Bank of India

- Monetary Authority
- Regulator and supervisor of the financial system
- Manager of Foreign Exchange
- Issuer of currency
- Developmental role
- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Chapter II - Foreign Investment Framework in India

Industrial Policy and Licensing

As part of the ongoing economic liberalization, the Indian Government has substantially removed bureaucratic controls on industry. Licensing has been completely abolished except:

- Five (5) industries in which Licensing is compulsory viz.,
 - Distillation and brewing of alcoholic drinks
 - Cigars and Cigarettes of tobacco
 - Electronic Aerospace and Defense equipment
 - Industrial explosives
 - Hazardous chemicals
- For manufacture of items reserved for SSI Sector by non-SSI units;
- Proposals attracting Locational restrictions.

At present only two (2) sectors are reserved for public sector viz., Atomic Energy and Railways.

Locational requirement

- No Industrial Licence required from the Indian Government (except for industries subject to compulsory licensing) if not located within 25 kms of the Municipal limits in 23 cities with population more than one million (as per 1991 census).
- Local zoning and land use regulations as also environmental regulations apply.
- Electronics, Computer software and Printing are exempt from such Locational restriction.

Policy Relating To Small-Scale Undertaking

- A small-scale industrial (SSI) unit is an industrial undertaking having an investment of less than Rs. 50 million in plant and machinery
- Manufacture of items reserved for the small-scale sector by a non-SSI unit requires an industrial license.
- Foreign direct investment (FDI) / corporate equity up to 24% is permitted in the SSI sector. SSI status is lost if FDI / corporate equity exceeds 24%. However, the company can manufacture SSI reserved item upon undertaking an export obligation of 50%.
- SSI units enjoy a number of concessions, privileges and preferences such as excise duty exemption/ concession up to specified limits on turnover, inapplicability of some labour laws, concessional finance from scheduled banks, etc.

Foreign Investment Policy

In the following sectors, FDI is totally prohibited

- Retail trading (except Single Brand Product retailing)
- Atomic energy
- Lottery business
- Gambling and Betting

Foreign investment in India can either fall under the: I) Approval route or II) Automatic route.

Approval Route

In cases where Automatic Route is not available, an application has to be made to the FIPB, Ministry of Finance, Government of India. However considering the on going changes in the FDI guidelines, such cases will reduce drastically and most of the cases will now fall under the Automatic route.

OR

Automatic Route

Under the current FDI Policy, Indian companies engaged in most of the sectors / industries can issue shares to foreign investors up to 100% of their paid up capital under the Automatic Route, no permission is required from the Government of India or RBI.

Automatic route is however not available in the following cases

- Where foreign investors already have a financial or technical collaboration in the same field as the proposed operations in India. (Applicable for agreements subsisting as on 12th Jan, 2005. Agreements executed /to be executed after this date, should contain relevant clauses to safeguard the interest of JV partners)
- Where investment by the Non-resident investor exceeds 24% in a sector, which is reserved for SSI (however, this restriction does not apply to units located in SEZs), etc.

The following paragraphs explain the salient features and procedural aspects applicable under the Automatic route:

Post investment procedure

The Indian company has to follow a three stage reporting procedure.

In the first stage, the Indian company has to file plain paper Report to the concerned Regional Office of RBI within 30 days of receipt of funds. The Report should include the name & address of the foreign investor, date of receipt of funds and the amount (in rupees and foreign currency), name and address of the bank through which funds are received.

In the second stage, the Indian company has to file a Report in Form FC-GPR - Part A with the Bank through which remittance is received for forwarding the same to the concerned Regional Office of the RBI. Along with the Form, various other documents including Board Resolution for allotment of shares, share valuation certificate, etc have to be filed.

After the above formalities are complied with, on an Annual basis the Indian Company has to file a Report in Form FC-GPR – Part B with the Statistical department at the Mumbai office of the RBI. The annual report containing details of investments, retained earnings, number of employees, etc has to be filed by 30th of June every year giving position as on 31st March of that year.

Capitalization / Issue of Equity Shares in certain cases by non-cash mode

Generally FDI inflows are required to be under the following mode:

- By inward remittances through normal banking channels; or
- By debit to the NRE / FCNR bank accounts of Non Resident Indian investors.

- As a rule, issue of shares to persons not resident in India against any other mode or in kind is not permissible.

However in the following cases, issue of shares is permissible even though there is no remittance of funds:

- against amounts due for lump-sum fees and royalty payable under a technology transfer agreement;
- against instalment payable against foreign currency loan (normally referred to as External Commercial Borrowings (ECBs))

Sector specific FDI policy

The following table depicts the sectoral policy for FDI. In case where sectors / activities are not listed below, FDI is permitted up to 100% under the automatic route.

Sr. No.	Sector / Activity	FDI Cap / Equity	Entry Route
1.	Airport		
a.	Greenfield projects	100%	Automatic: Subject to certain regulations
b.	Existing projects	100%	For FDI above 74% FIPB approval is required. Subject to certain regulations
2.	Air Transport Services	49%- FDI; 100%- for NRI investment	Automatic: Subject to no direct or indirect participation by Foreign Airlines
3.	Asset Reconstruction Companies	49% (Only FDI)	FIPB
4.	Alcohol -Distillation & Brewing	100%	Automatic: Subject to license by appropriate authority
5.	Atomic Minerals	74%	FIPB: Subject to compliance with certain guidelines
6.	Banking - Private sector	74% (FDI+FII) Automatic	Subject to compliance with certain guidelines
7.	Broadcasting		
a.	FM Radio	FDI +FII investment up to 20%	FIPB: Subject to compliance with certain guidelines
b.	Cable network	49% (FDI+FII)	FIPB { Subject to compliance with certain rules}
c.	Direct-To-Home	49% (FDI+FII). Within this limit, FDI component not to exceed 20%	FIPB { Subject to compliance with certain guidelines }
d.	Setting up hardware facilities such as up-linking, HUB, etc	49% (FDI+FII)	FIPB { Subject to Up-linking Policy notified by Ministry of Information & Broadcasting }
e.	Up-linking a News & Current Affairs TV Channel	26% FDI+FII	FIPB {Subject to guidelines issued by Ministry of Information & Broadcasting}
f.	Up-linking a Non- news & Current Affairs TV Channel	100%	FIPB { Subject to guidelines issued by Ministry of Information & Broadcasting }
8.	Cigars & Cigarettes - Manufacture	100%	FIPB { Subject to industrial license under the Industries (Development & Regulation) Act, 1951}
9.	Coal & Lignite mining for		

Sr. No.	Sector / Activity	FDI Cap / Equity	Entry Route
	captive consumption by power projects, and iron & steel, cement production and other eligible activities permitted under the Coal Mines (Nationalisation) Act, 1973.	100%	Automatic: Subject to provisions of Coal Mines (Nationalization) Act, 1973.
10.	Coffee & Rubber processing & warehousing	100%	Automatic
11.	Construction Development projects, including housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, townships.	100%	Automatic: Subject to various conditions like: <ul style="list-style-type: none"> • minimum capitalization of US \$ 10 million for 100% holding and US \$ 5 million for Joint Venture • Minimum area for development of housing plots - 10 hectares and for construction development projects - 50,000 sq. mtrs.
12.	Courier services for carrying packages, parcels and other items which do not come within the ambit of the Indian Post Office Act, 1898.	100%	FIPB: Subject to existing laws and exclusion of activity relating to distribution of letters, which is exclusively reserved for the State
13.	Defense production	26%	FIPB: Subject to licensing under Industries (Development & Regulation) Act, 1951 and guidelines on FDI in production of arms & ammunition
14.	Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, aquaculture, cultivation of vegetables, mushrooms, under controlled conditions and services related to agro and allied sectors	100%	Automatic
15.	Hazardous chemicals, viz., hydrocyanic acid and its derivatives; phosgene and its derivatives; and isocyanates and di-isocyanates of hydrocarbon.	100%	Automatic: Subject to industrial license under the Industries (Development & Regulation) Act, 1951 and other sectoral regulations
16.	Industrial explosives-Manufacture	100%	Automatic: Subject to license & compliance with local laws
17.	Insurance	26%	Automatic: Subject to licensing by the Insurance Regulatory & Development Authority
	Investing companies in		

Sr. No.	Sector / Activity	FDI Cap / Equity	Entry Route
18.	infrastructure / services sector (except telecom sector)	100%	FIPB
19.	Mining covering exploration and mining of diamonds & precious stones; gold, silver and minerals.	100%	Automatic: Subject to compliances with local laws
20.	Non- Banking Finance Companies- Approved Activities		
i) ii) iii) iv) v) vi) vii) viii) ix) x) xi) xii) xiii) xiv) xv) xvi) xvii) xviii) xix)	Merchant banking Underwriting Portfolio Management Services Investment Advisory Services Financial Consultancy Stock Broking Asset Management Venture Capital Custodial Services Factoring Credit Reference Agencies Credit Rating Agencies Leasing & Finance Housing Finance Forex Broking Credit card business Money changing business Micro credit Rural credit	100%	Automatic: Subject to minimum capitalization requirements for fund / non-fund based activities as under: <ul style="list-style-type: none"> • Minimum capitalisation for fund based NBFCs: <ul style="list-style-type: none"> • US \$ 0.5 million up to 51% holding • US \$ 5 million up to 75% holding and beyond 51% • US \$ 50 million up to 100% and beyond 75% • Minimum capitalisation of US \$ 0.5 million for non-fund based NBFCs
21.	Petroleum & Natural Gas Sector		
a.	Other than Refining and including market study and formulation; investment/ financing; setting up infrastructure for marketing in Petroleum & Natural Gas sector.	100%	Automatic: Subject to certain rules and regulations
b.	Refining	26% in case of PSUs 100% in case of Private companies	FIPB (in case of PSUs): Automatic: (in case of private companies) Subject to sectoral policy}
22.	Print Media		
a.	Publishing of newspaper and periodicals dealing with news and current affairs	26%	FIPB: Subject to certain guidelines
b.	Publishing of scientific magazines/ specialty journals/ periodicals	100%	FIPB: Subject to certain guidelines
	Power includes		

Sr. No.	Sector / Activity	FDI Cap / Equity	Entry Route
23.	generation (except Atomic energy); transmission, distribution and Power Trading.	100%	Automatic: Subject to certain local laws
24.	Tea Sector, including tea plantation	100%	FIPB: Subject to certain rules and regulations
25.	Telecommunication		
a.	Basic and cellular, Unified Access Services, National/ International Long Distance, V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added telecom services	74% (Including FDI, FII, NRI, FCCBs, ADRs, GDRs, convertible preference shares, and proportionate foreign equity in Indian promoters/ Investing Company)	Automatic up to 49% FIPB beyond 49% Subject to certain guidelines
b.	ISP with gateways, radio-paging, end-to-end bandwidth.	74%	Automatic up to 49%. FIPB beyond 49% Subject to licensing and other compliances
c.	a) ISP without gateway; b) Infrastructure provider providing dark fiber, etc. c) Electronic mail and voice mail	100%	Automatic up to 49% FIPB beyond 49% Subject to certain rules, guidelines and licensing requirements in some cases
d.	Manufacture of telecom equipments	100%	Automatic: Subject to sectoral requirements
26.	Trading		
a.	Wholesale / cash & carry trading	100%	Automatic: Subject to certain guidelines
b.	Trading for exports	100%	Automatic
c.	Trading of items sourced from small scale sector	100%	FIPB
d.	Test marketing of such items for which a company has approval for manufacture	100%	FIPB
e.	Single Brand product retailing	51%	FIPB
27.	Satellites - Establishment and operation	74%	FIPB: Subject to certain guidelines
28.	Special Economic Zones and Free Trade Warehousing Zones covering setting up of these Zones and setting up units in the Zones	100%	Automatic: Subject to Special Economic Zones Act, 2005 and the Foreign Trade Policy

Forex Regulations

Forex transactions or transactions with non-residents are regulated under the Foreign Exchange Management Act (FEMA), 1999. RBI is the main agency which deals with and regulates matters under FEMA. The INR is fully convertible for current account transactions, subject to a negative list of few transactions that are prohibited / require prior approval.

A foreign-invested Indian company is treated on par with other locally owned companies. Accordingly all, the regulations also apply to such foreign-invested companies as well.

Under the FEMA, forex transactions are divided into two broad categories - current account transactions and capital account transactions. Transactions that alter the assets or liabilities outside India of a person resident in India or in India, of a person resident outside India have been classified as capital account transactions. All other transactions would be current account transactions.

