Doing Business in India

This document describes some of the key commercial, financial, legal, tax and regulatory factors that are relevant on setting up a business in India

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Disclaimer: This reference guide describes some of the key commercial, financial, legal, tax and regulatory factors that are relevant on setting up a business in India. This reference guide has been compiled by K Vijayaraghavan & Associates LLP, DFK, Hyderabad (KVA) for the sole purposes of sharing a broad perspective of the laws and regulations that need to be taken care of while deciding to set up a business in India. The contents of this reference guide are intended for guidance only and it is highly recommended that any action thereupon, should be taken under appropriate professional guidance. KVA does not accept any liability for any action undertaken suo motu, by the readers, without seeking the confirmation of an appropriate professional body.

Background

Country overview

India is a country in South Asia with a democratic republic and federal structure consisting of 28 states and 8 union territories, New Delhi being its Capital.

With 1.38 billion people, India is the second-most populous country in the world, bounded by the Indian Ocean to the south, the Arabian Sea to the south west and the Bay of Bengal to the south east.

It shares its borders with Pakistan to the west, Bhutan, China and Nepal to the north east, Bangladesh and Myanmar to the east.

Political overview

India is a federation with a parliamentary system governed under the Constitution of India, which serves as the country's supreme legal document.

The President is the Chief of State and is indirectly elected by an electoral college consisting of elected members of both houses of Parliament for a five-year term. The Prime Minister is the Head of Government and is chosen by Lok Sabha members (House of the People, lower chamber) of the majority party, following legislative elections, to serve a term of five years.

Economic Overview

Today India is ranked the fifth largest economy, and third largest in terms of Purchasing Power Parity (PPP). India has ranked 63rd amongst 190 nations in the World Bank's Ease of Doing Business index. The size of the economy is estimated at US$ 2.9 trillion in 2019. India's market size is pegged to grow at a thriving $ 6 tn in the coming years.

The WEO Update of January 2020 has projected the growth of Indian economy to increase to 5.8 per cent in 2020 expecting India to contribute significantly to an eventual pickup in the growth of world output. India's GDP in nominal prices was ` 190.1 lakh crore (US$ 2.7 trillion) in 2018-19.

In India, inflation slightly rose to 4.1 per cent in April-December 2019, after a sharp decline from 5.9 per cent in 2014 to 3.4 per cent in 2018.

Government of India has launched various flagship programmes bringing about significant transformation in Indian economy –

Digital India

Digital India is an umbrella programme that covers multiple Government Ministries and Departments. It weaves together a large number of ideas and thoughts into a single, comprehensive vision so that each of them can be implemented as part of a larger goal. Digital India aims to provide the much needed thrust to the nine pillars of growth areas, namely Broadband Highways, Universal Access to Mobile Connectivity, Public Internet Access Programme, e-Governance: Reforming Government through Technology, e-Kranti - Electronic Delivery of Services, Information for All, Electronics Manufacturing, IT for Jobs and Early Harvest Programmes. Each of these areas is a complex programme in itself and cuts across multiple Ministries and Departments.

Make In India

Investment promotion is a multidimensional and complex process which requires continuous efforts to be channelized around Ease of Doing Business, FDI reforms, skill development, infrastructure creation and fiscal incentives. All these activities have been brought into focus after launch of Make in India initiative by the Government in September, 2014 to make India the most preferred investment destination. The Government has put in place a comprehensive FDI policy regime by bringing more activities under the automatic route, increasing sectoral caps and easing conditionalties. In addition to this, a number of measures have been undertaken to ease the business environment of the country. Various State and Central Government services are being integrated on a single window e-biz portal.

Startup India

Startup India initiative is intended to build a strong eco-system for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large scale employment opportunities. The Government through this initiative aims to empower Startups to grow through innovation and design. In order to meet the objectives of the initiative, Government of India has announced an Action Plan that addresses all aspects of the Startup ecosystem. The Action Plan is divided across the following areas:

1. Simplification and Handholding
2. Funding Support and Incentives
3. Industry-Academia Partnership and Incubation

With this Action Plan the Government hopes to accelerate spreading of the Startup movement.

Foreign Direct Investment

Foreign Direct Investments (FDI) in India has witnessed a positive trend since the launch of the Make in India campaign in 2014. FDI inflow from April 2014 to March 2020 (USD 357.35 Bn) is 52.5% of the overall FDI received in the country since April 2000 (USD 680.91 Bn). For the first time, India has crossed the USD 70 Bn mark in FY 2019-20 and recorded total FDI inflow of USD 73.45 Bn. India ranked as the 9th largest recipient of FDI in 2019 according to World Investment Report 2020 by United Nations Conference on Trade and Development (UNCTAD).

Apart from being a critical driver of economic growth, Foreign Direct Investment (FDI) has been a major non-debt financial resource for the economic development of India. The Indian Government's favourable policy regime and robust business environment has ensured that foreign capital keeps flowing into the country.

FDI limits with respect to the shareholding of an Indian company can be divided into the following categories:

Prohibited Sectors

These comprise of those sectors in which FDI is prohibited in India, namely:

a. Lottery Business including Government / Private lottery, Online lotteries, etc.
b. Gambling and Betting including casinos etc.
c. Chit funds
d. Nidhi company
e. Trading in Transferable Development Rights (TDR)
f. Real Estate Business or Construction of farm houses
g. Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes

Sectors not open to private sector investment- atomic energy, railway operations (other than permitted activities mentioned under the Consolidated FDI policy) FDI, up to 100%, in the majority of the sectors / activities in terms of sector specific guidelines falling under the automatic route does not require any prior approval either by the government or the Reserve Bank of India.

However, in few sectors, which are under the automatic route, foreign investment cannot exceed specified limits such as Infrastructure, Commodity Exchanges, and Petroleum etc.

Sectors under Government Route

Under the Government Route, prior to investment, approval from the Government of India is required. Proposals for foreign direct investment under Government route, are considered by respective Administrative Ministry/Department.

