Doing Business in India

With Special Reference to Tax Treaties between India and

Canada
Germany
Japan
Mauritius
Netherlands
Singapore
Switzerland
UK
USA

April 2016
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We have been adjudged the winner of the Indian Law Firm of the Year 2010 for TMT by IFLR. We have won the prestigious “Asian Council’s Socially Responsible Deals of the Year 2009” by Pacific Business Press.

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Our research oriented approach has also led to the team members being recognized and felicitated for thought leadership. NDAites have won the global competition for dissertations at the International Bar Association for 5 years. Nishith Desai, Founder of Nishith Desai Associates, has been voted 'External Counsel of the Year 2009' by Asian Counsel and Pacific Business Press and the 'Most in Demand Practitioners' by Chambers Asia 2009. He has also been ranked No. 28 in a global Top 50 “Gold List” by Tax Business, a UK-based journal for the international tax community. He is listed in the Lex Witness ‘Hall of fame: Top 50’ individuals who have helped shape the legal landscape of modern India. He is also the recipient of Prof. Yunus 'Social Business Pioneer of India' – 2010 award.

We believe strongly in constant knowledge expansion and have developed dynamic Knowledge Management ('KM') and Continuing Education ('CE') programs, conducted both in-house and for select invitees. KM and CE programs cover key events, global and national trends as they unfold and examine case studies, debate and analyze emerging legal, regulatory and tax issues, serving as an effective forum for cross pollination of ideas.

Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has now been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).

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1. Introduction

India is the seventh largest country by area and the second-most populous country in the world. It has a large and growing middle-class with an increasing rate of domestic consumption that makes it an important market.

Additionally, it has strong fundamentals like a stable Westminster-style parliamentary democracy, cost-competitiveness and abundant supply of well-qualified and well-trained human resources across functional areas that make it a preferred destination for investment, both as a source of manufacturing, and delivery of services and also as a market for the consumption of the goods and services generated as a consequence of such investment.

Today, economy of India is the seventh largest in the world by nominal Gross Domestic Product ("GDP") and third largest by purchasing power parity and the annual growth rate of GDP has been 7.3% from 2011 to 2015. The country is classified as a newly industrialised country, one of the G-20 major economies, a member of BRICS and a developing economy with an average growth rate of approximately 7% over the last 2 decades. One of the significant consequences of this growth has been the transformation of a primarily agrarian economy into service and industry oriented economy. These changes have also led to India emerging as a global center for information technology and information technology enabled services like business process outsourcing. Manufacturing cost competitiveness has contributed to India becoming attractive destination for outsourcing industrial production, particularly for specialty manufacturing.

Recent global developments have demonstrated that India’s strong fundamentals and robust domestic consumption levels make it a resilient economy that can withstand global economic slowdown and declining consumption levels.

Further, it is expected that as India continues to grow, its need for development of its physical and human infrastructure will correspondingly increase. As per the White Paper on Infrastructure Financing brought out by CRISIL Ratings and ASSOCHAM India in December, 2015, it is estimated that India would need INR 31 lakh crores investment in infrastructure sector during 2015-20, of which 70% will be required in the power, roads and urban infrastructure sectors.

The big political change in India witnessed Mr. Narendra Modi led Bharatiya Janata Party ("BJP") taking the mantle of governance with landslide victory. The Modi government message of stability and predictability has helped in restoring investor confidence in the economy and providing a boost to economic growth. BJP had promised to formulate and maintain a business friendly regulatory environment in the country and since May 2014, the government has taken several strong measures to revive both growth cycle and investor sentiment. In the initial round of its major policy initiatives, the Modi government allowed the foreign direct investment

1. Source: https://en.wikipedia.org/wiki/Economy_of_India (last accessed on April 14, 2016)
2. Source: http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG (last accessed on April 14, 2016)
5. CRISIL (formerly Credit Rating Information Services of India Limited) is a global analytical company providing ratings, research and risk and policy advisory services.
Provided upon request only

FDI in railways and defence sectors, followed by labour reforms, complete deregulation of diesel prices and easing of FDI rules in construction. The Union Budget of 2015-16 ("Budget 2015") was the first full budget presented by the Modi government and passed as the Finance Act, 2015. It affirmed on the government’s promise to ease doing business in India and took steps to bring the requisite changes needed to propel India towards double digit growth. Recently, the Modi led government has announced the Union Budget 2016-17 ("Budget 2016") which continues in the path of the Budget 2015 by further liberalizing FDI caps, facilitating early resolution of disputes, and addressing the smaller complexities in Indian tax legislation which have been pain points for foreign investors.