Current Account Transactions

Prior approval of the RBI is required for acquiring foreign currency above certain limits for the following purposes, approval of RBI is not required if payment is made through Resident Foreign Currency Account):

- Holiday travel over USD 10,000 per person p.a.
- Gift over USD 5,000 / donation over USD 10,000 per remitter / donor p.a.
- Business travel over USD 25,000 per person per visit
- Foreign studies as per estimate of institution or USD 100,000 per academic year, whichever is higher
- Consultancy services for infrastructure project procured from abroad over USD 10 Million per project and for other projects over USD 1 Million per project
- Reimbursement of pre incorporation expenses over USD 100,000

Certain specified remittances are prohibited

- Remittance out of lottery winnings
- Remittance of income from racing / riding etc. or any other hobby.
- Remittance for purchase of lottery tickets, banned / prescribed magazines, football pools, sweepstakes etc.
- Payment of commission on exports made towards equity investments in Joint Ventures/ Wholly Owned subsidiaries abroad of Indian Companies.
- Payment of commission on exports under the Rupee State Credit Route
- Payment related to "Call Back Services" of telephones

Capital Accounts Transactions

Capital account transactions can be undertaken only to the extent permitted. RBI has prescribed a list of capital account transactions, which inter alia include the following:

- Transfer or issue of any foreign security by a resident/ security by a non resident (please refer to Chapter 5 for details)
- Borrowing/ lending in foreign exchange

- Export/ import of currency
- Transfer / acquisition of immovable property in / outside India

Remittance up to USD 100,000 p.a. (over and above ceilings prescribed for other remittances mentioned above) by a resident individual for any current account or capital account transaction is allowed without any approval and documentation.

Repatriation of Capital

Foreign capital invested on repatriation basis in India is generally repatriable, along with the appreciation, if any, after the payment of taxes due on them.

Acquisition of immovable property in India

Generally foreigners are not permitted to acquire immovable property except in certain cases, where the property is required for the business of the Indian branch. A Liaison office can acquire property only by way of lease for a period of upto five years or the period for which RBI has given its approval (whichever duration is shorter). As mentioned earlier, a foreign invested Subsidiary / JV is treated at par with locally owned Company and hence they can buy property required for the purpose of the business. NRIs / PIOs are also permitted to acquire certain properties.

Royalties and Technical Know-how Fees

Indian companies that enter into technology transfer agreements with foreign companies are permitted to remit payments towards know-how and royalty under the terms of the foreign collaboration agreement, subject to limits as explained in Chapter 4.

Dividends

Dividends are freely repatriable after the payment of Dividend Distribution Tax of 16.995% by the Indian company declaring the dividend. No permission of RBI is necessary for remittance to the foreign shareholder.

Other Remittances

No prior approval is required for remitting annual profits earned by Indian branches of foreign companies (other than banks) to their Head Offices outside India (Subject to withholding taxes and submission of a Certificate from a Chartered Accountant). Remittances of winding-up proceeds of a branch / liaison office of a foreign company in India are permitted subject to RBI approval. Remittances of winding-up proceeds of a project office of a foreign company in India are permitted under the automatic route subject to fulfillment of applicable compliances.

Netting out forex receivables and payable

One aspect that most of the foreign investors find it difficult to understand is the netting out of forex receivable and payable. The current FEMA regulation does not allow such netting out and book adjustments. All such transactions have to be settled through inward and outward remittance through normal banking channels. However, an SEZ unit can adjust export receivables against import payments and pay / receive net amount provided the transaction of export and import is with the same party after complying with laid down procedures.

Chapter III - Entry Vehicles – Forms of Entity

Liaison, Branch And Project Office

Liaison Office

Foreign companies doing business in India often start with establishing a liaison office to assess the market conditions and the investment climate in India.

Permissible activities and regulatory overview

Prior permission of the RBI is required to establish a liaison office in India. This office can be established for carrying on permissible activities prescribed under FEMA¹ as under:

- Representing the parent company/ group companies
- Promoting export / import from / to India (it can display goods, distribute literature for the same but cannot sale the same)
- Promoting technical / financial collaborations between parent / group companies and companies in India
- Acting as a communication channel between the parent company and Indian companies.

The permission is granted normally for an initial period of 3 years, which can be periodically revalidated thereafter.

Liaison offices cannot earn any income in India or engage in any revenue generating activities in India. Further, all expenses for the set-up, operation and maintenance of the liaison office has to be met out of foreign exchange remittances from the head office. It is recommended that all such expenses are routed through the liaison office bank account in India and not paid directly by the Head Office.

Liaison offices can take property (office or residential) on lease for duration upto 5 years without seeking any RBI approval. However, it cannot buy property.

In addition to the prior approval of RBI for setting up liaison office in India, such offices are required to file certain documents with the ROC and also comply with various corporate requirements. These requirements are also common to Project Office and branch offices as well; the same have been explained at the end of this chapter.

Branch Office

A branch or a subsidiary is often the next step after the establishment of a Liaison office. A branch is often not a preferred form as it does not enjoy limited liability and is subject to a higher tax rate than a subsidiary. However, some investors prefer to set up a branch due to corporate policy, utilization of tax losses that may be expected as a start-up, etc.

Permitted activities and regulatory overview

As in the case of a liaison office, prior approval of the RBI is required to establish a branch office in India. The permitted activities² are as under:

¹ Foreign Exchange Management (Establishment in India of Branch or office or other place of Business) Regulations, 2000

² Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000

- Export/ import of goods;
- Rendering professional or consultancy services;
- Carrying out research work, in which the parent company is engaged in;
- Promoting technical or financial collaborations between the Indian companies and parent or overseas group company;
- Representing the parent company in India and acting as buying/selling agent in India;
- Rendering services in information technology and development of software in India; and
- Rendering technical support for the products supplied by parent/group companies

A branch can acquire immovable property in India necessary for or incidental to carrying on business activity subject to compliance with all the laws, rules and regulations in force. Such property can also be mortgaged as a security for borrowings from banks.

In addition to the prior approval of RBI for setting up branch office in India, such offices are required to file certain documents with the Registrar of companies and also comply with various corporate requirements. These requirements are also common to Project Office and liaison offices, the same have been explained at the end of this chapter.

Profit Repatriation

Repatriation of net profits from the Indian branch is permitted from year to year on payment of applicable taxes and prescribed certification.

Project Office

Background

Foreign Companies wishing to execute a project in India have an option to establish a Project Office (PO) in India, which would be a temporary office until the conclusion of the Project in India. Increasingly, foreign companies have preferred to establish such temporary offices in India to execute short-term projects on a turnkey basis.

Contracts of Foreign vendors with Indian purchasers, invariably involve an offshore component of goods and services (i.e. sourced outside India) and onshore component of goods or services (i.e. sourced in India). Part of the consideration may be negotiated in terms of £ or \$ to fund offshore component and the balance could be in INR (Indian Rupees) in respect of the Indian activities. In such cases the creation of a project office becomes important, as a bank account in India is required; equipment needs to be imported, etc.

Prior Approval of Reserve Bank

RBI has granted general permission to foreign entities for setting up a project office in India subject to specified conditions as under:

- a) Foreign entity has secured from an Indian company a contract to execute a project in India and;
- b) The contract is funded by inward remittance of foreign exchange from abroad; or
The project is funded by a bilateral or multilateral International Funding agency³; or
The project has been cleared by an appropriate authority; or

³ World Bank or International Monetary Fund or similar agency

A company or entity awarding the contract has been granted a Term Loan by a Public Financial Institution or a bank in India for the project.

Under the liberalized regime, the PO's Banker is required to furnish in a report to the concerned Regional Office of RBI, the prescribed particulars of the Foreign Company and the contract in India.

Company

Formation of a Company

Foreign Companies also have the option of incorporating a Company under the Companies Act, 1956 either as:

- Joint Venture Company; or
- Wholly Owned Subsidiary

Foreign equity in such Indian companies can be up to 100% depending on the requirements of the investor and subject to any equity caps prescribed in respect of the area of activities under the FDI policy.

Incorporation of Company

For registration and incorporation, an application has to be filed with the ROC. Once a company has been duly registered and incorporated as an Indian company, it is subject to Indian laws and regulations as applicable to other domestic Indian companies. This topic is dealt in detail in Chapter no. V.

Compliance / Restrictions common to liaison, project and branch office

Forex Regulations

- Under FEMA, an office or branch in India of a foreign company is regarded as a resident in India. An Indian office or branch of Foreign Company has to comply with the same exchange control requirements as are applicable to a local Indian company (which could also be a WOS of a foreign company).
- The office can only carry out the activities that are permitted under the scope of the approval.
- A project office can only undertake activities relating and incidental to execution of project.
- Prior permission of RBI is required in case the 'Head Office a/c' (in the books of Indian office) is to be credited otherwise than on account of funds transferred to Indian office or is debited otherwise than for meeting local expenses of the Indian office.

Corporate law compliances common to Liaison, Project and Branch Office

- Under the Indian Companies Act, 1956 all foreign companies having a place of establishment are required to register themselves with the ROC within 30 days from the date of establishment of the office. The registration needs to be done with the ROC of the State in which Office is established as well as the ROC at New Delhi.
- The Foreign Company is required to nominate a person resident in India on whom the notices and other documents could be served on behalf of the company.
- Any change in the documents filed with ROC needs to be intimated to the ROC.

- The accounts of Indian business are required to be maintained as per accrual method of accounting as prescribed under the Indian Companies Act⁴.
- The Foreign Company is required to exhibit the name of the company, country of incorporation and the fact of limited liability of the company in English language and a local language outside every office and the place where it carries its business.
- The above particulars are also required to be stated in English language in all business letters, bill-heads, notices and other official publications.
- The Foreign Company has to file English version of world accounts (together with those of its subsidiaries) as well as annual accounts of the Indian business with the ROC within 9 months of the close of the financial year along with list of all places of business established in India.

Various Registrations

Apart from RBI approval and ROC registration, the following are some of the registrations and approvals required in order to carry on the activities for which the office has been opened:

- Registration under the Shop and Establishment Act (applicable in some states)
- Permanent Account number from tax authorities
- Tax Deduction Account Number from tax authorities
- Value Added Tax registration, if applicable, from local VAT authorities
- Profession Tax registration from local VAT authorities (applicable in some states)
- Importer-Exporter Code, in case of an import / export activity
- Service tax registration, where applicable, from Service Tax authorities

⁴ Section 209 of the Companies Act, 1956

Chapter IV - Joint Ventures and Technology Transfer

Joint Venture Agreement

Joint ventures - an art

Cross-border alliances between corporations are a fact of modern business. Some alliances are no more than fleeting encounters lasting only as long as it takes one partner to establish a presence in a new market while others are a prelude to a merger of the technologies and capabilities of two companies. Whatever may be the duration or the objectives of various alliances, being a good partner has become an important asset for any corporation. This is particularly relevant in the global context where the ability to create and sustain collaborations is vital in companies obtaining a significant competitive advantage.

However, it has been seen that too often companies devote more time to screening potential partners in financial terms rather than in managing the partnership in human terms. More attention is paid to controlling the relationship than about nurturing it. Joint ventures are like marriages - they require trust, honesty, integrity, communication, care and vision if the alliance is to last for the long-term. The scope for collaboration is strengthened when communication is intensive and the relationship is more family-like rather than rational. It is generally observed by various studies that North American companies are more concerned with the economics of the deal and frequently neglect the human aspects. On the other hand Asian companies appear to be more adept at dealing with inter-personal relationships.

Of course, both partners must be in a win-win situation. To highlight the personal side of business relationships is not to deny the importance of sound financial and strategic analysis.

The need for joint ventures

In today's world, many projects are too large for any one company to undertake as it may involve huge financial commitments - this is especially true in the infrastructure area. Market access is another reason for the international proliferation of joint ventures. Conducting research is another area where the risks need to be shared. Joint ventures must yield benefits for both partners but more importantly they should offer the parties an option to implement their vision for the future and exploit unforeseen opportunities.

Alliances are of special relevance in emerging markets such as India as these markets come out of their self-imposed isolation and insulation from external world markets and move towards a relatively open competitive business environment. Indian-owned businesses in recent years realized their inadequacies in terms of products, technology, infrastructure and even management processes. On the other hand, several multinational companies find themselves ill equipped to latch on to market opportunities due to lack of local knowledge and inadequate distribution network. Alliances between those possessing different skills and strengths in technology, marketing and distribution, etc. have become not only desirable but also necessary.

While the process of forming these alliances calls for skilled negotiators and planners, the challenge lies in managing and making the alliance work. It is of critical importance that the professional drafter of the agreements must be involved not only at the negotiations but also when the business plans are being discussed between the two potential partners.

Success of Joint Ventures

The success of JVs is built on:

- A common strategic vision shared by the parties;
- A strong commitment to each other and to the joint venture; and

- Providing business contributions by the parties that are complementary.