Choice of Legal Form:

As an Incorporated Entity:

Type of entity	Meaning / Structure	Governing Act	Minimum members required	Special Features
Limited Liability Partnership (LLP)	Limited Liability Partnership (LLP) is a corporate structure that combines the flexibility of a partnership and the advantages of limited liability at a low compliance cost.	Limited Liability Partnership Act, 2008.	Minimum 2 partners required. Out of which at least 1 should be resident in India.	A LLP is an incorporated entity separate from its partners, which has perpetual succession. Any individual or Body corporate can be a partner in LLP. The liability of the partners is limited.
One Person Company (OPC)	One Person company means an entity incorporated as a company with a single person as its member.	Companies Act, 2013.	An OPC shall have only 1 member. Such member is required to be an Individual and resident in India.	There is no such limit on authorized share capital or the paid up share capital for incorporation of an OPC. The OPC has a perpetual succession, where the nominee shall become the member of the company after the retirement of original member. It is a form of Private Company and all the provisions of the private company shall apply to OPC unless otherwise provided.
Private Limited Company	A Private company is incorporated by a closed group of persons and the stocks of such a company are not traded publicly. It is managed by its Board of Directors who are appointed by the members to carry on the day-to-day business activities. The liability of the members is limited by Shares or by the amount of Guarantee.	Companies Act, 2013.	A minimum of 2 members are required to incorporate a private company. Also, a minimum of 2 directors are required for carrying out the business operations.	There is no such limit on the authorized share capital or paid up share capital for incorporation of a private company. It cannot issue a prospectus in the open market nor can it make or accept deposits from the public. The maximum number of members is limited to two hundred.

Public Limited Company	A public company is an incorporated entity the paid up share capital of which is subscribed by Public at large.	Companies Act, 2013.	A minimum of 7 Members are required to incorporate a public company. Also, a minimum of 3 directors are required for carrying out the business operations.	There is no such limit on the authorized share capital or paid up share capital for incorporation of a public company. The shares of the public company can be traded among the public without any restriction. There is no limit imposed on the maximum number of members of the public company.

As an Unincorporated Entity:

Type of entity	Meaning / Structure	Governing Act	Minimum members required	Special Features
Sole Proprietorship	The Sole proprietorship is the simplest form of carrying on a business activity. Here the proprietor is the single man managing the entire show on his own name or on some trade name.	No specific act.	As the name suggests, only a single person is required to carry on the business activities.	There is no statutory limit on minimum capital requirement to commence the business operations. The proprietor requires to obtain a trade license specifying the nature of activities intended to be carried on. The business is not a separate entity from its owner, the sole proprietor shall be personally liable for the business liabilities as well.
General Partnership	A union of two or more persons having a common business objective and working in co-ordination with each other and sharing the results of the business operations is called as partnership.	The Indian Partnership Act, 1932.	A minimum of 2 persons are required to form a partnership.	The partners need to execute a partnership deed specifying the rights and obligations of all the partners. A partnership firm can have a maximum of 20 partners. However, the number is restricted to 10 partners, if the firm carries out banking business. Generally it is advisable to get the partnership deed registered, as if the firm is not registered, it is deprived of certain legal benefits. The liability of all the partners is joint and several.

Branch Office for Foreign Companies	The entities incorporated outside India can establish their physical presence in India through establishment of a Branch Office.	Reserve Bank of India Act, 1934. Companies Act, 2013.	As it is just an extension of already incorporated business, there is no requirement of minimum members.	The branch office needs to obtain Branch License from RBI and it is required to follow all the instructions and conditions set by RBI while granting such license. The branch office is required to submit an Annual Activity certificate to the RBI. There are restrictions imposed by RBI on certain activities, which the branch office is not allowed to carry on. The company shall have a profit track record during the immediately preceding five financial years and the net worth of not less than USD 0.1 million.
Liaison Office	Liaison office is a place of business to act as a channel of communication between the principal place of business and the entities in India.	Reserve Bank of India Act, 1934.	As it is just an extension of already incorporated business, there is no requirement of minimum members.	The Liaison office needs to obtain License from RBI. The Liaison office is not allowed to undertake any commercial activity in India. The expenses of the liaison office shall be incurred only through the inward remittances of foreign exchange received from the head office outside India. The entity shall have a profit track record during the immediately preceding three financial years and the net worth of not less than USD 50,000.

Audit Requirements:

There Audit requirements in India can generally be classified into two board categories:

Audits Mandated by Law:

Company Audit

Every company incorporated in India is mandated by the Companies Act, 2013 to get its financial statements audited by an independent Chartered Accountant or a firm of independent Chartered Accountants. The main objective of conducting this audit is to ensure that the company draws its financial statements in accordance with the applicable Financial reporting Framework and all the matters necessary to be disclosed to the stakeholders are adequately disclosed.

Income Tax Audit

Under the Income tax Act, 1961, a person carrying on business, is compulsorily required to get its accounts audited if his total sales, turnover or gross receipts (as the case may be) exceeds INR Ten million for the year. This limit is increased to INR Fifty million if the payments and receipts in cash do not exceed 5% of the total payments and receipts respectively.

Further, every person carrying on profession shall, if his gross receipts in profession for the year exceeds INR Five million be liable to get the tax audit conducted.

The tax audit can be carried out by an independent Chartered Accountant.

GST Audit

Every registered person whose turnover during a financial year exceeds INR Twenty million shall get his accounts audited by a Chartered Accountant or a Cost Accountant.

Internal Audit

The Companies Act, 2013 has mandated every listed company (unconditional); an unlisted public company having paid up share capital of INR Five Hundred million or more or Outstanding deposits of INR Two Hundred and fifty million or more or turnover of INR Two billion or more or outstanding loans or borrowings exceeding INR One billion to get the internal audit conducted to ensure the adequacy and operating effectiveness of the internal controls established within the organization.