Another big step for the business community has been the announcement of “Start-up India” initiative by the Government with the vision of creating a vibrant, innovative entrepreneurship ecosystem in India. As part of the initiative, flurry of reforms have been announced with the objective of ease of doing business in India by various ministries. All in all, there is little doubt that India is one of the world’s most attractive investment destinations and will continue to be so in the future.

This paper introduces the basic legal regime regarding the conduct of business in India and answers questions and issues commonly raised by overseas investors. It is intended to act as a broad legal guide to aid your decision making process when deciding to start and carry on operations in India. However, it should not be used as a legal opinion on any specific matter. The laws discussed here are subject to change and the regulatory environment in India is dynamic, therefore we would recommend that you please contact us if you would like to invest in India or expand your operations in India. We would be happy to assist you.

2. India’s Legal System

India has always been a land of mystery in many ways and the Indian legal system is no different. Understanding the Indian legal system is one of the keys to establishing a successful business relationship with India.

India follows the common law system and incorporates essential characteristics of common law jurisdictions, for instance courts follow previous decisions on the same legal issue and decisions of appellate court are binding on lower courts. As a result of adopting all these principles the Indian legal system is akin to the English legal system. However unlike England, India has a written constitution.

I. Nature of the Constitution of India

The Constitution of India (the “Constitution”) is quasi-federal in nature, or one that is federal in character but unitary in spirit. The Constitution possesses both federal and unitary features and can be both unitary and federal according to requirements of time and circumstances.

The federal features of the Constitution include distribution of powers between national (or federal) government and government of the various constituent states. There are two sets of governments, one at the central level and the other at state level and the distribution of powers between them is enshrined in the Union, State and Concurrent lists.

The Constitution also possesses strong unitary features such as the unified judiciary (while the federal principle envisages a dual system of courts, in India we have unified Judiciary with the Supreme Court at the apex), appointment of key positions (for e.g. governors of states, the Chief Election Commissioner, the Comptroller and Auditor General) by the national government etc.

II. Division of Legislative Powers between the Centre and States

The legislative powers are divided between the federal and state legislature. The Constitution identifies and allocates the “fields of legislation” between the federal and state legislatures through 3 distinct lists:

1. the Union List has 100 entries that are exclusively reserved for the federal parliament and includes subjects like, national defence, incorporation of companies, banking and the RBI etc.;

2. the State List has 61 entries that are exclusively reserved for various state legislatures and includes subjects like, agriculture, land and trade and commerce within the state’s territories; and

3. the Concurrent List contains 52 entries and includes subjects such as contracts, bankruptcy and insolvency, trust and trustees etc., on which both the federal and states legislature may legislate; however, in case of a conflict, the federal law shall prevail.

III. Delegated Legislation

In addition to the legislative powers conferred on the federal and state legislatures, the Constitution recognises ‘delegated legislation’ which includes the exercise of legislative power by a governmental agency that is subordinate to the legislature.

At times, a statute may be incomplete unless it is read with the concomitant delegated legislation. Hence it is important to consider the delegated legislation which includes rules and regulations and may at times vary between two states.
IV. Court System in India – Hierarchy of Courts

The Supreme Court of India is the highest appellate court and adjudicates appeals from the state High Courts. The High Courts for each of the states (or union territory) are the principal civil courts of original jurisdiction in the state (or union territory), and can try all offences including those punishable with death.

The High Courts adjudicate on appeals from lower courts and writ petitions in terms of Article 226 of the Constitution of India. There are 24 High Courts in India.

The courts at the district level administer justice at district level. These courts are under administrative and judicial control of the High Court of the relevant state. The highest court in each district is that of the District and Sessions Judge. This is the principal court of civil jurisdiction. This is also a court of Sessions and has the power to impose any sentence including capital punishment.

There are many other courts subordinate to the court of District and Sessions Judge. There is a three tier system of courts. On the civil side, at the lowest level is the court of Civil Judge (Junior Division). On criminal side the lowest court is that of the Judicial Magistrate Second Class. Civil Judge (Junior Division) decides civil cases of small pecuniary stake. Judicial Magistrates decide criminal cases which are punishable with imprisonment of up to 5 years.
3. Investment Into India

With the basic understanding of the Indian legal system, international companies or investors seeking to set up operations or make investments in India need to appraise and structure their activities on three pillars:

A. Strategy

- Observing the economic and political environment in India from the perspective of the investment;
- Understanding the ability of the investor to carry out operations in India, the location of its customers, the quality and location of its workforce.