The stages of establishing a JV

- Selection of partner
- The negotiation phase
- The execution phase
- The operation phase
- The maturity phase

Documentation

Typically a JV Agreement should generally contain the following clauses to make it a comprehensive document:

- Parties to JV agreement
- Business objects and products of the JV
- Formation of JV company
- Registered office
- Equity participation by the local and foreign investors
- Finance arrangements
- Specific obligations of the JV Partners.
- Agreement as to future issue of capital
- Appointment of directors
- Conduct of the affairs of the JV company
- Transfer pricing and buy / sell agreements
- Share transfers
- Distribution / Dividend Policy
- Name / Brand licensing agreement
- Research and development – Improvement and innovation
- Non-competition provisions
- Confidentiality / Secrecy
- Period of agreement
- Termination
- Force Majeure
- Bearing of pre-operative expenses / costs
- Dispute Resolution – Walking in the woods, Arbitration etc.
- Governing law
- Assignment
- Precondition
- Supremacy

In case of a 50:50 JV, special terms like no casting vote for Chairman of the Board of Directors, etc. should be incorporated.

Technology Transfer Agreements

The topic of technology transfers encompasses commercial aspects and a range of laws including intellectual property. No generalizations are possible regarding the terms of the contract and much would depend upon the facts and circumstances underlying a particular technology transfer. The following is a general overview of certain commercial and legal aspects that may be considered in a contract for technology transfer.

Nature of the contract

A contract for technology transfer can be a license agreement. The license agreement normally refers to the licensing of intellectual property rights such as patents, trade marks, copyrights, etc. Any technology transfer contract broadly deals with the mode of transfer of the technology, its use under certain terms and conditions and the results if there is a breach in the terms and conditions. The mode of transfer can take place through documents or through the provision of technical services, assistance and training, software programmes on diskettes or even through the sale of machinery, raw materials or components that embody technology.

Typical provisions of a license agreement

Illustrative lists of the provisions of a typical license agreement are as under:

- Product/service definition
- Licensed property
- Technical know-how
- Territory and sub-licensing
- Commercial production
- Licensor's obligations
- Licensee's obligations
- Warranties, indemnity and infringement
- Product liability and indemnity
- Improvements and Inventions
- Inspection and information
- Payment of consideration
- Currency and taxes
- Confidentiality
- Duration of the agreement
- Termination
- Consequences of termination
- Applicable Law
- Dispute resolution
- Force Majeure
- Amendment

- Assignment or other transfer
- Preconditions

Payment of Fees under the License Agreement

Following payments by Indian companies are allowed under the automatic route:

- Lump sum payments up to US\$2 million;
- Royalty payment limited to 5 per cent for domestic sales and 8 per cent for exports, without any restriction on the duration of the royalty payments.
- The royalty limits are net of taxes and are calculated according to standard conditions.
- The royalty will be calculated on the basis of the net ex-factory sale price of the product, exclusive of excise duties, minus the cost of the standard bought-out components and the landed cost of imported components, irrespective of the source of procurement, including ocean freight, insurance, custom duties, etc.

Procedure for Automatic Route

Bankers allow remittances for royalty, payment of lump-sum fee and remittance for use of Trade mark /Franchise in India within the limits prescribed under the automatic route.

Chapter V - Overview of Corporate Laws

The Companies Act, 1956 provides the legislative framework for incorporation, management, operating regulations including procedures for day-to-day running of a company. This Act along with Securities and Exchange Board of India Act, 1992 (which governs matters pertaining to functioning of listed Companies) lays down the basic provisions governing corporate structures in India. Apart from this there is a Competition Act, 2002 (replacing Monopolies and Restrictive Trade Practices Act, 1969) that has bearing on the size of the corporate structure, mergers and acquisition plans of Indian companies.

Notes:

- The term Companies Act in the following pages refer to the Indian Companies Act, 1956.
- The term Public Company in the following pages refer to Public Ltd Company incorporated in India
- The term Private Company in the following pages refer to Private Ltd Company incorporated in India

Types of companies

A Foreign Company wanting to establish a subsidiary in India may opt one of the following forms depending on their requirements and policies.

- Private limited company
- Public limited company
- Other companies

Private Limited Company

A private company⁵ is one, which (by its Articles of Association):

- Restricts the right of its shareholders to transfer the shares;
- Limits the number of shareholders (excluding present and past employee shareholders) to 50;
- Prohibits the company from making invitation to public to subscribe for any shares or Debentures of the company; and
- Prohibits any invitation or acceptance of deposits from Public except from its members, directors and their relatives.

A minimum of 2 shareholders and Directors are required to form a private limited company and the paid-up capital should be minimum Indian Rupees (INR) 100,000.

The name of a Private Company carries a suffix 'Private Limited' (Pvt. Ltd.). E.g. Trumac Cosmetics Private Limited

Public Limited Company

A public company is a company which is not a private company⁶. The abovementioned restrictions applicable to a private company are not applicable to a public company. A minimum of 7 shareholders and 3 Directors are required to form a public company and the paid up capital

⁵ Section 3(1) (iii) of the Companies Act, 1956.

⁶ Section 3(1)(iv) of the Companies Act, 1956

should be minimum INR 500,000. Also, a Private Company, which is subsidiary of Public Company, is defined as a Public Company⁷. The name of a Public Company carries a suffix 'Limited' (Ltd.), e.g. Blackstone Publications Ltd.

Under the Companies Act, a Private Limited Company enjoys certain privileges and are exempt from various provisions of the Act unlike a Public Company, which is subject to greater scrutiny, transparency and compliance regulations. Further, functioning of a Public Company (which is listed on a Stock Exchange in India) is also regulated by Securities and Exchange Board of India (SEBI)⁸. In the past few years, the compliance and reporting obligations prescribed by SEBI for listed Public Companies has increased substantially. This is one of the reasons, which prompted some of the listed companies to de-list from the stock exchanges. Most Foreign Companies incorporate their subsidiaries in India as a 'Private Limited' company to avoid detailed compliances under the Companies Act & from SEBI.

Other Companies

The above two types of companies (viz., private and public) are basically companies limited by shares. Apart from the above, there are various types of companies viz.,

- Companies limited by guarantee and having share capital.
- Companies limited by guarantee without share capital.
- Producer Companies

Note: These companies are less frequently used by foreign companies and may not be of much relevance.

Common Requirements / Applicability of Provisions to all types of Companies

Director Identification Number (DIN)

Any person who desires to act as a director of a Company incorporated in India is required to obtain the Director Identification Number (DIN) issued by the Ministry of Corporate Affairs (MCA), the apex body which monitors the activities of the Companies incorporated in India. An application is to be made in the prescribed form to the MCA.

Digital Signature

MCA has launched the MCA 21 project according to which all Companies are required to file various forms and documents electronically. In order to authenticate the e-forms, the Director(s) need to apply for Digital Signature from one of the authorized Certifying Authorities (required only for the Director who will Sign / authenticate the forms to be filed with ROC in India). Henceforth all the forms and documents (except a few such as incorporation documents) will have to be filed electronically only.

Steps for incorporating a Private Company can be divided into three stages

- **Ascertaining the status of DIN & DSC of the proposed Directors**
- **Application for name availability. (In e-Form no. 1A):**

⁷ w.e.f. 13-12-2000 vide Companies (Amendment) Act, 1956

⁸ SEBI also governs Public Companies which are not listed on stock exchange, to a limited extent

As per the current Indian Regulations, the name should reflect the proposed activities of the Company. The availability of the name depends upon the fact that the name should not be similar to the name of an existing Indian company.

In case the name contains any of the following word, the minimum authorized capital requirements apply as under:

Key word	Minimum Authorised capital (INR)
Corporation	50 million
International, Globe, Universal, Continental, Inter-continental, Asiatic Asia, being the first word of the name.	10 million
If the above words are used among the name (not being first word)	5 million
Hindustan, India, Bharat, being the key word.	5 million
If any of these words are used within the name with or without brackets	0.5 million
Industries / Udyog	10 million
Enterprises, products, business, manufacturing	1 million

- **Obtaining Certificate of Incorporation:**

After the name is approved, following documents are to be submitted to the ROC after payment of applicable stamp duty / fees to the ROC:

- Memorandum and Articles of Association of the Indian company (which are about 50 pages).
- Prescribed forms

Types of share capital

The share capital of a company is basically categorized into two types:

1. Equity Share capital; and
2. Preference Share capital.

Private Companies are not subject to any rules in respect of differential right shares (as to dividend or voting). Special rules have been prescribed for Public Companies on issue of such shares⁹.

Preference Shares carry a preferential right to a fixed amount of dividend, right to be paid any arrears of dividend remaining due on such share and preferential right over equity shareholder in respect of repayment of capital at the time of liquidation. Preference shares may be either participating preference shares or non-participating. Preference Shares are always redeemable. The Companies Act, 1956 prohibits issue of irredeemable Preference shares or Preference shares that are redeemable after the expiry of a period of twenty years from the date of issue.

As per FEMA regulations, Preference shares which are not convertible into Equity shares are considered as debt and governed by the ECB regulations. Hence in a case where as per ECB regulations, an Indian company cannot accept foreign currency debt, then it cannot receive funding by way of non-convertible Preference shares. In such cases, funding of the Indian

⁹ Companies (issue of share capital with differential voting rights) Rules, 2001.

company can be by way of Equity shares or convertible Preference shares or borrowing from a bank in India.

Meetings

Shareholders Meetings

- A company is ordinarily required to hold its Annual General Meeting (AGM) every calendar year¹⁰ within six months from the close of the financial year. At every annual general meeting, ordinary businesses such as adoption of accounts and directors' report, declaration of dividend, appointment of directors and auditors are transacted.
- A company may also call an Extraordinary General Meeting (EGM) of the shareholders, whenever it is necessary to transact special businesses.
- In addition to the above meetings of companies, a public company is required to hold a statutory meeting within 6 months of the date on which it is entitled to commence business¹¹.
- Resolutions passed at the General Meeting may be either Ordinary Resolution or Special Resolution. A Resolution is said to be ordinary, if the votes cast in favour of the Resolution exceeds the votes, if any, cast against the resolution (more than 50%).
- A resolution is a special resolution, if the votes cast in favour of the resolution is not less than three times the number of votes, if any, cast against the resolution (atleast 75%).
- The Companies Act provides for number of businesses that must be approved by the members by means of a Special Resolution only.
- Quorum for Shareholders Meetings of a Public Company is 5 Members and for a Private Company it is 2 Members.

Meetings of the Board of Directors

- One Meeting is required to be held in every quarter and four such meetings are required to be held in every calendar year¹².
- Board of Directors shall act on behalf of the Company by resolutions passed by majority of the Directors personally attending the meeting and entitled to vote thereat. There are some businesses of the company (applicable only in case of a public company), which require consent of all the Directors present at the meeting.
- The Companies Act also provides for passing of resolution by circulation¹³. Such resolutions can be passed by circulating the draft of the resolution (together with necessary papers) to the Directors in India (sufficient enough to constitute quorum) and to others at their usual address in India and the same has been approved by such of the directors as are then in India or majority of them.

Appointment of Directors / Secretary / Managing Director

A private limited company is required to have at least two directors. The maximum numbers of directors have to be mentioned in the Articles of Association. However if the maximum limit fixed is 12 or less than 12, then any increase beyond 12 will require shareholders' consent and approval of the Central Government However Private Companies are not required to obtain the approval of Central Government. There is no ceiling to the maximum number of Directors. Only

¹⁰ Section 166 & 210 of Companies Act.

¹¹ Statutory Meetings of company.

¹² Section 285 of the Companies Act.

¹³ Section 289 of Companies Act.

individuals are eligible to be appointed as directors of the company and therefore, no body corporate, association or firm can be appointed as director of the company.

The Companies Act, 1956 does not prohibit appointment of a foreign national as directors (though there are restrictions on appointment of foreign nationals as managing directors and whole-time directors of a public companies or private companies which are subsidiaries of public companies). At present, there is no specific requirement that one or more directors should be an Indian resident or citizen (as in the corporate laws of some of the other countries). However, it may be advisable to have sufficient Indian directors for smooth and efficient administration of company and to avoid any complex international tax issues.

A Public Company must have minimum three directors. Listed Companies are required to have an optimum combination of executive & non-executive Directors, with not less than 50% of the Board comprising of non-executive directors. Such companies are required to have sufficient number of independent directors¹⁴. The number of independent directors, out of 50% non-executive directors would depend on whether the Chairman is executive or non-executive. In case of a Company having a non-executive Chairman, at least one third of the Board of Directors should comprise of independent directors and in case of a Company having executive Chairman at least half of the Board should comprise of independent directors.

A company (both private as well as public) having paid up capital of INR 20 million or more is required to appoint a qualified Company Secretary for complying with statutory requirements.

Every Public Company or a private company which is a subsidiary of a public company having a paid-up share capital of not less than INR 50 million are legally required¹⁵ to appoint a managing director/ manager / whole time director.