Cost Audit

The Companies Act, 2013 has mandated certain classes of companies engaged in manufacturing of certain types of articles to get their cost accounts audited by a Cost Auditor.

Secretarial Audit

The Companies Act, 2013 has mandated every listed company and an unlisted public company having paid up share capital of INR Five Hundred million or more or turnover of INR Two billion or more or outstanding loans or borrowings of INR One billion or more to get the secretarial audit conducted to ensure the compliance with legal and procedural matters.

Voluntary Audits:

The entrepreneur always has the option to get the various kinds of audits conducted voluntarily even if they are not mandated by the law. The entrepreneur may choose the periodicity of these voluntary audits and determine the scope in consultation with the professionals.

Employment laws and Statutory Payments:

India is a member of the International Labour Organisation and complies with the convention it has ratified. In India the labour and employment laws are listed under the concurrent list in the constitution, which means that the Union Parliament and the State Legislature have co-equal powers to enact the laws relating to all labour and employment matters in India.

India has a large pool of all types of labour as well as an adequate supply of office staff for both management/supervisory and clerical posts. Skilled manpower and professional managers are available at a comparatively moderate cost. India is particularly rich in IT professionals. Both Indian and multinational recruitment agencies exist in the market.

Keeping in view the huge labour force in the country, all the labour and employment laws generally distinguish between the employees treated as workmen (unskilled / shop-floor employees) and non-workmen (Management / Supervisory level employees), where the emphasis is given on protection of the rights of the workmen.

The major labour laws applicable to employers and employees in India have been outlined below:

Payment of Bonus Act, 1965

This act provides for the payment of bonus at a minimum rate of 8.33% to the employees drawing a salary of up to INR 21,000/- per month.

The Payment of Gratuity Act, 1972

This act provides for the payment of gratuity to all the employees at the time of their retirement / termination of services who have served the organization for a continuous period of 5 years or more. The amount of gratuity to be paid is to be calculated by multiplying the last drawn half month salary to the years of service rendered.

Employees Provident Fund and Miscellaneous Provisions Act 1952

This act aims at encouraging the habit of savings among the employees by mandating the deposit of a fixed percentage (i.e. 12%) of salary to the Provident Fund, also the employer is required to make an additional contribution of 12% of employees' salary (capped at INR 1,800 per month) to the employees' provident fund.

Employees State Insurance Act 1948

This act aims at providing the financial assistance to employees in case of sickness, maternity or injury suffered during the time of employment. For this purpose, the act has mandated the deposit of 0.75% of the salary from employee's account and 3.25% of the salary from the employer's account to the Employees' State Insurance Fund for the employees' drawing a salary of up to INR 21,000/- per month.

Minimum Wages Act, 1948

The minimum wages for each cadre of employees employed in different industries is notified by the government once in every six months based on the consumer price index rates. The Employer is required to the wages equal to or more than the notified minimum wages.

The Payment of Wages Act, 1936

This act regulates the period of wage payment and specifies the time limits and mode for payment of wages to the employees.

The Maternity Benefit Act, 1961

It provides for 26 weeks wages during maternity as well as paid leave in certain other related contingencies.

Sexual Harassment Of Women at Workplace (Prevention, Prohibition & Redressal) Act, 2013

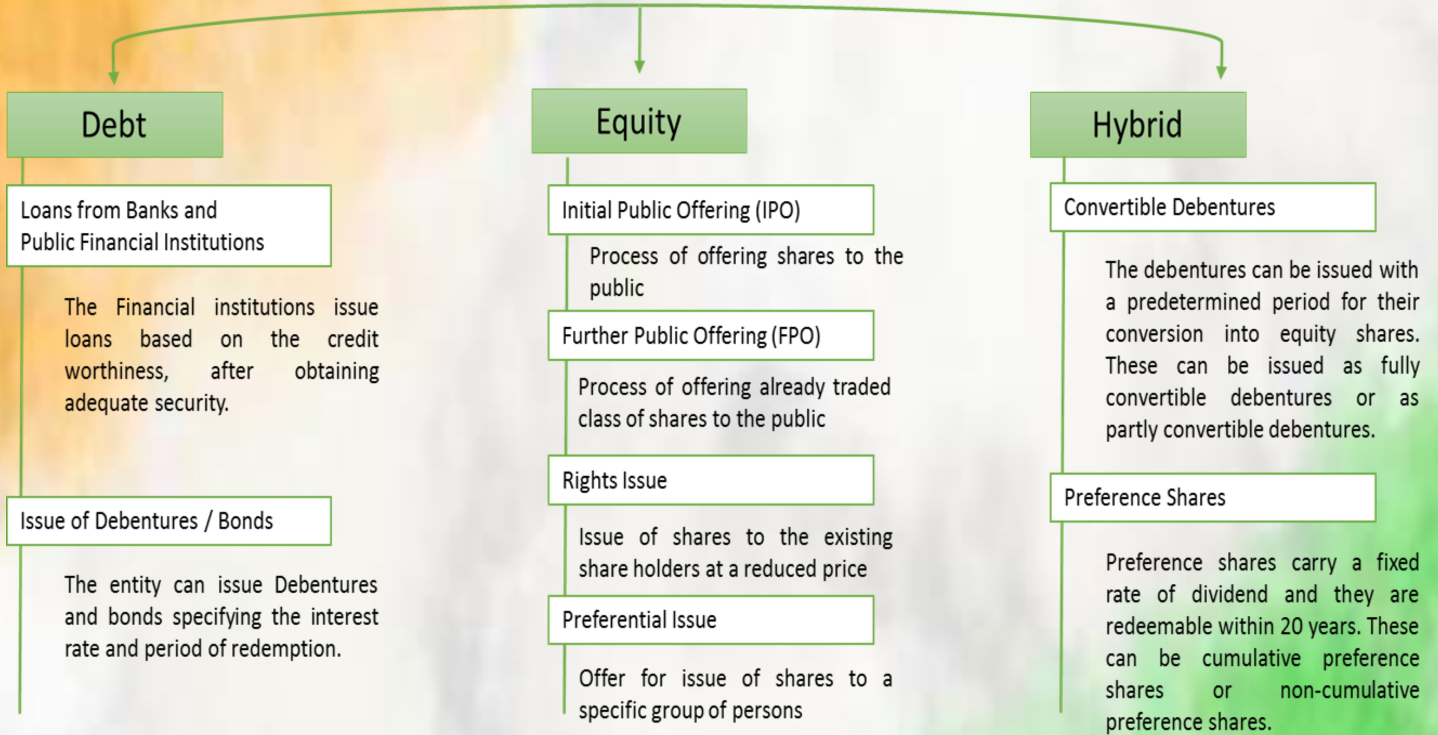
The entity needs to constitute an Internal Complaints Committee and the members of such committee shall meet at appropriate intervals to ensure that the complaints if any are addressed adequately and the required awareness is being spread among the employees.