B. Law

- Exchange Control Laws: Primarily the Foreign Exchange Management Act, 1999 ("FEMA") and circulars, notifications and press notes issued under the same;
- Corporate Laws: Primarily the Companies Act, 1956 and Companies Act, 2013 (collectively the "Companies Act") and the regulations laid down by the Securities and Exchanges Board of India ("SEBI") for listed companies in India;
- Sector Specific Laws: In addition to the above-mentioned general legislations, specific laws relating to Financial Services (banking, non-banking financial services), Infrastructure (highways, airports) and other sectors are also applicable.

C. Tax

- Domestic Taxation Laws: The Income Tax Act, 1961 ("ITA"); indirect tax laws including laws relating to value added tax, service tax, customs, excise etc.;
- International Tax Treaties: Treaties with favorable jurisdictions such as Mauritius, Singapore, the Netherlands etc.

I. Foreign Direct Investment

Setting up India operations or investing in India by non-residents requires conformity with India’s foreign exchange regulations, specifically, the regulations governing FDI. Most aspects of foreign currency transactions with India are governed by FEMA and the delegated legislations thereunder. Investments in, and acquisitions (complete and partial) of, Indian companies by foreign entities, are governed by the terms of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (the “FDI Regulations”) and the provisions of the Industrial Policy and Procedures issued by the Secretariat for Industrial Assistance ("SIA") in the Ministry of Commerce and Industry, Government of India.

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

A. Prohibited Sectors

There are some sectors where FDI is prohibited, including:

- Atomic Energy
- Lottery business
- Gambling and betting
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
B. Sectors under automatic route

Under the automatic route, for investments into an Indian company (carrying on business in the specified sectors that are identified as under ‘automatic route’) prior approval of India’s central bank, the RBI or the approval of the Central Government (through the Foreign Investment Promotion Board (“FIPB”)) is not required.

i. Sectors under automatic route with 100% FDI

FDI, up to 100%, is permitted in most sectors in India under the ‘automatic route’.

ii. Sectors under automatic route with thresholds

In few sectors, which are under the automatic route, foreign investment cannot exceed the specified limits. Sectors with such limits are:

- **Defence (49%)** – FDI under the automatic route into defence sector has been permitted up to 49%. For investment above 49% approval of Government will be required on a case to case basis if it is likely to result in access to modern and ‘state-of-art’ technology in the country. ¹²

- **Insurance (49%)** – FDI cap into the insurance sector has been increased to 49% under the automatic route subject to verification by Insurance Regulatory and Development Authority (“IRDA”). ¹³

- **Commodity Exchanges (49%)** – foreign investment into commodity exchanges – FDI + Foreign Institutional Investor (“FII”)/ Foreign Portfolio Investor (“FPI”) – is permitted up to 49% under the automatic route. Investment by registered FII/FPI under Portfolio Investment Scheme (“PIS”) will be limited to 23% and investment under FDI Scheme is limited to 26%.

C. Sectors under Government approval route

There are some sectors where FDI is allowed only with the approval of the Central Government. Some of them are:

- **Railways** – while 100% FDI is allowed in the railways infrastructure sector under the automatic route, proposals involving FDI beyond 49% in sensitive areas require to be brought before the CCS for consideration by the Ministry of Railways (“MoR”) from a security point of view. ¹⁴ In November 2014, the MoR issued sectoral guidelines ¹⁵ for domestic/ foreign direct investment in railways. The guidelines set out conditions and approvals that are required for private/ foreign participation in the railways sector. Under the FDI Policy, 2015 the list of ‘prohibited sectors’ has been revised to replace ‘railway transport’ with ‘railway operations’, thus permitting foreign investment in ‘railway transport’ under the automatic route.

- **Print Media specifically publishing of newspaper and periodicals dealing with news and current affairs and publication of Indian editions of foreign magazines dealing with news and current affairs (26% FDI and investment by non-resident Indians (“NRI”)/ person of Indian origin (“PIO”)/ FII/ FPI is permitted with prior approval of Government).**

- **Print Media specifically publishing/ printing of scientific and technical magazines/ specialty journals/ periodicals and publication of facsimile edition of foreign newspapers (100% foreign investment is permitted with prior approval of Government).**


¹³. For additional conditions refer to press note http://dipp.nic.in/English/acts_rules/Press_Notes/pnr1_2016.pdf


• Multi brand retail trading (approval required for foreign investment which is limited to 51%).