Remuneration to Directors

- Managing Director or Whole time directors of Public companies and Private Limited companies, which are subsidiaries of Public Companies may receive remuneration by way of salary, perquisites, commission and other allowances upto 5% of net profits for one such managerial person or 10% for all of them together. Directors (other than whole-Time Director or Managing Director) may receive remuneration upto 1% of net profits where the company has Managing Director/Whole Time Director or Manager and 3% of net profits in case the Company do not have Managing Director/Whole Time Director or Manager.
- Higher remuneration may be available with approval of Central Government.

The above limits do not apply to private companies (which are not subsidiaries of public companies). WOS of foreign companies invariably would not be regarded as subsidiaries of public companies (if it qualifies for 4(7) exemption) and hence there would be no cap on managerial remuneration payable by such companies.

Dividend

Dividend is generally declared at an AGM where among other things, the annual accounts are considered and adopted. However, the Board may also declare and pay interim dividend.¹⁶

Every company is required to transfer a portion of its net profit to General Reserves before deciding to pay dividend. The amount of transfer to General Reserve varies with the rate of dividend proposed to be paid.

¹⁴ Independent directors are those directors who apart from receiving fees for attending Board or committee meetings do not have any other material pecuniary relationship or transaction with the company, its promoters, its management or its subsidiaries, which in the judgement of the Board may affect the independence or judgement of other Directors.

¹⁵ Section 269 of the Companies Act, 1956

¹⁶ It is advisable to provide in the Articles of Association a specific right to the Board to declare interim dividend

Utilization of General Reserve

The accumulated profit in the form of General Reserve can be utilized for issue of Bonus shares, thereby increasing share capital of the company.

Buyback

A company may, if provided in the Articles, buy-back its shares from the existing shareholders to the extent of 25% of total paid up capital and free reserves¹⁷ provided that post-buyback debt equity ratio does not exceed 2:1 and subject to compliance of other rules¹⁸ and regulations¹⁹ in this behalf. The company can exercise buy-back only after obtaining the prior approval of the shareholders at the General Meeting. However, Board of Directors are entitled to make a buy-back without general meeting resolution upto 10% of the total paid up capital and free reserves of the company (Board Route).

Director's report

There shall be attached to every balance sheet a report by the Board of Directors, which shall be placed at an Annual General Meeting (AGM). This report shall include, *inter alia*, following matters:

- State of Company's affairs;
- Amount proposed to be carried to reserves;
- Amount recommended as dividends;
- Comments on any adverse remark or qualification made in the auditors' report; and
- Other important matters such as sector outlook, foreign exchange flow, other internal aspects of the company, director's responsibility statement etc.

AGM and Filing

All companies are required to present before the members the financial statements comprising the audited balance sheet and profit and loss account for the accounting period along with Auditors' Report and Directors' Report at every AGM to be held within 6 months of the close of the financial year. These financial statements (along with Auditors' and Directors' Report) and an Annual Return are to be filed with the ROC within prescribed time.

Preservation of books of account

Under the Companies Act, the Books of accounts together with the supporting vouchers / documents relevant to any entry in the books of accounts are required to be preserved in good order for a period of 8 years.

Other requirements

Companies are required to:

- maintain prescribed statutory registers;

¹⁷ Provided that buy-back in any financial year shall not exceed twenty-five percent of its total paid up equity capital in that financial year

¹⁸ Private Limited Company & unlisted Public Limited Company (Buyback of Securities) Rules, 1999.

¹⁹ SEBI (Buyback of Securities) Regulations, 1998

- file various returns, resolutions and annual accounts with the ROC from time to time;
- file particulars of any charge or encumbrance created on the property of the company with the ROC within the prescribed time;
- prepare and maintain Minutes of the meeting of shareholders as well as Board of Directors.

Cess

The Companies (Amendment) Act 2002 has prescribed that every company shall pay cess²⁰ to the Central government for the rehabilitation or revival of sick industrial company²¹ at a rate not less than 0.005% and not more than 0.1% (as may be prescribed by Central Government) on the value of annual turnover or on gross receipt, whichever is more. The cess is to be paid within three months from the close of the financial year. The Notification specifying the effective date of levy is currently awaited.

Competition laws

Competition Act, 2002²² has been enacted to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets. This Act prohibits anti-competitive agreements, abuse of dominant position and regulates certain combinations (acquisitions and mergers) that has or is likely to have an appreciably adverse effect on competition within the relevant market in India.

²⁰ Section 441A of Companies Act, 1956

²¹ A "Sick Industrial Company" means - (a) an Industrial company, the accumulated losses of which in any Financial Year, are equal to 50% or more of its average net worth during four years immediately preceding such financial year or (b) which has failed to repay its debts within any three consecutive quarters on demand made in writing for its repayment by the creditor of such company.

²² Prior to enactment of Competition Act, 2002, Monopolies and Restrictive Trade Practices Act, 1969 (MRTP) regulated anti-competitive / anti-trust agreements/ transactions / activities.

Chapter VI - Taxation in India

Direct Taxes particularly with reference to corporate assessee

Tax Year

In India, income is chargeable in respect of each tax year called "Previous Year". Such previous year is uniform and is a 12-month period commencing from 1st April to 31st March. Income is assessed with reference to each "Assessment Year" i.e. the year following the previous year with reference to which the income is charged. [For ex: income earned in previous year 1st April 2006 to 31st March 2007 (P Y 2006-07) will be chargeable to tax in Assessment Year commencing from 1st April 2007 and ending on 31st March 2008 (A. Y. 2007-08)].

Resident Corporation

A foreign company can set up a WOS in India for carrying out its activities. Such subsidiary is treated as an Indian resident and an Indian company for all Indian regulations (Income Tax, FEMA and Companies Act, etc), despite being 100% foreign owned.

Source of Income

Companies resident in India are taxable on their world income (or "global income"). However, any double taxation arising on account of taxation in source countries as well as taxation in India is granted relief under relevant tax treaties (or u/s 91 of ITA in case of non-treaty countries).

Computation of Total Income

As noted above, all income accruing or arising in India is taxable in India subject to Double Taxation Avoidance Agreement (DTAA) with the country of residence of the recipient of income.

The taxable income is computed under different heads of income of which "Income from Business or Profession" is more relevant for a corporate assessee. The business income is computed after adding certain disallowances to the declared profits and reducing certain allowances / benefits. Disallowances include depreciation as per accounts, loss on sale of assets, and other statutory disallowances as per ITA, etc. However, depreciation is allowed separately at rates prescribed in the ITA.

Corporate Tax Rates

- Domestic Company- **33.99%**²³
- Foreign Company- **42.23%**²⁴

Foreign Company's WOS in India would be regarded as a domestic company and would be liable to pay taxes at the rates applicable.

Individual Taxation

For Resident / Not Ordinary Residents and Non Residents, the maximum effective rate of tax is 30% (plus 10% surcharge if income exceeds INR 1Million p.a. and education cess @ 3%)

Dividend Distribution Tax

²³ Inclusive of Surcharge @ 10% (in case the income exceeds INR 10,000,000) and Education Cess @ 3%.

²⁴ Inclusive of Surcharge @ 2.5% and Education Cess @ 3%.

Dividend income is exempt in the hands of the shareholders. However, a dividend distribution tax @16.995% (inclusive of surcharge @ 10% and education cess @ 3%) is levied on companies declaring dividend.

Minimum Alternate Tax (MAT)

With an object to bring zero tax companies under the tax net, MAT @ 11.33% of book profits is levied on companies whose tax payable is less than 10% of their book profits. In such a situation, on payment of MAT the company would not have to pay any other corporate taxes. In other words, companies have to pay higher of the MAT or the normal corporate tax.

Fringe Benefit Tax

A separate tax, known as the “Fringe Benefit Tax” (FBT) has been levied on the employer on the value of fringe benefits provided or deemed to have been provided to the employees. The FBT is payable @ 33.99% on the value of perquisites deemed to be included in the definition of fringe benefits, and provided or deemed to have been provided by an employer to his employees during the Financial year.

In this context “Fringe Benefit” has been defined to mean:

- Any privilege, service, facility or amenity, directly or indirectly provided by an employer to his employee (including former employee or employees) by reason of his employment;
- Any free or concessional ticket provided by the employer for private journeys of the employees and their family members; and
- Any contribution by the employer to an approved superannuation fund exceeding one lakh rupees in respect of each employee.

In addition to the above, certain expenses incurred by the employer in the course of his business or professions are also deemed to be fringe benefits. FBT is payable even in cases where no tax is otherwise payable by the employer. This tax is payable on a quarterly basis within the prescribed time limit, failing which would attract interest @ 1% p.m. till the default continues.

An illustrative list of expenses treated as deemed fringe benefit and liable to fringe benefit tax together with rate of valuation and tax are given hereunder:

Sl. No.	Expenses on (See Note 1)	Extent of expenditure to be considered as FBT	Effective rate of tax
1.	Entertainment	20%	6.798%
2.	Provision of hospitality in the form of food or beverages other than in office or factory	20%	6.798%
3.	Conference	20%	6.798%
4.	Sales promotion expenses excluding in print or electronic media	20%	6.798%
5.	Employees welfare excluding statutory expenditure, like, ESIC, First Aid, etc.	20%	6.798%
6.	Conveyance	20%	6.798%
7.	Use of hotel and lodging facilities	20%	6.798%
8.	Repair, running and maintenance of motor cars including depreciation	20%	6.798%
9.	Repair, running and maintenance of aircraft including depreciation	20%	6.798%
10.	Use of telephone other than leased telephone lines	20%	6.798%
11.	Maintenance of any accommodation in the nature of guest house	20%	6.798%

Sl. No.	Expenses on (See Note 1)	Extent of expenditure to be considered as FBT	Effective rate of tax
12.	Festival celebration	50%	16.995%
13.	Use of health clubs and similar facilities	50%	16.995%
14.	Use of other club facilities	50%	16.995%
15.	Gifts	50%	16.995%
16.	Scholarships	50%	16.995%
17.	Tour and travel including foreign travel	5%	1.70%

In case of certain industries, like hotel, construction, manufacture or production of pharmaceuticals or computer software, persons engaged in the business of carriage of passengers or goods by motor car, aircraft, the value of some of the expenses, for the levy of FBT is reduced to 5% or NIL. For details please refer to section 115WC (2).

Capital Gains Tax

Capital Gains Tax is chargeable as under:

Sr. No	Particulars	Tax Rates	
		Domestic Company	Foreign Company
A.	Short Term Capital Gains (STCG) arising on transfer of any asset, other than equity shares in listed companies or units of equity oriented mutual funds ²⁵	33.99%	42.23%
B.	Long Term Capital Gain (LTCG) arising on transfer of any asset held for a period of more than 12 months in case of shares and securities, other than equity shares in listed companies or units of equity oriented mutual funds ²⁶ ; and more than 36 months in case of other assets.	22.66%	21.115%

- **Permanent Account Number (PAN):** All assesses are required to obtain Permanent Account Number (PAN). They are required to quote the PAN in tax returns, correspondence with any income tax authority and tax payment / documents filed under the Act.
- **Tax Deduction Account Number (TAN):** Every person deducting tax at source in accordance with the provisions of ITA, 1961 is required to apply to the tax officer for allotment of a TAN within one month from the end of the month in which tax is deducted for the first time.

Withholding taxes

²⁵ The ITA, 1961 provides for preferential treatment for transfer of equity shares of listed companies through recognised stock exchanges, and units of equity oriented mutual funds. Transfer of such assets held for up to 12 months qualifies for a preferential tax rate of 11.22% in case of Indian companies, and 10.455% in case of foreign companies. However, the concession tax is subject to transaction being chargeable to securities transaction tax (STT).

²⁶ The preferential treatment for transfer of equity shares of listed companies through recognised stock exchanges, and units of equity oriented mutual funds is also available for such assets held for more than 12 months. Transfer of such assets qualifies for a full tax exemption for Indian as well as foreign companies. However, the exemption is subject to transaction being chargeable to securities transaction tax (STT).

All companies are required to deduct tax at source at the appropriate rate at the time of making certain specified payments or at the time of crediting the account of the payee, whichever is earlier. An exception exists in respect of salary payments where the tax is required to be deducted only at the time of making payments. The tax so deducted is required to be deposited with the Central Government of India within the specified period (generally 7 days from the end of the month of deduction).

The different types of payments liable for tax deduction at source (TDS) include:

- Payment of Salaries
- Fees for professional or technical services
- Payment of Interest
- Payments to contractors or sub contractor
- Payments to non-resident
- Payment of Rent
- Payment of commission or brokerage

The person responsible for deduction of tax at source is required to ensure the following:

- The tax deducted has been paid to the credit of Central Government within the prescribed time limit.
- A Tax Deducted at Source (TDS) certificate is furnished within the specified time to the payee in respect of tax deducted.

Further a company is required to electronically file quarterly statements for the period ending on June 30, September 30, December 31 & March 31 with the tax authorities within the time prescribed time (15 days from the end of every quarter) and in the forms prescribed.