Corporate Social Responsibility:

As per the provisions of Companies Act, 2013; every company having net worth of INR Five billion or more, or turnover of INR Ten billion or more, or net profit of INR Fifty million or more during any financial year shall constitute a corporate social responsibility committee and spend at least 2% of the average net profit of the three immediately preceding previous years towards carrying out social activities.

The CSR ambit is getting bigger and for upcoming years it would turn as a unique knowledge base for analyzing and achieving sustainability goals as among various large economies India is a country which has assured by mandating CSR through its legislative action.

Means of raising funds in India:



Taxation

Direct Tax

Income Tax

Income Tax is levied under the Income tax Act, 1961 which is administered by Central Government. It applies to all individual, companies, firms, Limited Liability Partnerships association of persons and other artificial juridical persons. A tax year (referred to as 'Financial Year' or 'Previous Year) runs from 1st April to 31st March in India

Residential Status

Taxability of an income in India depends upon residential status of various taxable persons, is determined as provided in the table below.

Category	Condition for qualifying as a 'Resident'
Individuals	Present in India for **182 days or more** in a tax year, or Present for 60 days* or more in a tax year and for 365 days or more in past 4 tax years immediately preceding the relevant tax year
Companies	Companies incorporated in India, or Foreign Cos. having 'place of effective management' in India
Firm / LLP / Others	Control **and management** of its affairs is situated (wholly or partially) in India

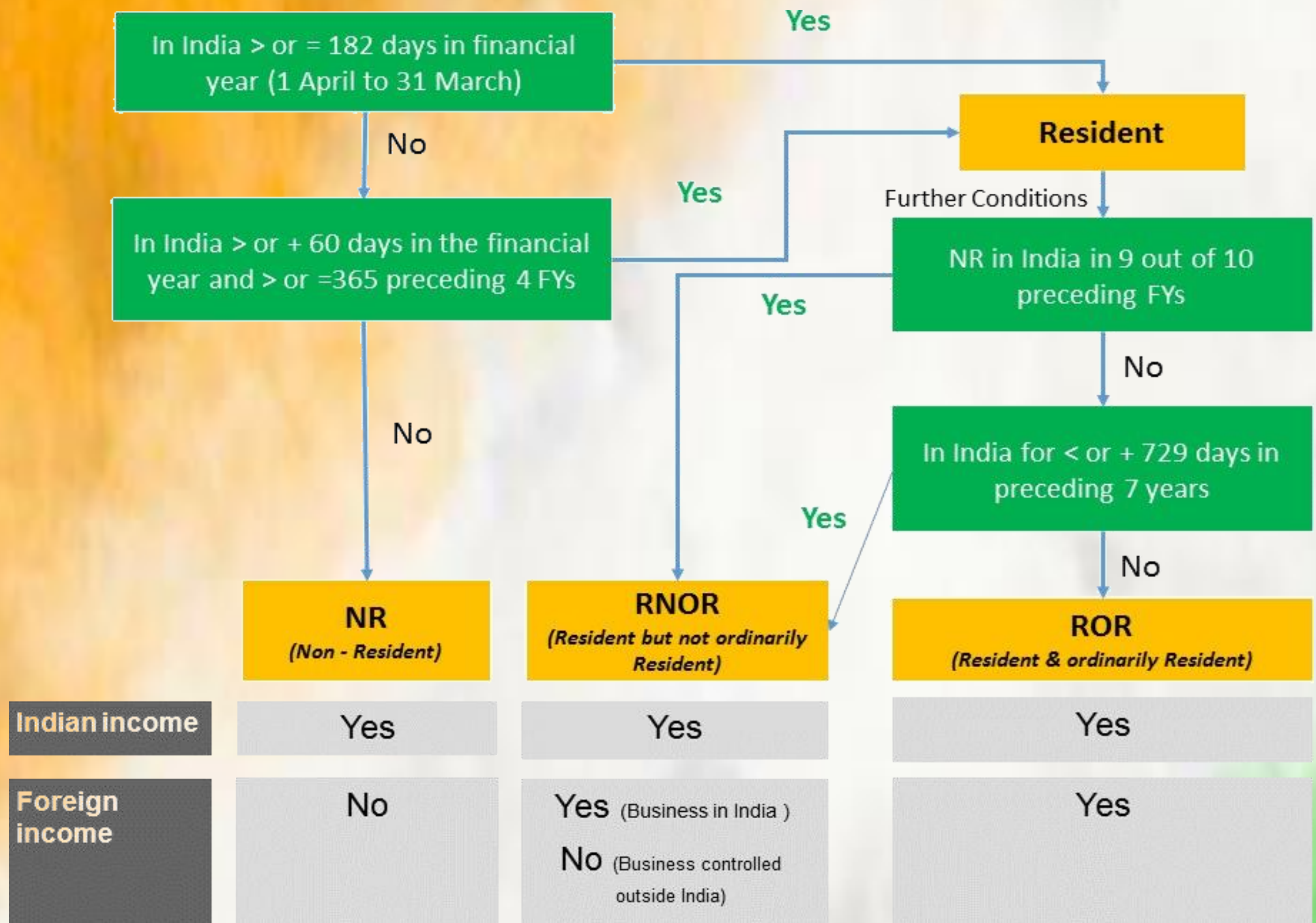
Resident but not ordinarily resident (NOR): A resident individual who does satisfies either of the following conditions, qualifies as a Resident but not ordinarily resident ('NOR'):

a. If he was a NR in India, in 7 out of 10 immediately preceding tax years, or
b. If he was present in India for a 729 days or less, in 7 immediately preceding tax years
c. If he was present in India for a period of 120 days or more but less than 182 days and having total income other than foreign income of more than INR 1.5 million