D. Sectors with partial automatic route and partial government route

In certain sectors a foreign investor can invest up to a certain percentage of shareholding of an Indian company under the automatic route. Government approval will be required for any foreign investment beyond the specified percentage. These sectors are:

• Banking in private sector (74% foreign investment is permitted including investment by FII/FFI in which up to 49% is under the automatic route and foreign investment beyond 49% and up to 74% is under Government approval route).
• Airports – existing project (approval required for foreign investment beyond 74%)
• Telecom Services (approval required for foreign investment above 49%)
• Single brand product retail trading (approval required for foreign investment above 49%)

E. Other Conditions

Certain sectors and businesses in India have minimum capitalization norms for a foreign investor intending to invest in these sectors. These sectors include:

i. Non-Banking Financial Services (“NBFC”)

In addition to the prescription on investment amount, for few sectors, the FDI norms also contain additional terms and conditions that are required to be complied with by the foreign investor.

ii. FDI in single brand retail is subject to the following conditions

• Products to be sold should be of a 'single brand' and the products should be sold under the same brand internationally;
• If the FDI is proposed to be beyond 51% then sourcing of 30% of the value of the goods purchased should be done from India.

iii. FDI in multi brand retail is subject to certain conditions, such as:

• Minimum amount of USD 100 million to be invested by the foreign investor
• 50% of the total FDI in the first tranche to be invested in the backend infrastructure within 3 years
• Retail sales outlets may be set up in those States which have agreed or agree in future to allow FDI in multi brand retail trade
• 30% mandatory local sourcing requirement from Indian micro, small, medium industries which have a total investment in plant and machinery not exceeding USD 2 million.

F. FDI Policy Reforms

Government, in keeping with its promise of ease of doing business in India, came up with many reforms to the foreign investment. Key highlights of the changes are as stated here:

i. B2B E-Commerce

100% FDI permitted in companies engaged in the activity of buying and selling through the e-commerce platform only in the Business to Business (“B2B”) segment. 16

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ii. B2C E-Commerce

FDI in Business to Consumer ("B2C") segment is permitted in the following circumstances, subject to conditions:

- 100% FDI under automatic route is permitted in marketplace model of e-commerce. Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.

- FDI is not permitted in inventory based model of e-commerce. Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly. 17

iii. Real estate and development sector

While 100% FDI was allowed under automatic route, the conditionalities attached to the investment has been reformed 18:

- No minimum area requirements or minimum capitalization requirements

- The investor is permitted to exit from the investment: (i) after 3 years from the date of each tranche of foreign investment, or (ii) on the completion of the project; or (iii) on the completion / development of trunk infrastructure.

- Further, transfer of stake from one non-resident to another non-resident, without repatriation of investment will neither be subject to any lock-in period nor to any Government approval.

- Each phase of a project to be considered a separate project for the purposes of the FDI Policy.

iv. Operating leases permitted under the automatic route for NBFCs

FDI Policy, 2015 permits FDI up to 100% under the automatic route in operating leases for NBFCs. In May 2012, the RBI had clarified that the ‘leasing and financing’ activity of NBFCs where FDI up to 100% is permitted under the automatic route covers only ‘financial leases’ and not ‘operating leases’. However, under the FDI Policy 2015, the DIPP has allowed FDI up to 100% in ‘operating leases’ as well. Further, FDI is currently only permitted in 18 identified activities, however, the Budget 2016 proposes to extend investment to such activities which are regulated by financial regulators.

v. FDI in Limited Liability Partnership ("LLP") 19

Earlier, FDI in LLPs was permitted only through the Government approval route and LLPs were not allowed to make downstream investments. Now, FDI in LLPs has been permitted under the automatic route in LLPs operating in sectors/ activities where 100% FDI is allowed, through the automatic route and there are no FDI linked performance conditions. Also, an Indian company or LLP, having foreign investment, will be permitted to make downstream investment in another company or LLP in sectors in which 100% FDI is allotted under the automatic route and there are no FDI linked performance conditions.

vi. FDI in company which does not have operations 20

Earlier, companies which did not carry on any operations were required to obtain Government approval prior to receiving foreign investment. Now, Indian company which does not have any operations and also does not have any downstream investments, will be permitted to have infusion of foreign invest-