Any failure to deduct tax or to deposit the same into the Government Treasury would have serious repercussions in the form of:

- Disallowance of expenditure itself.
- Interest liability @ 1% per month on the short fall from the time the amount was deducted / deductible till the time the amount is paid.
- Penalty equal to the amount of tax.
- Prosecution in select cases.

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- Fees for professional or technical services
- Payment of Interest
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Further a company is required to file quarterly statements for the period ending on June 30, September 30, December 31 & March 31 with the tax authorities within the time prescribed time and in the forms prescribed.

Return of Income

Every Indian company is required to electronically file its Return of Income by 31st October each year. Compiling a proper return of income is of utmost importance else it could result in high pitched assessment by the tax authorities. To this end, proper disclosures are required to be made, backed by appropriate notes.

Return in respect of Fringe Benefit Tax

The Companies who are liable to the FBT as discussed above are required to file an annual return with the tax authorities by 31st October following the end of the financial year.

Revenue Audit / Assessment

If the tax officer considers it necessary to ensure that the taxpayer has not understated the income or claimed excessive loss or has not paid the tax due, he may issue a notice to the taxpayer to produce documents / evidences in support of the return of income filed by him on a year to year basis. Thereafter taking into consideration all the material gathered from the tax payer, the tax officer passes an order called "assessment order" in writing determining the total income and the tax payable / refundable by / to the taxpayer²⁷.

Others

Wealth tax - Companies are subject to wealth tax at the rate of 1% on the excess of "net wealth" over INR 1.5 million. Indian companies are subject to wealth tax with regard to assets (wealth) located whether in India or abroad while foreign companies are liable to wealth tax only with regard to assets located in India. Assets includible in "net wealth" are restricted to residential houses; commercial properties not used for purposes of business, cars, precious metals, boats, aircrafts, and urban land and specified cash in hand. Debts which are secured on or which have been incurred in relation to the said assets are deductible in computing "net wealth". Practically, most of the companies, except a very few with enormous wealth, would not be within the wealth tax net due to various exemptions and threshold limits.

Expatriate Taxation

Expatriates coming to India are also subject to payment of taxes at the rates applicable to individuals, as discussed earlier. The following paragraphs cover essential aspects of expatriate taxation in India.

Permanent Account Number (PAN)

All expatriates are required to obtain PAN by making an application to the tax authorities.

²⁷ Section 143(3) of the ITA

Salary

Foreign employees seconded to India by the foreign employer can be directly paid up to a maximum of 75% of their net salary (i.e. after payment of income tax) in their home country. It is however, mandatory to pay the balance 25% of the 'net of tax salary' in rupees in India. Further income tax is payable on the whole salary since accrued in India. The balance lying in the bank account of expatriate employee in India can be repatriated abroad under the current exchange control regulations. Alternatively, they can be paid by the Indian office or Subsidiary or JV in which case the expatriate can make recurring remittance abroad for family maintenance upto 100% of the net salary.

Tax Payments and Withholding Tax Requirements

Every employer in India is required to deduct income tax at the time of payment of salary to the employees. For this purpose, the employer must estimate the employee's income for the year, compute his tax liability, and then deduct the tax in equal monthly installments before making any payments to the employee. The tax so deducted must be paid into the Government treasury within one week from the last day of each month in which the deduction is made. All employers must issue a tax-withholding certificate to employees within the period of one month from the close of the relevant financial year. Expatriate-employees can claim credit for the tax deducted in their Return of Income/personal assessment, on the basis of this certificate.

Applicability of Indian Income Tax Act to Expatriates

Residential status

Liability for income tax in India under the Indian Income-tax Act, 1961 (ITA) depends upon the taxpayer's residential status, not on his citizenship.

Under ITA residential status of an individual is determined by the number of days, the expatriate is physically present in the country during a fiscal year, which in India, begins on April 1st and ends on March 31st. To assess the tax burden, ITA classifies taxpayers as residents, non-residents, or not-ordinarily residents.

Resident

An individual is considered a resident of India if he satisfies either of the following basic conditions:

- He is physically present in the tax year for 182 days or more; or
- He is physically present in India for 60 days or more during the tax year, and 365 days or more during the four preceding tax years.

Resident and Ordinarily Resident (ROR):

To determine whether an individual is an ordinarily resident, he must satisfy two **additional conditions**, (over and above one of the two basic conditions noted above):

- He should have been resident in India during at least two out of ten years preceding the relevant tax Year; **and**
- He should have been in India for 730 days or more during the seven years preceding the relevant tax year.

An Individual who satisfies one of the basic conditions but fails to satisfy both the additional conditions is considered as 'Resident but Not Ordinarily Resident' (NOR). Further, an individual who satisfies one of the basic conditions specified above and also

satisfies both the above conditions are considered as 'Resident and Ordinarily Resident' (ROR).

Non- resident:

Individuals who are not residents are considered non-residents.

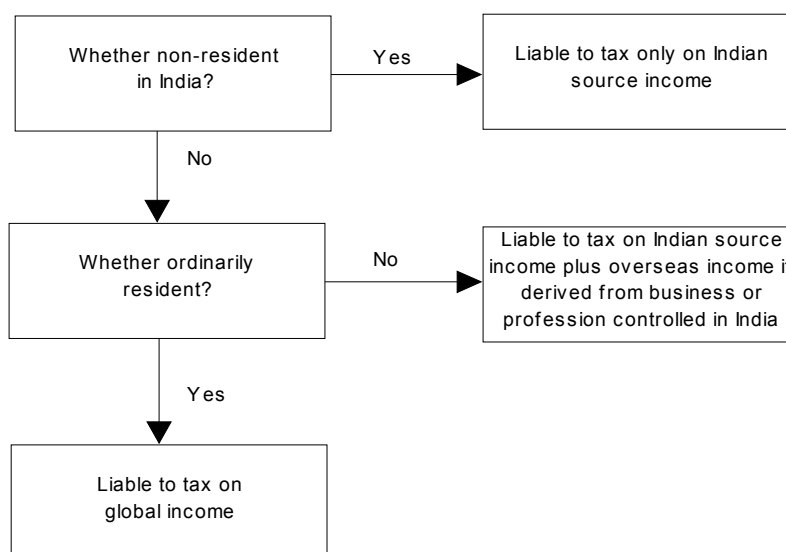
Summary

The overall position has been noted in the following table:

Rules of Residence at a Glance		
Ordinarily resident	Not ordinarily resident	Non-resident
Must satisfy at least one of the basic conditions and both the additional conditions	Must satisfy at least one of the basic conditions and one or none of the additional conditions	Should satisfy none of the basic conditions

Based on aforesaid principles, an expatriate coming down to India for the first time would remain a NOR for the first two years after arrival.

Residential Status and Tax Liability



Thus, a ROR is taxable in respect of his global income as opposed to Non-Resident and NOR who are liable to tax only in respect of only Indian source Income. 'Global Income' would mean any income which is earned or received anywhere in the world, whether in or outside India. Therefore, any interest, dividend, rent etc. earned by the deputed employee outside India would be liable to tax in India once the employee attains the status of Resident and Ordinarily Resident.

Taxation under Indian Income Tax

Salary is taxable in India if:

- Salary is received in India (irrespective of where the services are rendered); or
- Services, (for which the salary is payable), are rendered in India.

Therefore, when an expatriate works in India; his entire salary-related income is subject to tax in India, even if he is paid outside India.

If an expatriate's employment contract requires him to work both in and out of India, a portion of his salary based on the number of days worked outside India, which is not relatable with his employment in India may not be taxable in India.

Salary for the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment would also be taxable in India.

The definition of salary under ITA is very wide and includes wages, pension, commission, leave encashment, gratuity, accretion to provident fund, etc. Salary also includes perquisites like rent-free accommodation, car, any benefit granted free or at a subsidized rate, etc. which are to be valued as per the valuation rules specified. Any profits in lieu of salary are also taxed as salary, e.g. House rent allowance, City compensatory allowance, etc.

Salaries are taxable on receipt or accrual basis, whichever is earlier.

Short-Stay Exemption under Indian Income Tax

Section 10(6)(vi) of the ITA provides exemption in respect of salaries received by an individual who is not a citizen of India subject to certain conditions. The section lays out that in the case of a person who is not a citizen of India, remuneration received by him, as foreign employee for services rendered in India would be exempt in India. This is however, subject to the following conditions:

- The foreign enterprise is not engaged in any trade or business in India;
- His stay in India does not exceed in the aggregate a period of ninety days in such previous year; and
- Such remuneration is not liable to be deducted from the income of the employer chargeable under this Act.

All the above conditions are cumulative. Therefore, in case of an employee, not being a citizen of India whose stay is less than 90 days during a given financial year, he shall not be liable to be tax in India subject to the fulfillment of other two conditions. **It is pertinent to note that this exception could be claimed by a foreign citizen employee irrespective of his residential status in the country of residence.**

Short –Stay Exemption under Treaty

Alternatively, benefits / relief can be claimed under the treaty. Section 90 of ITA deals with the provisions of double tax avoidance agreement. The provisions of DTAA or ITA, whichever are more beneficial to the expatriate employee shall prevail.

India currently has comprehensive tax treaties with 70 countries. Most treaties provide for exemption from income tax if an expatriate stays in India for less than 183 days in a tax year. This is generally subject to the fact that the salary is paid by an employer who is not a resident of India, and the salary is not claimed as tax-deductible business expenditure in India

However, it is pertinent to note that an expatriate employee can claim the above referred benefit under the treaty only if he is resident of one or both the contracting states.

Perquisites / Allowances Payable to Expatriates

There are several perquisites/allowances payable to expatriate employees, which are eligible for exemption/concessional tax rate under the Indian Income Tax Act. The salaries/allowances to employees may be paid bearing these tax-favoured components of salary in mind.

Transfer Pricing and International Taxation

Transfer Pricing

Detailed provisions relating to transfer pricing were introduced in India by the Finance Act, 2001 in order to facilitate the computation of reasonable, fair and equitable profits and tax in India in the case of businesses carried on by multinational companies. Simply put, Transfer Pricing is the process of adjusting the prices of cross-border transactions between related / associated parties. The transfer pricing provisions generally follow the OECD guidelines relating to the same. However, there are certain fundamental differences in that the Indian provisions require the computation of an 'arms length price' as against the internationally accepted norm of arms length range. Further the arms length price is to be computed as the 'arithmetic mean' of comparable results. A variance of around 5% of the mean may be opted for.

Definitions

Section 92 of the Income Tax Act, 1961 provides that the price of any transaction between associated enterprises, either or both of whom are non resident for tax purposes ('International transaction'), shall be computed having regard to the arm's length principle.

Two enterprises are considered to be associated if there is direct/indirect participation in the management or control or capital of an enterprise by another enterprise or by same persons in both the enterprises.

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

- Direct/Indirect shareholding having 26% or more of voting power.
- Advancing of loans of 51% or more of total assets.
- Appointment of more than 50% of the board of directors,
- Goods manufactured are sold under Influenced prices.
- Dependence on IPRs owned by either party

Determination of "arms length price"

A very important aspect of the concept of Transfer Pricing is the process of determining the arm's length price. The Central Board of Direct Taxes (CBDT) has prescribed five methods for determining the arm's length price.

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

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

Burden of Proof and Assessment

The burden of proving that the international transactions are in accordance with the arms length principle lies with the taxpayer. For this purpose, the ITA requires the maintenance of prescribed

information and documents relating to international transactions undertaken between associated enterprises. Failure to do so attracts stiff penalties.

Also, it is mandatory to obtain an accountant's certificate in a prescribed format in respect of all international transactions between associated enterprises. Such report should contain prescribed particulars of the transaction and has to be filed with the tax authorities by October 31 (in case of companies) of the relevant assessment year, along with the tax return.

Once the accountant's certificate has been filed with the tax return, the concerned tax officer may call for the prescribed documentation in the assessment proceedings. Based on available information, the tax officer may adjust or re-compute the prices used in international transactions. Such an adjustment would attract tax and interest on the additional amount.

Stringent penal provisions have been prescribed for non-compliance with the prescribed requirements under the new transfer-pricing regime. The same are briefly noted below:

Nature of penalty prescribed	Quantum of penalty
Addition to Income on account of concealment or furnishing of inaccurate details	100% to 300% of tax on addition to Income
Failure to maintain documentation	2% of value of the international transaction entered into between related parties (i.e. mainly the value of export billing recorded in the books).
Failure to furnish documentation to tax authorities, when called for	2% of value of the international transaction entered into between related parties
Failure to furnish Accountants' Certificate	INR 100,000/-

With the approval of the commissioner of income tax, the tax officer may refer the case for a detailed review to specially appointed Transfer Pricing Officers (TPO). The order of such TPO would have to be considered by the Assessing officer in finalizing the assessment proceedings.