The duration of 60 days shall be replaced by 182 days in following two cases:

a. Where an Indian citizen leaves India in any previous year as a member of the crew of an Indian ship or for the purposes of employment outside India;
b. Where an Indian citizen or a person of Indian origin, who being outside India, comes on a visit to India in any previous year.

Place of Effective Management - It means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.



Heads of Income

Income from Salaries

Resident employees are taxed on salary income, regardless of where it was earned. In general, most elements of compensation are taxable in India. Bonus paid at the commencement or completion of employment is included in taxable salary income. Specified allowances are either tax exempt or included in the taxable income at a lower value, subject to certain conditions

Income from House Property

Any income arising out of letting of house property by way of rent shall be liable to tax. Such income will be added to the gross income when computing the tax liability. Any interest paid on a loan can be claimed as a deduction provided certain conditions are met. Further, a statutory deduction equal to 30% of the annual value will be available.

Profits and Gains from Business or Profession

Business Income is taxed on a net basis i.e. receipts minus expenses, to be determined in accordance with the books of accounts maintained by the taxpayer.

Non-resident companies having a Permanent Establishment in India are under a mandatory requirement to maintain books of accounts and offer income for tax on a net basis.

Capital Gains

Gain arising on transfer of capital asset is charged to tax under the head Capital Gains. Income from capital gains is classified as Short Term Capital Gains and Long Term Capital Gains.

Short Term Capital Gains arising on transfer of equity shares or units of equity oriented mutual-funds or units of business trust, which are transferred on or after 1-10-2004 through a recognised stock exchange and such transaction is liable to securities transaction tax (STT), such gain is charged to tax at fifteen percent. Short Term Capital Gains arising out of transactions other than mentioned earlier is charged to tax at normal rate of tax which is determined on the basis of the total taxable income of the taxpayer. Long Term Capital Gain are taxed at twenty percent, after allowing the benefit of indexation. But in certain special cases, the gain may be charged to tax at ten percent.

Income from Other Sources

Income from other sources is a residual head of income. Any item of income Chargeable to tax but does not fall within the ambit of other four heads of income shall be included under this head.

Carry forward and set off of Losses

The Indian Income Tax Act gives detailed provisions for the carry forward and set off of losses under each head of income. Set off within the head is generally permitted with few restrictions, while inter-head set off has tighter constraints to be observed. A loss is generally permitted to be carried forward for a period of 4-8 years, depending upon the nature of head it pertains to.

Tax Rates

Taxation for Individuals

The tax rate for individuals is determined based on a progressive slab which currently stands as under:

Tax Rate	Income (INR)
Nil	Up to INR 250,000
5%	INR 250,001 - INR 500,000
20%	INR 500,001 - INR 1,000,000
30%	Above INR 1,000,000

Special Tax Rate-

The Finance Act, 2020, has provided an option to Individuals for payment of taxes at the following reduced rates from Assessment Year 2021-22 and onwards. The option to pay tax at lower rates shall be available only if the total income of assessee is computed without claiming specified exemptions or deductions.

Rate	Total Income (INR)
Nil	Up to 250,000
5%	From 250,001 to 500,000
10%	From 500,001 to 750,000
15%	From 750,001 to 1,000,000
20%	From 1,000,001 to 1,250,000
25%	From 1,250,001 to 1,500,000
30%	Above 1,500,000

Surcharge Rates –

Total Income(INR)	Surcharge Rates
5 million - 10 million	10%
10 million - 20 million	15%
20 million - 50 million	25%
50 million - 100 million and more	37%

Such surcharge is subject to applicable marginal relief. Additionally, a Health and Education Cess is levied at the rate of 4% on the amount of income-tax plus surcharge.

The first INR 300,000 is exempt for resident senior citizens (aged 60 or over, but under 80), and INR 500,000 is exempt for very senior citizens (at least 80 years of age); for all others, the first INR 250,000 is exempt. A tax rebate up to INR 12,500 is allowed for individuals with taxable income of up to INR 500,000.

Taxation for partnership firms and LLPs

Both partnership firms and LLPs are taxed alike, at a flat rate of 30% on net business income, i.e. total receipts less expenditure. An additional surcharge of 12% of tax shall be applicable where the income exceeds 10 million INR, subject to marginal relief. A Health and Education

Cess is levied at the rate of 4% on the amount of income-tax plus surcharge.

Interest and remuneration paid to partners are tax deductible expenses, if paid within the prescribed range. Any amount paid over the prescribed range is disallowed and taxed in the hands of Firm/ LLP at 30%.

Share in profit/loss is tax exempt in the hands of partners. Remuneration/interest to the extent allowed as tax deductible expense to the Firm/LLP is taxed in the hands of the individual partners, as per slab rate system.

Corporation Taxation

Domestic Company

The currently applicable tax rates (exclusive of surcharge and cesses) are as follows:

Particulars	FY 2020-21
Turnover in FY 2017-18 ≤ INR 4000million	25%
Any other domestic company	30%

The amount of income-tax shall be increased by a surcharge at the rate of 7% of such tax, where total income exceeds INR ten million but not exceeding INR hundred million and at the rate of 12% of such tax, where total income exceeds INR hundred million, subject to marginal relief.