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ment under automatic route for undertaking activities which are under automatic route and without FDI linked performance conditions.

vii. FDI by swap of shares

Any investment involving swap of shares, which was under Government approval route, is now permitted under the automatic route for sectors which are under automatic route.

viii. Entities controlled by NRI

A company, trust and partnership firm incorporated outside India and owned and controlled by non-resident Indians can invest in India with special dispensation as available to NRIs under the FDI Policy.

ix. FDI in trading

A single brand retail trading entity operating through brick and mortar stores permitted to undertake retail trading through e-commerce. 100% FDI under automatic route permitted in duty free shops. Also, wholesale trader can undertake single brand retail trading subject to certain conditions.

x. Filing of FC-TRS in case of acquisition of shares by non-residents (NRs) on the stock exchanges

The lack of clarity regarding the party responsible for filing of Form FC-TRS (declaration for transfer of shares from and to NRs) for acquisition of shares by NRs on the floor of stock exchanges has now been clarified under the FDI Policy, 2015. In case of acquisition of shares by NRs (including NRIs) on the stock exchanges, the investee company (whose shares are being acquired) would be required to file Form FC-TRS. However, the FDI Policy, 2015 creates ambiguity as to whether this requirement to file FC-TRS would extend to NR-NR transfers as well.

xi. Change in investment limit for proposals to FIPB under the approval route

DIPP has as of November 2015, increased the threshold for proposals to be submitted to FIPB under approval route. Proposals with total foreign equity inflow of and below INR 5000 crore (covered under the approval route) can be submitted to the FIPB for its consideration and approval. All the proposals with total foreign equity inflow in excess of this limit would go to the Cabinet Committee of Economic Affairs (“CCEA”) for its consideration and approval.

G. Finance Act, 2016

The reforms proposed by Budget 2016 have yet to be passed in the Finance Act, 2016; however, some proposed changes affecting the laws governing foreign currency transactions in India are:

- expanding the scope of eligible instruments permitted under the FDI route. While the additional instruments have not been detailed, it may cover optionally convertible instruments (preference shares and/or debentures) or redeemable instruments (preference shares and/or debentures)

- permitting FPI investment in unlisted debt securities as well as pass through securities issued by securitization companies.

- rationalizing the withholding requirements on distributions made to exempt investors or exempt streams of income for category-I and category-II Alternate Investment Funds (“AIF”).

II. Downstream Investment

FDI into Indian companies/ LLPs may be direct or indirect and FDI norms apply to both direct and indi-

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rect foreign investments into an Indian company/LLP. In case of direct investment, the non-resident investor invests directly into an Indian company/LLP.

Indirect FDI is referred to as the downstream investment made by an Indian company/LLP, which is owned or controlled by non-residents, into another Indian company. As per the FDI policy such downstream investment is also required to comply with the same norms as applicable to direct FDI in respect of relevant sectoral conditions on entry route, conditionalities and caps with regard to the sectors in which the downstream entity is operating.

Companies are considered ‘owned’ by foreign investors if they hold more than 50% of capital of the company and are deemed to be foreign ‘controlled’ if the foreign investors have a right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholdings or management agreements.

An investing Indian entity that is ‘owned’ and ‘controlled’ by resident Indian citizens and/or Indian companies, which are ultimately owned and controlled by resident Indian citizens is regarded as a domestic company. Any downstream investment by such investing Indian company, even if it has foreign investment, would not be considered for calculation of indirect foreign investment and is not required to be in compliance with the relevant sectoral conditions on entry route, conditionalities and caps, with regard to the sectors in which the downstream entity is operating.

Further, downstream investment made by a 100% foreign owned and/or controlled banking company as a result of any loan structuring scheme, in trading books or acquisition of shares as a result of default in loan, will also not be considered as indirect foreign investment.

III. Additional Procedural Requirements

Foreign investment is usually in the form of subscription to or purchase of equity shares and/or convertible preference shares / debentures of the company. The investment amount is normally remitted through normal banking channels or by debit to the Non-Resident External Rupee ("NRE") / Foreign Currency Non-resident (B) ("FCNR") account of the non-resident investor with a registered Authorized Dealer or AD (a designated bank authorized by the RBI to participate in foreign exchange transactions).