International Taxation

Investment into the Indian Company can be made either by the Parent Company directly or through a suitable holding company jurisdiction. The objective is to minimize the taxes of the group as a whole considering various tax and non-tax (commercial) factors. The following factors are relevant before structuring the investments into the Indian Company:

- Profits earned in India could be repatriated in the form of Dividend. A dividend distribution tax @ 16.995% needs to be paid by the Indian Company on declaration of such dividends. Such dividends may also be taxable in the Country where Foreign Holding Company is registered in accordance with the domestic laws of the Country where the Foreign Holding Company is registered.
- Other profit extraction techniques such as interest, fees for technical services, royalties, commissions, etc. could also be devised depending on the commercial objectives and precise facts of each case. Such payments to the Foreign Company may attract withholding taxes as per the treaty, which India has with the Foreign Country or Indian domestic laws, whichever is favourable to tax payer. Such withholding taxes could also be minimized / reduced based on India's favourable treaty with a third country.
- So far India has concluded 70 **Comprehensive tax treaties**. All the Comprehensive Avoidance of Double Taxation Agreements concluded by India since 1965 to date are listed below

The treaties currently in force are

Armenia	Cyprus	Israel	Malta	Philippines	Spain	Turkmenistan
Australia	Czech Republic	Italy	Mauritius	Poland	Srilanka	Uganda
Austria	Denmark	Japan	Mongolia	Portuguese Republic	Sudan	Ukraine
Bangladesh	Finland	Jordan	Morocco	Quatar	Sweden	United Arab Emirates
Belarus	France	Kazakstan	Namibia	Romania	Swiss	United Arab Republic (Egypt)
Belgium	Germany	Kenya	Nepal	Russian Federation	Syria	United Kingdom
Brazil	Greece	Korea	Netherlands	Saudi Arabia	Tanzania	United States
Bulgaria	Hungary	Kyrgyz Republic	New Zealand	Singapore	Thailand	Uzbekistan
Canada	Indonesia	Libyan Arab Jamahiriya	Norway	Slovenia	Trinidad and Tobago	Vietnam
China	Ireland	Malaysia	Oman	South Africa	Turkey	Zambia

Indirect Taxation

There are number of indirect taxes in India, some at Central (Federal) level, some at State level and a few at Municipal levels. The important ones are described hereunder:

Customs Duty

The customs administration in India vests in the Central Board of Excise & Customs (CBEC) for implementing the provisions of the Customs Act.1962. There are two main wings of Customs House. The 'Appraisalment' wing is assigned the job of collection of revenue, while the 'Preventive' wing aims at prevention of smuggling. Levy of customs duty on the imported goods is based on customs duty rates proposed by the Finance Minister in his Budget proposals (which generally takes place on the last day of February every year). During the course of the year, the CBEC can issue Notifications exempting items from duties.

Imports into India

Items not mentioned as Prohibited, Restricted or Canalised for import in ITC (HS) Classification of Export and Import items are freely permitted for Imports. There is no need to obtain any license or permission for importing such goods. The ITC (HS) Classification of Export and Import items contain 98 Chapters and in each chapter there are column headings covering Code, items description, policy and nature or restriction, etc. Indian Customs use an 8 digit ITC (HS) Code in all documents.

Classification of Customs Tariff

The basic legislation is the Indian Customs Act, 1962 read with Customs Tariff Act, 1975. Section 12 of the Customs Act, 1962 empowers levy of duties on goods imported into India. However, the rates at which the import duties shall be leviable have been respectively specified in the First Second Schedule to the Customs Tariff Act, 1975-("C T A")

Types & Levy of Customs duties

- **Basic Customs duty:** all goods imported into India are chargeable to duty at rates prescribed in the 1st Schedule of the CTA. This Schedule is amended from time to time. This duty can be levied either as a percentage of value of goods or at a specified rate. The peak rate for non-agricultural goods is 10% with a few exceptions.
- **Additional Duty:** Also known as countervailing duty, it is levied on the cost of imported goods and is equal to excise duty levied on like goods when manufactured in India. The objective is to ensure that the protection provided by the import duty to domestic industry is not eroded. It is levied under Section 3 (1) of the CTA. Currently it is 16.48%.
- **Additional Duty:** It is levied at the rate of 4% under Section 3 (5) of the CTA to counter local sales tax / VAT for the time being leviable on sale, purchase of a like Item in India.
- **Education Cess:** Is liable on Customs Duty (and not on the value goods imported) @ 3%.

Customs Duty Calculations

Calculation of total duty payable on importation

		Rate	Amount
TV	Transaction Value (including 1% landing cost)		100.00
A	Basic Customs Duty	10.00%	10.00
B	Additional Duty of Customs u/s. 3(1) of CTA on (TV + A)	16.48%	18.13
C	Education cess on (A+B)	3.00%	0.84
D	Additional Duty of Customs u/s 3(5) of CTA on all above (TV+A+B+C)	4.00%	5.16
E	Total duty (A+B+C+D)		34.13
F	Credit available against Excise duty (B +D)		23.29

Excise Duty

Excise duty is levied on manufacture of goods in India. General rate is 16% on advalorem basis and some goods attract specific duty. The duty is payable on the value of goods manufactured. However, credit (CENVAT credit) is available in respect of excise duty paid (by seller) on inputs procured locally which are used in the manufacture of final product. Also, credit (CENVAT credit) is available for countervailing duty paid (16.48%) on imported components used in the manufacture of the final products. The factory needs to obtain Excise License.

Value Added Tax (VAT) / Central Sales Tax

VAT is governed by the following legislations:

- State VAT Legislation - In respect of sale of goods within a State, VAT law of the concerned State will apply. Most of the States are under VAT regime and the general rates are 4% or 12.5%.
- Central Legislation - In respect of sale of goods from one State to another, Central Sales tax (CST) is applicable. The present rate of CST is 3%.

VAT is payable on sale of goods in India. However, subject to compliance of laid down conditions no VAT is payable if the sale or purchase is in the course of import into India or export of goods out of India.

VAT / CST registration needs to be obtained for dealing in goods.

Service tax

Service tax is levied at 12.48% on the value of taxable services rendered. Currently, more than 100 services are covered under the Service Tax regulations.

Octroi Duty and Entry tax

Octroi duty is payable on entry of goods in the municipal limits and Entry tax is levied for entry of goods in a State. Currently, Octroi duty is levied only in the State of Maharashtra. The rate of Octroi duty would vary from city to city so also the rate of Entry tax would vary from State to State.

Stamp duty

Under the Stamps Act, various transactions²⁸ are required to be recorded on the instruments containing stamps of a value as specified by the Act. This would vary from State to State.

Municipal taxes

Municipal taxes may be payable on immovable property bought / leased. This tax varies from Municipality to Municipality.

General

There are detailed procedures and regulations under each of the laws for deposit of duties / taxes, filing of returns, etc. which needs to be complied with.

²⁸ Most of the states exempt transactions related to sale of merchandise for eg. in the state of Maharashtra the same is exempt

Chapter VII - Export Incentive Schemes

Export Oriented Units (EOU)

Introduction

100% Export Oriented Units (EOU) scheme focuses on promotion of exports through grant of various incentives and benefits to registered units. Since its launch, the scheme has yielded far-reaching results and has re-triggered India's economic growth through increased exports and FDI.

Permissible activities

A 100% EOU is a unit which has undertaken to export its entire production of goods, except permissible sales in Domestic Tariff Area (DTA). Such units may be engaged in export of all kinds of goods (barring trading activities) including repair, remaking, testing, calibration, quality improvement, up-gradation of technology and re-engineering activities, etc. for export in freely convertible foreign currency (subject to prescribed conditions).

Salient Features of EOU scheme

No separate license required for import.

No export / foreign exchange earning commitment – it is sufficient if the unit is a positive Net Foreign Exchange Earner (NFE) cumulatively over initial 5 years

Up to 50% of value of exports can be sold locally in DTA on payment of applicable duties and taxes (subject to achieving positive NFE)

Minimum Investment: INR Rupees 10 Millions

100% EOUs can be situated anywhere in India.

Scrap / waste / remnants / unutilized materials / surplus or obsolete capital goods may be exported or sold in the DTA on payment of duties or destroyed in presence of the custom/excise officer

Second Hand capital goods without any age limit may also be imported duty free

100% export earnings can be maintained in free forex in the Exchange Earners Foreign Currency (EEFC) Account

Extended credit period (1 year) for export realization as against the normal period of 6 months

The manufacturing has to be carried out in a custom bonded premises

FDI Policy

- 100% FDI permissible.
- Exemption from industrial licensing requirement for manufacturing items reserved for SSI sector.

Income-tax Incentives

- Concessional Income tax at 11.33% on export profits till 31 March 2009

Indirect tax benefits

- No import duty on specified inputs and capital goods
- No Excise Duty on procurement of indigenous goods.

- Reimbursement of Central Sales Tax (CST) paid on purchases from DTA.

Special economic zones (SEZ)

SEZ scheme is one of the most controversial export development measures initiated by the Government of India in recent history. Due to the flawed thinking and lack of experience on part of the bureaucracy, the scheme envisages setting up of small SEZs all over the country instead of creating large and mega projects which was the model followed by China. Due to the tax and other benefits available, a number of Real Estate developers have jumped on to the SEZ bandwagon and have tried to bring small parcels of land in the SEZ schemes and make a killing. Another major political issue is acquisition of farm land and handing it over to industrialists for setting up large SEZ projects. This has been a post in various parts of the country by farmers and has led to loss of lives and properties. This has compelled the Government to go slow on SEZ approvals and come out with a rehabilitation policy for the displaced farmers.

- SEZs are governed by SEZ Act, 2005 and SEZ Rules, 2006.
- SEZ Act has overriding effect over the provisions of any other laws which are inconsistent with the provisions of the SEZ Act, 2005.
- SEZ is a specifically delineated, duty free enclave, deemed to be outside the customs territory of
- India for the purposes of carrying out authorized activities.
- The SEZ Act provides the umbrella legal framework, covering all-important legal and regulatory
- aspects of SEZ development as well as for units operating in SEZs.

Development of SEZ

- SEZs are notified by the Ministry of Commerce and can be set up by private developers or by Central / State Governments, or jointly by any two or more of the above.

Features of the SEZ Scheme:

- **Single window Clearance including all regulatory approvals like factory License, Pollution control clearance, etc.**
- **No separate license required for import**
- **No export / foreign exchange earning commitment – it is sufficient if the unit is a positive Net Foreign Exchange Earner (NFE) cumulatively over initial 5 years**
- **Supplies from the DTA to SEZ regarded as ‘deemed exports’, entitling DTA suppliers to certain export benefits.**
- No cap on Foreign Investment for SSI reserved items
- No fixed wastage norms.
- **Transfer of Land can be leased basis only, outright sale of land by the developer is not allowed**
- **Second Hand capital goods (only imported) without any age limit is allowed to be procured duty free**

- Supplies from SEZ to DTA considered as imports by the DTA buyer and liable to normal custom duty.

Tax Benefits for the Developer of the SEZ

- Income Tax Incentives
 - 10-year tax holiday
 - Exempt from dividend distribution tax
 - Interest on long term finance is tax exempt
 - Long-term capital gains arising on transfer of shares in developer company is tax exempt
 - No MAT.
- Indirect Tax Incentives:
 - No import duty (Customs duty)
 - No Excise Duty
 - Exemption from Central Sales Tax (CST) on purchases from DTA
 - Exemption from Service tax

FDI Policy for Units in SEZ

100% FDI permitted under automatic route except for manufacture of defense equipment, atomic substances, hazardous chemicals, distillation, Cigarettes, Cigars & tobacco substitute & brewing of alcoholic drinks which require prior FIPB approval.

Basic conditions for a SEZ Unit

- SEZs units to be positive net foreign exchange earners cumulatively over 5 years.
- No limit on DTA (Domestic Tariff Area) sales
- Fresh Investment in Plant & Machinery is compulsory.

Fiscal benefits to a SEZ Unit

- 15 year corporate tax holiday on export profit – 100% for initial 5 years, 50% for the next 5 years and upto 50% for the balance 5 years equivalent to profits ploughed back for investment
- No MAT
- Same indirect tax benefits as the SEZ Developer

Liberal forex Regulations

- 100% export earnings can be kept in a Special Foreign Currency Account – minimal restrictions on business payments outside India
- Branches of foreign companies in SEZ are eligible to undertake manufacturing activities.
- An SEZ unit can adjust export receivables against import payments and pay / receive net amount provided the transaction of export and import is with the same party after complying with laid down procedures.

Offshore Banking Units

Offshore Banking Unit means a branch of a bank in India located in the SEZ with the permission of RBI.

Software Technology Parks of India (STPI)

Software Technology Parks (STP) scheme is a 100% export oriented scheme for encouraging development and export of computer software and IT enabled services from India. The STP scheme has yielded excellent and far-reaching results over the years enabling India to remain competitive in the global market. Approval for the STP unit is granted by the jurisdictional Director, STPI.