Special Tax Rate –

Particulars	FY 2020-2021
Where it opted for section 115BA - Wherein any domestic manufacturing company should not avail any deductions as specified or claim set-off of any loss.	25%
Where it opted for Section 115BAA – Wherein domestic company should not avail any deductions as specified or claim set-off of any loss.	22%
Where it opted for Section 115BAB – Wherein a domestic manufacturing company has been set up on or after 1st October, 2019 and commences manufacturing on or before 31st March, 2023; satisfies the conditions as prescribed without claiming tax exemptions and incentives.	15%

The rate of surcharge in case of a company opting for taxability under Section 115BAA or Section 115BAB shall be flat 10% irrespective of amount of total income.

A minimum alternate tax is payable at the rate of 15% (plus applicable surcharge and cess) on the adjusted book profits of corporations whose tax liability is less than 15% of their book profits. Such tax can be carried forward for 15 years. The domestic company who has opted for special taxation regime under Section 115BAA & 115BAB is exempted from provision of MAT.

Foreign Company:

The currently applicable tax rate for foreign companies stands at 40%. The amount of income-tax shall be increased by a surcharge at the rate of 2% of such tax, where total income exceeds INR ten million but not exceeding INR hundred million and at the rate of 5% of such tax, where total income exceeds INR hundred million. However, the surcharge shall be subject to marginal relief.

A Health and Education Cess will levied at the rate of 4% on the amount of income-tax plus surcharge on all companies.

Taxability of Expatriates

Remuneration received by foreign expatriates working in India generally is assessable under the head “salaries” and is deemed to be earned in India. Irrespective of the residence status of an expatriate employee, the salary paid for services rendered in India is liable to tax in India.

An international worker is required to contribute 12% of his/her salary to the social security system. Employers are required to deduct the social security contribution from the employee’s monthly pay and, after making a matching contribution of 12%, to deposit the sum with the Indian social security authorities / fund.

Exemption

To exempt international workers from the requirement of contributing towards Indian social security funds, India has entered into Social Security Agreements (SSA) and Bilateral Comprehensive Economic Agreements (BCEA) with various countries. As a result, inbound assignees from countries with which India has entered into a SSA, and holding Certificate of Coverage (COC) issued by their home country, can claim exemption from Indian social security contributions.

Withdrawal Benefits

An international worker can withdraw their accumulated balance in the provident fund in the following circumstances:

a. Retirement from service in the establishment or after attaining 58 years of age, whichever is later.
b. Retirement on account of permanent and total incapacity to work due to bodily or mental infirmity as certified by a prescribed medical officer/ registered practitioner,
c. When suffering from certain diseases detailed in the terms of the scheme

Any lump sum withdrawn by international workers from their provident fund account on retirement or otherwise, after completing five years of continuous service in a covered establishment in India or under other specified circumstances, is exempt from tax.

Taxability of Dividends

W.e.f from FY 2020-21, the domestic company isn't required to pay Dividend Distribution Tax on any amount declared, distributed or paid by such company by way of dividend. Dividend received from domestic company is taxable in the hands of the shareholders.

Equalisation levy

In line with OECD's BEPS project Action Plan 1 (Digital Economy), India had introduced an Equalization Levy of 6% which is applicable on payment made by a resident carrying on business or profession or the Indian PE of a non-resident to a non-resident providing specified services such as online advertisement etc, and an Equalization Levy of 2% is charged on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply of services made or provided or facilitated by resident, non-resident in the specified circumstances, or by a person who buys such goods or services or both using internet protocol address located in India.

Withholding Taxes

There is an obligation on the payer both resident as well as non-resident, to withhold tax when certain specified income/payments are credited and/or paid. Any person making a payment to any non-resident shall be liable to deduct tax for -

a. Interest paid to a Non-Resident on a foreign currency borrowing or a debt is generally subject to 20% withholding tax plus the applicable surcharge and cess. However, the rate may be reduced under a tax treaty. In absence of a tax registration number, the applicable tax treaty rate or 20% (whichever is higher) shall be applicable.
b. Royalty/Fees for Technical Services paid to a Non-Resident are subject to a basic gross withholding tax rate of 10%, plus the applicable surcharge and cess. The rate may be reduced under a tax treaty.
c. Dividend income, in the hands of a non-resident person (including FPIs and nonresident Indian citizens (NRIs)), is taxable at the rate of 20% without providing for deduction under any provisions of the Income-tax Act. However, where the dividend is received in respect of GDRs of an Indian Company or Public Sector Company.

   (PSU) purchased in foreign currency, the tax shall be charged at the rate of 10% without providing for any deductions.

India has a comprehensive tax treaty network. India's treaties generally contain OECD-compliant exchange of information provisions. India has entered into associations for relief from double taxation of nonresident companies and to allow for the exchange of

information and for recovery of Income tax. Out of the Covered Transaction Agreements (CTAs) with 93 countries 22 countries have already ratified the MLI

Double Tax Avoidance Agreement

When a person who qualifies as a non-resident (under the ITA) is a tax resident of a country with which India has entered into a Double Taxation Avoidance Agreement (also known as a DTAA or a 'tax treaty'), and the terms of such DTAA are beneficial to him (in comparison to the ITA), he can opt to be governed by the same instead of the ITA. Relief is granted in respect of income chargeable to tax, both under the Income tax Act of India and the domestic tax laws in that other country.

India has entered into 93 such DTAAs so far, to promote mutual economic relations, trade and investment. Moreover, there is a constant endeavour to evolve these DTAAs keeping in view the changes in international tax and investment climate.

Advance Rulings

To facilitate full planning and to avoid any future disputes under the Income-tax Act, a resident or a non-resident can approach the Authority for Advance Rulings to determine the income tax aspects of any proposed or current transaction. Rulings pronounced by the AAR are binding on tax authorities. Therefore, a favorable ruling helps in achieving finality as regards Indian tax implications.