Transfer or issue of shares of an Indian company to a non-resident will be subject to certain, pricing guidelines. These guidelines have been laid down by the RBI (in the case of companies not listed on a stock exchange) and by SEBI (in the case of listed companies). RBI has rationalized the pricing guidelines from the earlier prescribed DCF / RoE method to "internationally accepted pricing methodologies for companies not listed on a stock exchange. The pricing guidelines however remain unchanged for companies listed on a stock exchange i.e. pricing shall be as per SEBI guidelines. 25

In another move RBI has permitted issue of partly paid shares and warrants to non-residents (under the FDI and the FPI route) subject to compliance with the other provisions. 26

The company is required to report the details of the consideration received for issuing its securities to the regional office of the RBI in the prescribed forms together with copies of the Foreign Inward Remittance Certificate ("FIRC"), arranged for by the AD evidencing the receipt of the remittance along with the submission of the “Know Your Customer” ("KYC") report of the non-resident investor. A certificate from the Statutory Auditors or Chartered Accountant indicating the manner of calculating the price of the shares also needs to be submitted.

All of these documents must be submitted within thirty days of the receipt of the foreign investment and must be acknowledged by the RBI’s concerned regional office, which will subsequently allot a Unique Identification Number (“UIN”) for the

amount reported. The Indian company is required to issue its securities within 180 days from the date of receipt of foreign investment. Should the Indian company fail to do so, the investment so received would have to be returned to the person concerned within this time-frame.

The RBI, in keeping with the Government’s promise to ease doing business in India, has launched the ebiz platform, whereby reporting of Advanced Remittance Form (“ARF”) and Foreign Currency Gross Provisional Return (“FCGPR” form filed to report subscription of shares and other permissible instruments of Indian company by a non-resident) under the FDI scheme was enabled to be done on the e-biz portal of the Government. This facility was extended to reporting of Foreign Currency Transfer of Shares (“FCTRS” form filed to report transfer of shares and other permissible instruments between resident and non-resident) under the FDI scheme. Presently online reporting is available parallel to physical reporting.

IV. Other Foreign Investments

A. FVCI

In addition to investing under the FDI regime, foreign investors which are registered with SEBI as a foreign venture capital investor (“FVCI”) are allowed to invest in Indian companies. FVCIs are allowed to invest in Core Investment Companies (“CICs”) in the infrastructure sector, Asset Finance Companies (“AFCs”) and Infrastructure Finance Companies (“IFCs”). SEBI and the RBI have extended certain benefits to FVCIs some of which include:

i. Free pricing

Registered FVCIs benefit from free entry and exit pricing and are not bound by the pricing restrictions applicable to the FDI investment route. However, this relaxation to FVCIs may be limited in light of the recent amendment to the income tax laws in India. Pursuant to the amendment, FVCIs may be liable to pay tax on the income generated through equity investments made at a price lower than the fair market value, in a company which does not have substantial public interest. The exemption from pricing guidelines was a very significant benefit from a FVCI point of view especially with respect to exits from unlisted companies through strategic sales or through buy-back arrangements with the promoters and the company.

ii. Lock-In

Under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“ICDR Regulations”) the entire pre-issue share capital (other than certain promoter contributions which are locked in for a longer period) of a company conducting an initial public offering (“IPO”) is locked for a period of 1 year from the date of allotment in the public issue. However, an exemption from this requirement has been granted to registered FVCIs, provided, the shares have been held by them for a period of at least 1 year as on the date of filing the draft prospectus with the SEBI. This exemption permits the FVCI to exit from its investments, post-listing.

B. Foreign Portfolio Investments

Separate and varying degrees of regulations have been prescribed to govern foreign portfolio investment regimes in India. SEBI and the RBI under extant securities and exchange control laws, allow portfolio investments in India by SEBI registered FIIs and by certain qualified foreign investors (“QFIs”) without being subjected to FDI restrictions. Subject to applicable conditions, the regulations permit FIIs (and its sub-account) and QFIs to invest in unlisted or

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listed shares, convertible or non-convertible debentures (listed and unlisted), Indian depository receipts, domestic mutual fund units, exchange traded derivatives and similar securities.

In 2014, SEBI notified the SEBI (Foreign Portfolio Investors) Regulations, 2014, ("FPI Regulations") which harmonized the portfolio investment routes of FIIs and QFIs into a new class of FPI. FPI is a dis-intermediated platform for trading in securities without SEBI approval.