Salient Features of STP scheme

- Single window clearance
- No export / foreign exchange earning commitment – It is sufficient if the unit is a positive net foreign exchange earner (NFE) cumulatively over initial 5 years
- Capital goods can be sourced on lease.
- Upto 50% of exports value can be sold locally with concessional duties and taxes (subject to positive NFE).
- Supplies from the DTA to STP units regarded as 'deemed exports', entitling DTA suppliers to certain export benefits.
- Unlike SEZs, the STP units can be situated anywhere in India.

FDI Policy

100% FDI permissible.

Income-tax Incentives

Concessional income tax at 11.33% on export profits till 31 March 2009.

Eligible IT-Enabled services

- Back-Office Operations
- Call Centers
- Content Development or animation
- Data Processing
- Engineering and Design
- Geographic Information System Services
- Human Resources Services
- Insurance Claim Processing
- Legal Databases
- Medical Transcription
- Payroll
- Remote Maintenance
- Revenue Accounting
- Support Centers and
- Web-site Services

Indirect tax Incentives

- No import duty
- No Excise Duty on indigenous procurement.
- Reimbursement of Central Sales Tax (CST) paid on purchases from DTA.

Liberal Forex Regulations

- 100% export earnings can be maintained in EEFC A/c.
- Extended credit period (1 year) for export realisation.

Other benefits

- Sub-contracting permissible
- Inter-unit transfer of goods / services permitted.
- Capital goods may also be transferred / given on loan basis to other STP units (with prior permissions).

Chapter VIII - Funding Options

A Foreign Company setting a WOS / JV in India can fund its investment through alternative options. The Share Capital can be divided into equity or preference shares or both. Both equity and preference shares are denominated in INR. Preference shares have a preferential right for repayment as also for dividend. The rate of dividend on preference shares can go upto 12%.

Tax Implications on Dividends (Common for Equity & Preference Capital)

Dividends paid by Indian Company would be exempt from tax in India in hands of the shareholder.

A 15% (plus 10% surcharge + 2% Education cess) distribution tax (effective rate of 16.995%) would be required to be paid by the Indian Company in respect of any dividends paid to shareholders.

Procedures: For Capital and Loan, there are formalities and filings with the RBI and the ROC. A brief note on various funding options is as follows

Equity Capital

Repatriation of Capital

Equity funds can be repatriated only on liquidation or on transfer of shares. Limited buy-back provisions are available under corporate laws.

To start with, the WOS / JV can have paid up Equity Capital of INR 100,000 or 500,000 as the case may be for a Private Limited Company or a Public Limited Company. Depending on the overall project cost and the applicable regulations regarding foreign currency loan (popularly called External Commercial Borrowings (ECB)), tax and other considerations, the balance financing can be done through issue of Redeemable Preference Shares or Loans.

Mobilization of Funds through Preference Shares

As per an amendment in April, 2007 Ministry of Finance has laid down that foreign investments through issuance of non-convertible / optionally convertible / partially convertible preference shares would be considered as debt and has to in conformity with the ECB guidelines / ECB caps. As such, Foreign investments coming through issuance of only fully convertible preference shares would be treated as part of equity share capital and same would be included in calculating foreign equity for the purposes of sectoral caps on foreign equity, where such caps have been prescribed. Hence only Companies eligible to borrow under the ECB guidelines can now issue redeemable preference shares, all other companies have to finance their projects by way of issue of equity shares or convertible preference shares or local borrowings in Rupees.

The dividend rate should not exceed the limit prescribed by the Ministry of Finance (currently fixed at 300 Basis Points above State Bank of India's Prime Lending Rate).

Foreign Currency Debt (External Commercial Borrowings (ECBs)):

External Commercial Borrowings (ECB) refers to commercial loans availed from non-resident lenders with minimum average maturity of 3 years. The forex regulations with regard to ECB, its term and the restrictions on interest, etc. are primarily governed by various notifications issued by the RBI from time to time. The salient features of the ECB regulations are summarized below.

ECB can be accessed under two routes, viz., (i) **Automatic Route** and (ii) **Approval Route**.

Permissible Amount and Maturity under Automatic Route

- ECB up to USD 20 million (approx. GBP 11 million) or equivalent with minimum average maturity of three years
- ECB above USD 20 million (approx. GBP 11 million) and up to USD 500 million (approx. GBP 275 million) or equivalent with minimum average maturity of five years

Approval Route (where borrower has to obtain the prior approval of the RBI before availing such loan) is applicable in the following cases:

- Cases falling outside the purview of the above mentioned limits (amount and maturity period)
- Cases where some specific categories of borrowers are involved (e.g. financial institutions).

Eligible Lenders

They include among others:

- International Financial Institutions
- Suppliers of Equipments
- Foreign Collaborators (loan from a foreign technology provider may fall under this category)
- Foreign Equity Holders (loan from the parent company would fall under this category)

All-in-cost ceilings (applicable for both Automatic and Approval Route)

Minimum Average Maturity Period	All-in-cost Ceilings over six month LIBOR
Three years and up to five years	150 basis points
More than five years	250 basis points

End Use Restrictions (applicable for both Automatic and Approval Route)

ECB can be raised only for investment in real sector²⁹ and certain infrastructure projects:

- Utilization of ECB is not permitted:
 - in real estate business;
 - for working capital / general corporate purposes;
 - for repayment of rupee loans;
 - for on-lending / investment in Capital Market.

Parking of ECB proceeds overseas (applicable for both Automatic and Approval Route)

ECB proceeds should be parked overseas until actual requirement in India.

Procedure (applicable for both Automatic and Approval Route)

Prescribed documents have to be submitted to the RBI which includes a copy of the Loan Agreement and a prescribed Form. Once the documents are submitted, the RBI allots a Loan

²⁹ The term 'Real Sector' is not defined in the Forex Regulations. Under common parlance this is generally interpreted to be a manufacturing sector. However, RBI may allow companies engaged in software development activities to avail ECB's on case to case basis. Generally cost involved for Real Estate component of the Project cost should be funded by way of Equity or Preference Shares.

Registration Number after which the funds can be remitted. Additional Form ECB has to be submitted in case of **Approval Route**.

Investments through Global Depository Receipts (GDRs) / American Depository Receipts (ADRs) / Foreign Currency Convertible Bonds (FCCBs)

Foreign investment through GDRs / ADRs / FCCBs is also treated as FDI. Indian companies are permitted to raise capital in the international market through the issue of GDRs/ADRs/FCCBs, subject to certain restrictions.

Issue of ADRs / GDRs does not require any prior approvals (either from Ministry of Finance / FIPB or RBI) except where the FDI after such issue would exceed the sectoral caps (as specified under Automatic Route for FDI), in which case prior approval from FIPB would be required. Issue of FCCBs up to USD 500 million also does not require any prior approvals. Only companies listed on the stock exchange are allowed to raise capital through GDRs / ADRs / FCCBs.

Chapter IX - Financial Reporting and Auditing Requirements

Accounting and Auditing Practices

Books of account

Books of accounts are required to be maintained by all companies to give a true and fair statement of the position of the company's affairs. The same are required to be maintained on accrual basis as per double entry system of accounting³⁰. These books of accounts along with other statutory registers and records are to be maintained at the registered office.

Choice of accounting year

The choice of the accounting year rests with the company and it could choose any suitable date as its year ending. The accounting year cannot extend beyond 15 months. However, with prior approval of the Registrar of Companies, the same may be extended to a period of 18 months.

However, while deciding on the accounting year one needs to keep in mind the requirements of the Indian Income tax Act. As per the Indian Income tax Act, it is necessary to close the accounts on 31st March each year and get the same audited (where the turnover exceeds INR 4 Million) irrespective of what is the accounting year under the Companies Act. For example if a company closes its accounting year in December every year under the Companies Act, then it would have to prepare the following set of accounts and get the same audited:

- From 1st January to 31st December every year - for filing the same with the Registrar of Companies
- From 1st April to 31st March every year – for filing with the Income tax authorities along with the Return of Income.

Accounting and reporting requirements

The guiding principles in the Indian accounting system are reliability and relevance, true and fair representations, prudence, consistency and completeness.

Accounts prepared by a company are required to be audited by a qualified Chartered Accountant. The professional body concerned with accounting and auditing requirements is The Institute of Chartered Accountants of India (ICAI). ICAI has from time to time issued Standards, Statements³¹ and Guidance Notes³² on a number of accounting and auditing matters.

Accounting Standards and Statements on Standard Auditing Practices have been issued with a view to ensuring that the financial statements are prepared in accordance with generally accepted accounting standards. The Indian Accounting Standards (AS) are modeled on the lines of International Accounting Standards (IAS).

It is mandatory for Indian Companies to comply with Accounting Standards prescribed by ICAI³³ while preparing Profit and Loss account and Balance Sheet of the company and where any of the prescribed standards has not been adopted, the companies are required to disclose in its financial statements, the deviations from the standard, the reasons for such deviation and financial effect of such deviation.

³⁰ Section 209 of the Companies Act, 1956

³¹ Statements on Auditing have been issued with a view to securing compliance by the auditors on matters, which in the opinion of the ICAI are critical for the proper discharge of their functions. These have been formulated after giving due consideration to International Auditing Guidelines (IAG)

³² Guidance Notes are primarily designed to provide guidance to auditors on matters, which may arise in the course of their professional work and on which they may desire assistance in resolving issues that may pose difficulty. Guidance Notes are recommendatory in nature.

³³ Section 211(3C) of the Companies Act, 1956

The auditors are statutorily required to qualify the audit report in respect of any deviations from the accounting standard considering the materiality of the relevant item.

Disclosure requirement

The preparation of financial statements is conditioned by the disclosure requirements prescribed by:

Schedule VI of the Indian Companies Act - Part I of Schedule VI of the Companies Act lays down the format of the Balance Sheet and the presentation under the main heads. Schedule VI gives a vertical and a horizontal format and the Balance Sheet can be prepared in either of the forms. Part II of Schedule VI lays down the major heads of accounts in respect of Profit and Loss Account.

Publications of the ICAI

Disclosure norms in Accounting Standards - The Accounting Standards also lay down certain disclosure norms in respect of various issues, which need to be followed in the preparation of the accounts

Standards prescribed by tax regulations

Section 145 of Indian Income Tax Act (ITA) prescribes the Accounting Standards to be followed in computing taxable profits. All taxpayers are required to follow such Accounting Standards as may be notified by the Central Government in computing their taxable profits. Currently, following standards have been prescribed.

- Accounting Standard I relating to disclosure of Accounting Policies
- Accounting Standard II relating to disclosure of Prior period and Extraordinary items and changes in accounting policies
- These standards are similar to AS 1 and AS 5 prescribed by ICAI in all material aspect.
- Director's responsibilities in relation to accounts:
- The Board of Directors are required to include in the Board's report a Directors'

Responsibility Statement indicating therein:

- That in the preparation of the annual accounts, the applicable Accounting Standards had been followed along with proper explanation relating to material departures;
- That the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;
- That the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

That the directors had prepared the annual accounts on going concern basis.

Also, the Board of Directors are required to give in the Directors report fullest information and explanation in its report on every reservation, qualification or adverse remark contained in the auditors report.

Auditing requirements

Statutory Audit

As per the Indian Companies Act, it is mandatory to get the accounts audited on an annual basis by a Chartered Accountant.

Tax Audit

If the gross annual receipts of any year exceed Rs. 4 Million (Approx. US \$.1 Million) in addition to the audited accounts, the taxpayer also needs to file a tax audit report. This audit is a detailed audit from the tax perspective. It is in the form of a questionnaire, which needs to be certified by the Chartered Accountant, doing the audit. This report is to be filed along with the Return of Income before 31st October following the end of fiscal year.

Cost Audit

Companies engaged in specified industries in addition to the above audits are required to get their cost accounts audited by an auditor who shall audit such accounts and submit a report in prescribed form to the Central Government with a copy to the company³⁴.

Internal Audit

Companies having a paid-up capital exceeding Rs. 5 million as at the commencement of the financial year concerned, or having an average annual turnover exceeding Rs. 50 million for a period of three consecutive financial years immediately preceding the financial year concerned are required to have an internal audit system commensurate with its size and nature of its business. Auditors are required to comment in their audit report on the adequacy of the internal audit system implemented by the company.

Appointment of Auditor

The Board of Directors should appoint the first auditor within a period of one month from the date of registration of company failing which, he is appointed by the members at the General Meeting of the company. An Auditor other than the first auditor is appointed at the AGM of the company and his term expires at the subsequent AGM. Thus, an auditor is required to be reappointed at every AGM unless he is disqualified or removed.