General anti avoidance rules (GAAR)

General Anti Avoidance Rule (GAAR), effective from 1st April 2017, is an anti-tax avoidance rule, framed by the Department of Revenue under the Ministry of Finance that has been introduced in the Income Tax Act to address aggressive tax planning and codify the doctrine of "Substance over Form".

Transfer Pricing

Comprehensive transfer pricing regulations (TRPs) have been introduced effective from April 1, 2001 with the objective of preventing MNCs from manipulating prices in intra group transactions such that the profits are not shifted outside India.

Under TPRs, International transactions between two or more associated enterprises (Including Permanent establishment) must be at arm's length prices (ALP). These regulations also apply to cost-sharing arrangements. Stringent penalties have been prescribed for non-compliance with the procedural requirements and for understatements of profits.

The transfer pricing provisions generally follow the relevant Organisation for Economic Co-operation and Development (OECD) guidelines. However, there are certain fundamental differences. Effective from April 1, 2012, TPR's have also been extended to certain specified domestic intra-group transactions.

Most systems allow use of transfer pricing multiple methods, where such methods are appropriate and are supported by reliable data, to test related party prices.

"Most appropriate method" can be defined as a method:

a. Which is best suited to facts and circumstances of Transactions.
b. Which is most reliable measure of an arm's length price. Among the commonly used methods are:
    1. Comparable uncontrolled prices
    2. Cost plus
    3. Resale price or mark up
    4. Profitability based methods.

Advance Pricing Agreement

In order to achieve long term finality on TP matters, taxpayers may enter into Advance Pricing Agreements (APAs) with tax authorities. These agreements may be unilateral or bilateral. APAs provide certainty for up to 9 years i.e. upcoming 5 future years and past 4 years. Till now India had officially signed more than 300 APAs.

Thin Capitalisation

The BEPS Action Plan 4 recommends alternate approaches for countries to limit tax base erosion through interest deductions and other financial payments. Provisions have been introduced in the

Income-tax Act that seek to limit the interest deduction of Indian companies or PEs of foreign companies in India. Taxpayers engaged in banking or insurance business are specifically excluded.

The provision will apply to interest or similar expenses paid (including those paid on existing debt) to (i) overseas associated enterprises or (ii) third-party lenders for whom the underlying debt is backed by an implicit or explicit guarantee or equivalent deposit from overseas associated enterprises.

Any interest paid for the year under consideration in excess of 30% of the EBITDA of the taxpayer will be treated as excess interest. Excess interest disallowed in a year will be eligible for carry forward up to eight consecutive years, subject to the above limits. The provision will, however, not apply to interest paid or payable up to INR 10 million.

Country-by-country reporting, master file, and local file

The Income Tax Act provides a specific regime with respect to Country-by-Country Reporting (CbCR), the Master File, and the Local File in line with OECD's final report on Base Erosion Profit Shifting (BEPS) Action Plan 13. The reporting provisions apply for the 2016-17 fiscal year if consolidated revenue of an international group in the prior year (that is, the 2015-16 fiscal year) exceeds the prescribed limit.

Secondary Adjustment

The secondary adjustment is an adjustment in the books of account of the taxpayer and its associated enterprise to reflect that the actual allocation of profits between the Indian taxpayer and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment. This is intended to remove the imbalance between the cash account and actual profit of the Indian taxpayer. The secondary adjustment is required only where a primary adjustment to the transfer price occurs in one of the following circumstances:

a. Where adjustment has been made on one's own by the taxpayer in one's income tax return.
b. Adjustment made by the Assessing Officer has been accepted by the taxpayer.
c. Arising due to the APA signed.
d. Application of Safe Harbour Rules.
e. Settlement arrived at under the MAP route.

However, secondary adjustments shall not be carried out by the taxpayer if the amount of the primary adjustment made in the case of a taxpayer does not exceed INR 10 million.

Notified jurisdictional area

The Income Tax Act contains a "tool box" to deal with transactions with entities located in non-cooperative countries or jurisdictions that do not exchange information with India. The government of India is empowered to notify such jurisdiction as a Notified Jurisdiction Area (NJA). The government discourages transactions by taxpayers in India with persons located in an NJA by providing onerous tax consequences on such transactions.

Tax Compliances

Every taxpayer is required to undertake certain compliances, such as:

a. Annual filing of:
   1. Return of income
   2. Report of audit under the ITA (if applicable)
b. Transfer Pricing certificate (if applicable)
c. Monthly deposition of withholding taxes
d. Quarterly filing of withholding tax return
e. Quarterly deposition of advance tax

Tax Incentives and deduction

Concessional Tax Rate

Concessional Rate of 15% is offered to newly incorporated domestic companies in the manufacturing sector which start manufacturing by 31st March 2023 and is extended to companies engaged in generation of electricity.

Immovable Property

Under the current regime, for computing the income arising from transfer of land or building or both under the

head business or profession, capital gains and income from other sources, the consideration for such transfer is deemed to be the value adopted for stamp duty purposes, if the sale consideration is less than the stamp duty valuation. The deeming provisions to substitute actual consideration with stamp duty valuation are not applicable, if the difference between actual sale consideration and stamp duty valuation does not exceed a safe harbor of 5 percent. It is now proposed to expand the harbor of 5 percent to 10 percent.

Non Filing of Return

A NR is exempted from the requirement to file a return of income in India if its total income consists only of specified interest or dividend income and appropriate taxes have been withheld at source on such income.

Tax Deducted at Source

Further, a concessional withholding tax rate of 4 percent will apply to borrowings from a source outside India by way of long-term bonds or rupee denominated bonds on or after 1 April 2020 until 30 June 2023 that are listed on a recognized stock exchange in any IFSC.