³⁴ Section 233B of Companies Act, 1956

Chapter X - Employee Regulations

In India, Labour Laws have an impact on almost all areas of employment. Most of the legislations aim at safeguarding the interests of workers in both the organized and the unorganized sectors. Disputes on employment related issues are generally settled by the Labour Courts in case of Industrial Employees and by Civil Courts in case of other categories of Employees. Some of the principal enactments and their objectives are listed below:

Sr. No.	Legislation	Broad Objective
1	Minimum Wages Act , 1948	Fixing of minimum wage rates in certain employments
2	Payment of Bonus Act, 1965	Fixing for minimum bonus levels
3	Payment of Gratuity Act , 1972	To provide for retirement benefits to the employees
4	Employees' Provident Funds and Miscellaneous Provisions Act, 1952	A social security legislation to provide for provident fund, family pension and insurance to employees
5	Employees' State Insurance Act ,1948	Basically an insurance scheme for employees if they become ill or disabled during the course of employment
6	Workmen Compensation Act, 1923	Providing for social security to workmen in the form of compensation in case of accidents etc.
7	The Maternity Benefit Act, 1961	Provision for maternity benefit to women
8	Industrial Disputes Act , 1947	To make provisions for investigation and settlement of industrial disputes
9	The Contract Labour (Regulation and Abolition) Act, 1970	Regulates the employment of contract employees and provides for minimum welfare measures for them. In certain circumstances empowers the appropriate authority to abolish the contract system of employment.
10	The Factories Act, 1948	Regulates working of factories and provides for safety and welfare of employees working in factories
11	The Industrial Employment (Standing Orders) Act, 1946	Requires certain factories and establishments to follow standing orders regulating the terms and conditions of employment of the workers
12	The Trade Unions Act, 1926	Prescribes the provisions for the registration of trade unions

The following are the salient features of the aforementioned legislations:

Minimum Wages Act, 1948

Under this Act minimum wages for employees working in specified employment categories mentioned in the schedule to the Act are fixed.

These wages range between INR 1,500 (US \$ 36) and INR 4000 (US \$ 98) per month depending on the location and skill levels and are revised bi-annually in conjunction with the cost of living index.

Rates can be fixed based on daily or monthly basis.

These wages are revised periodically by the Government in addition to the bi-annual revision mentioned hereinabove if it is felt that the same is needed to provide a living wage to the workers. Minimum Wages are payable irrespective of the financial position of the employer.

Payment of Bonus Act, 1965

This Act provides for minimum bonus payable of 8.33% of the salary and maximum bonus payable is 20% of the annual salary. The actual quantum of bonus to be paid is determined on the basis of the profits of the establishment.

This Act applies to every factory / establishment in which 20 or more persons are employed.

Newly set up establishments are not required to pay bonus until they derive profits or for five accounting years following the year when they start selling their products, whichever is earlier.

Employees (other than an apprentices) drawing salary (i.e. Basic + Cost of Living Allowance) upto Rs. 3,500 (US \$ 85) are eligible for the bonus.

Employees who have worked for less than 30 days in an accounting year are not eligible to receive bonus for that particular accounting year.

Payment of Gratuity Act, 1972

Gratuity is payable on retirement or termination of service, resignation or death of the employee. This Act applies to every establishment employing 20 or more persons at any time during the year.

The gratuity is payable to all employees who are employed for a minimum period of five years. In case of death or disablement of an employee, the nominees are entitled to get gratuity even if the employee has put in less than 5 years of service.

The rate of gratuity payable to employees is 15 days' salary for every completed year of service or a part thereof exceeding six months, subject to maximum of INR 3,50,000 (US \$ 8,537)

Employees' Provident Funds and Miscellaneous Provisions Act, 1952

This Act applies to every factory employing 20 or more persons.

This Act applies to all employees including contract labour or part-time labour. However, it does not apply to employees drawing salaries exceeding Rs. 6,500 (US \$ 159) per month at the time of their first employment.

The minimum contribution shall be the percentage of wages as under:

Scheme	Employer	Employee
Provident Fund	3.67%	12%
Pension Fund	8.33% (Upto a max. of Rs. 541/-) ³⁵	Nil
Deposit Link Insurance Fund	0.50%	Nil

The contributions under the Retirement Benefit Scheme of Provident Fund accrue to an employee after his termination, retirement, death or resignation. These contributions cannot be withdrawn (except in severely restricted circumstances like buying homes, marriage, and death in family etc.). The employer has to incur 1.61 % of total charges as administration charges in addition to the above payments.

Employees' State Insurance Act, 1948 (Esic Act):

The Act provides for Sickness / Accident / Maternity / Free Medical benefit, etc.

This Act covers all factories and also shops and commercial establishments if so notified by the Government.

The 'Factory' for the purposes of this Act means any premises where manufacturing process is carried out. If manufacture is without aid of power, the Act is applicable if persons employed are at least 20. If manufacture is with aid of power, the Act applies if persons employed are at least 10.

It applies to all persons employed for wages (all inclusive) up to INR. 10,000/- (US \$ 244) per month excluding overtime.

The employer is required to contribute 4.75% of the wages and employees' contribution is 1.75% of the wages.

Workmen Compensation Act, 1923

According to this Act workers and / or their dependents are provided with relief in the event of accidents arising out of or in the course of employment, causing death or disability.

This Act is not applicable to workers who are covered under Employees State Insurance Act and is applicable to those employed in employments mentioned in the 2nd schedule to the Act.

Employer is liable if a workman contracts any specified occupational disease, while he is in service of employer for at least 6 months

The amount of compensation varies depending on the age of the employee, whether the injury results in death or disablement, nature of disablement etc.

The Maternity Benefit Act, 1961

The Maternity Benefit Act regulates the provision of maternity and other benefits to women employees for a certain period before and after childbirth.

It covers almost all factories and undertakings (including every shop and establishment in which 10 or more persons are employed).

It provides for the maternity benefits in terms of paid leave etc. to be granted to women employees (who have worked for at least 80 days during 12 months immediately preceding her

³⁵ Government also contributes 1.16% of employees salary to Pension fund

expected delivery) upto 12 weeks provided that not more than 6 weeks shall precede prior to the date of her expected delivery.

Further, rules exist in respect of engagement of women employees for a specified period prior to or after the delivery period. It may be important to note that there is neither a wage ceiling for coverage under the Act nor there is any restriction as regards the type of work a woman is engaged in.

Industrial Disputes Act, 1947

This Act deals with industrial disputes between employers and employees and covers issues such as strikes, lock outs, lay off, retrenchment, closure, termination by way of discharge, dismissal, recovery of legal dues, etc.

It provides the machinery for settlement of industrial disputes through negotiations.

It applies to all industrial establishments all over India irrespective of the strength of its workers.

Under the provisions of this Act, no workman in any industrial establishment who has worked more than one year can be retrenched without being given one months notice in writing indicating the reason for the retrenchment or pay equivalent to the notice period.

The employee is also entitled to compensation of 15 days salary for each completed year of service.

Termination for misconduct must usually be preceded by an enquiry where opportunity is given to the workman to defend himself.

The dismissal or retrenchment or layoff of the workmen can be contested in the court of law.

There is a prescribed procedure which has to be followed in case the retrenchment is on account of closure / winding up of the business.

If number of workmen is 100 or more, prior permission of Appropriate Government is necessary for retrenchment or closure or lay-off.

If any change is to be effected in the conditions of service of the employees Notice has to be given to the employees and the change can only be effected after following the procedure prescribed by the Act.

The Contract Labour (Regulation and Abolition) Act, 1970

This Act applies to every establishment in which 20 or more workmen are employed as contract workers. If the Act is applicable then the establishment needs to get a certificate of registration from the appropriate authority before employing any workers on contract basis.

The Act requires certain basic minimum facilities to be given to contract workers. If the contractor does not provide these then the Principal Employer is responsible for providing the same.

Only non-core functions like house-keeping, canteen, etc. can be outsourced.

Though the contractor is responsible for the payment of wages the Principal employer is required to ensure that the same are paid in full as statutorily required. If the contractor fails to pay the same the Principal employer is required to pay the wages or any shortfall in the wages.

The Appropriate Government may, after consultation with the Board constituted under the Act, prohibit the employment of contract labour in any process, operation or other work in any establishment.

The Factories Act, 1948

This Act applies to all factories. A factory is defined as any premises where 10 or more workers are working and in any part of which a "manufacturing process" is being carried out with the aid of

power. If no power is used in the manufacturing process then 20 or more workers need to be employed to constitute a factory.

The Act provides for registration and licensing of factories. Certain categories of factories need to have their construction plans approved prior to construction of the factory.

Each factory must designate and “occupier” who is a person who has ultimate control over the affairs of the factory. In case of partnerships firms one of the partners has to be designated or will be deemed to be the occupier and in case of companies one of the directors has to be nominated or any director can be deemed to be the occupier, The occupier is held responsible for all breaches of the law and can be criminally prosecuted.

The Act prescribes minimum health, safety and welfare measures to be implemented in all factories. Special provisions are prescribed for factories engaged in “hazardous processes”.

The Act also prescribes the working hours, weekly offs, rest intervals and annual leave for the workers with special provisions for women and adolescents.

The Industrial Employment (Standing Orders) Act, 1946

This Act applies to all “industrial establishments” employing 100 or more workmen. Industrial Establishment is defined to include factories.

The Act requires all covered establishments to either adopt the model standing orders as their standing orders or to submit their own standing orders to the appropriate authority for certification,

The standing orders provide for the conditions of employment of the employees i.e. classification for workmen, hours of work, holidays, wages, shift working, procedure for recording attendance, procedures to be followed for granting leave, termination of employment, procedure to be followed for dismissal in case of misconduct etc.

The Trade Unions Act, 1926

The Act provides for registration of trade Unions and prescribes the rights and liabilities of registered trade unions.

General

There are other Central and State Labour legislations in addition to the ones discussed above which may also be applicable to an establishment depending on the place where it is set up, its size and the nature of the activities it is engaged in.

Employees who are engaged primarily to perform supervisory, administrative or managerial duties are not covered by the provisions of the Acts mentioned hereinabove except for the Payment of Gratuity Act which applies to all employees. All other service conditions of these employees can be determined by contracts which would be governed by the Indian Contract Act, 1872. The employment contract would typically mention a severance or a termination clause under which either the employer or the employee can terminate the employment contract by giving appropriate notice as per the terms of the contract.

Chapter XI - Glossary of Terms

AAR	Authority For Advance Rulings	INR	Indian Rupee
ADR	American Depository Receipts	IPR	Intellectual Property Rights
ARC	Asset Reconstruction Company	IRDA	Insurance Regulatory & Development Authority
AY	Assessment Year	ISP	Internet Service Provider
BED	Basic Excise Duty	IT	Information Technology
BPO	Business Process Outsourcing	ITA	Income Tax Act, 1961
CBDT	Central Board Of Direct Taxes	JV	Joint Venture
CBEC	Central Board Of Excise And Customs	MAT	Minimum Alternative Tax
CCI	Controller Of Capital Issues	MRP	Maximum Retail Price
CENVAT	Central Value Added Tax	NBFC	Non-Banking Financial Companies
CIF	Cost Insurance Freight	NFE	Net Foreign Exchange
CST	Central Sales Tax	NRI	Non-Resident Indian
DDT	Dividend Distribution Tax	OECD	Organization For Economic Co-Operation And Development
DIPP	Department Of Industrial Policy And Promotion	p.a.	Per Annum
DTAA	Double Taxation Avoidance Agreement	PIO	Person Of Indian Origin
DTA	Domestic Tariff Area	PSU	Public Sector Units
ECB	External Commercial Borrowing	R&D	Research & Development
EC	Education Cess	RBI	Reserve Bank Of India
EHTP	Electronic Hardware Technology Park	ROC	Registrar Of Companies
EOU	Export Oriented Units	SEBI	Securities & Exchange Board Of India
FBT	Fringe Benefit Tax	SED	Special Excise Duty
FCCB	Foreign Currency Convertible Bonds	SEZ	Special Economic Zone
FDI	Foreign Direct Investment	SIA	Secretariat For Industrial Assistance
FEMA	Foreign Exchange Management Act	SSI	Small Scale Industries
FII	Foreign Institutional Investors	STP	Software Technology Park
		STPI	Software Technology Park Of India
FIIA	Foreign Investment Implementation Authority	STT	Securities Transaction Tax
FIPB	Foreign Investment Promotion Board	USD	United States Dollars
FY	Financial Year	VAT	Value Added Tax
GDP	Gross Domestic Product	WOS	Wholly Owned Subsidiary
GDR	Global Depository Receipts	WTO	World Trade Organization
HSN	Harmonized System Of Nomenclature		

Disclaimer

This is for private circulation only.

This booklet has been prepared as service to our clients / associates, prospective foreign investors, etc with a view to provide an overview of tax and regulatory aspects of doing business in India. Though every care has been taken to ensure that the contents are correct and accurate, the reader is well advised to seek professional advice before acting on any information provided in this booklet.

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