The withholding tax rate applicable to fees for technical services payable to residents is to be reduced from 10 percent to 2 percent (excluding fees for professional services)

Investment linked incentive for research and development -

Investment-linked tax incentives are provided by allowing deductions on any expenditure of capital nature incurred wholly and exclusively for the purposes of certain specified business transactions. 100% deduction shall be allowed with respect to following –

a. Revenue expenditure incurred on payment of salary to an employee engaged in scientific research for 3 years preceding the commencement of business.
b. Payment to a research association/university, college or other institution for scientific research
c. Expenditure on scientific research by companies engaged in the business of manufacture or production as prescribed incurred in the previous year (other than expenditure in the nature of cost of any land and building).

Indirect Tax

Customs Duty

Customs duty, a federal government levy is, leviable on import/ export of goods to/from India. The taxable event for levy is import/export and import/export duty is payable at the time of import/export of goods to/from India. India follows the Harmonised System of Nomenclature (HSN) classification rules, and the goods are classified under different chapter/ tariff headings, primarily according to their description, components and use. The duties or taxes applicable on import shall comprise:

a. Basic customs duty – BCD (standard rate of 10 per cent)
b. Customs cess (leviable on component of BCD at 3 per cent)
c. IGST at 18 per cent (leviable on total value of BCD plus customs cess)

GST

Due to the federal tax structure in India, power to tax rests with the Centre as well as States and hence there exist several indirect tax laws that apply to goods and services, such as Central Sales Tax, Service Tax, Purchase Tax, etc.

GST is to be levied on supply of all goods and services except the supply of alcohol for human consumption. Levy of GST on petroleum crude, high-speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel has been postponed and to be notified by the government at a later date.

Dual Structure Levy

GST is a dual structure wherein both centre and states/UTs have the power to levy the tax on supplies on goods and services. The dual levy structure will be as under:

a. Central Goods and Services Tax (CGST) to be levied by the centre and State Goods and Services Tax (SGST)/Union Territory Goods and

Services Tax (UTGST) to be levied by respective states/union territories on all supplies within a state/union territory;

b. Integrated Goods and Services Tax (IGST) to be levied by centre on all supplies between the two different states/union territories. Further, IGST is also to be levied on export/import of goods or services from/to India.
c. Compensation Cess (Cess) to be levied on specified supplies for the purpose to compensate the states for the loss of revenue on account of implementation of GST.

Nature of Supply

Levy of CGST and SGST/UTGST or IGST will depend upon the nature of supply. Separate provisions for goods and services have been incorporated under GST law to identify the nature of supply. Location of supplier and the place of supply of goods or services are the two factors to determine the nature of supply.

a. Intra-state supply: Location of supplier and place of supply of goods or services are within the same state/union territory.
b. Inter-state supply: Location of supplier and place of supply of goods or services are with different states/union territory.

Input Tax Credit

Any registered taxable person can claim credit of input tax paid provided they satisfy certain conditions. Credit of input tax paid on Non-taxable supplies, Exempt Supplies and Nil rated supplies shall not be available. Any unutilised credit available under the previous regime can be carried forward and be utilised for paying taxes on output supplies under GST.

Trade and Logistics:

An efficient and reliable logistics network coupled with a transparent and consistent cross border trade facilitation process is a key driver of export competitiveness in the country. It acts as an enabler for expanding the foreign markets for indigenous goods. An efficient logistics ecosystem will also encourage investments in the country, especially FDI and will in turn positively impact international trade

Different parts of the logistics value chain currently are being managed by many ministries including Road Transport and Highways, Shipping, Railways, Civil Aviation, D/o Posts, Commerce and Industry, Finance and Home Affairs. In addition, a large number of government agencies including Central Drug Standard Control Organization, Food Safety and Standards Authority of India, Plant and Animal Quarantine Certification Service provide relevant trade clearances and impact the value chain.

There is significant potential for India to integrate and optimize the various elements of its logistics value chain, to ensure seamless, multi modal growth of an efficient logistics sector. Advancements in digital technologies, changing consumer preferences due to e-Commerce, government reforms, and shift in service sourcing strategies are expected to lead the transformation of the Indian logistics ecosystem. The logistics market in India is forecasted to grow at a CAGR of 10.5% between 2019 and 2025. It has been awarded infrastructure status which has made it easier for investment inflows and has become a major growth driver of the logistics industry.

Increasing investments and trade points toward a healthy outlook for the Indian freight sector. Port capacity is expected to grow at a CAGR of 5% to 6% by 2022, thereby, adding a capacity of 275 to 325 MT. Indian Railways aims to increase its freight traffic from 1.1 billion tons in 2017 to 3.3 billion tons in 2030. Freight traffic on airports in India has the potential to reach 17 million tones by FY-2040.

Process of Winding Up:

Voluntary winding up of a company

If the Articles of Association (AOA) provide for the winding up of the company on occurrence of any event or if the members of the company suo-moto choose to wind up the company, then this procedure for the company is said to have been voluntarily wound up.

Fast Track Exit Scheme (FTE)

This kind of winding up is for striking off the name of defunct companies from the register of companies. A defunct company is that which does not have any assets or liabilities and which has not carried out any business activity for at least one year.

Compulsory Winding up of the company

The Tribunal passes an order for compulsory winding up of the company in the following situations:

a. The company is unable to pay off its debts.
b. The company or its management has been found guilty of any unlawful act.
c. Fraudulent act or misconduct committed by the company or the management.
d. Default in filling annual returns or financial statements with the ROC for a period of five consecutive years.
e. Tribunal is of the view that the company should be wound up.

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Sign off and Disclaimer:

This document is provided by Ragunathan Kannan, K Vijayaraghavan & Associates LLP as a general overview of matters to be considered when setting up an overseas business in India. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided in this publication.

If you are setting up a business in India, the members of DFK International can help you to achieve this efficiently. You will receive practical advice on business issues, tailored to meet your objectives, from experienced business advisers. For further information on the services available from the DFK member firms in India please contact:

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