C. Investment by Non-Resident Indians

The Union Cabinet, on May 21, 2015, gave its approval for amending the definition of NRIs in the FDI policy and to clarify that investments made by NRIs on non-repatriable basis shall be treated at par with domestic investments. 30

i. Start-up India Initiative

The Government’s new initiative of “Start-up India” to give boost to ecosystem of entrepreneurship and innovation has garnered a lot of attention and response. A start-up has been defined and the process of its recognition (through mobile application/portal of DIPP) and eligibility for obtaining tax benefits has been notified by DIPP. 31 An entity (i.e. a private limited company/ limited liability partnership/ a registered partnership firm) incorporated/registered in India shall be considered as a ‘startup’:

a. Up to 5 years from the date of its incorporation/ registration,

b. If its turnover for any of the financial years has not exceeded INR 25 crores, and

c. It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property.

Following the launch, various ministries came forward with measures to ease doing of business in India. Some of the reforms are:

- Real time registration of a company
- No licences/permits/approvals/tax for start-ups in which non-risk non-hazardous activities
- Overriding effect on many legislations including legislations on tax (both direct and indirect), environmental legislations, labour legislations etc.
- Tax sops and incentives
- Loans to be treated as priority sector lending
- Credit guarantee for loans
- Strong Intellectual Property Rights ("IPR") regime and strengthening of IPR enforcement
- Simpler listing requirements
- Facilitate easy exit

RBI has also announced a list of clarifications/reforms/proposals which would be applicable to foreign investments in Start-ups. 32 Some of the key changes are:

- FVCI will be permitted to invest in all startups regardless of the sector that the startup would fall under
- Transfer of shares or ownership with deferred considerations and facilities for escrow or indemnity arrangements for a period of 18 months would now be allowed
- Simplification in the process for dealing with delayed reporting of FDI related transaction by building a penalty structure into the regulation itself
- Enabling online submission of A2 forms for out-

32. The notifications/circulars under the Foreign Exchange Management Act, 1999 ("FEMA"), notifying these changes is still awaited.
ward remittances on the basis of the form alone or with upload/submission of document(s) depending on the nature of remittance.

- Indian startups may issue shares against any other funds payable by the startup company.

Since the initial announcement about the Start-up India initiative in January 2016, the Government’s steps taken to provide operational ease for startups is promising.

D. Black Money Act, 2015

In 2015 the Government introduced the Black Money Act to bring back to India undisclosed offshore income and assets of residents that had escaped being taxed in India. The Black Money Act provides for a penalty up to 90% of the value of an undisclosed asset in addition to a tax at 30%, as well as sentences of rigorous imprisonment, to be imposed in certain cases. The legislature had also introduced a one-time compliance opportunity for persons who were affected by the Black Money Act to provide a chance to voluntarily declare their undisclosed foreign assets by September 30, 2015 in return for a reduced penalty rate of 30%.

Recently, in Budget 2016, the Government has proposed to introduce another one-time compliance window in order to allow persons to disclose previously undisclosed income and avoid being charged under the harsher provisions of the Black Money Act. This new compliance window is proposed to be open for a limited duration from June 1, 2016 to September 30, 2016, and will be available for persons to declare income:

a. for which they have either not filed income tax returns or not made disclosure in their income tax returns; or

b. which has escaped assessment of tax by virtue of non-filing of income tax returns or non-disclosure of full and true material facts.

This window is open for income earned up to financial year 2015-16. Persons making such declaration will be required to pay tax at 30% of the previously undisclosed declared income, along with 25% cess and 25% penalty on the quantum of tax payable, effectively amounting to a total levy of 45% on the quantum of Undisclosed Income.

The Black Money Act has ramifications for those foreigners and foreign companies who qualify as ‘tax residents’ under the existing ITA. For individuals, the ITA has a day-count test of physical residence in India. Expats should therefore be covered since there is no exemption on the basis of nationality or citizenship. It is also a matter of concern for dual resident individuals. Even if they are considered non-resident under the double tax avoidance agreements, they may need to disclose their foreign assets and income in India because the Black Money Act connects to the residence test under the ITA. For foreign companies, the test of residence under the ITA (as amended by the Finance Act, 2015) is whether the company is incorporated in India or has its ‘place of effective management’ in India (“POEM”). POEM has been defined to mean “a place where key management and commercial decisions are necessary for the conduct of the business of an entity as a whole, in substance made”. In order to provide some clarity on how to determine the POEM of a company, the Government released draft guidelines on December 23, 2015. However, the guidelines are yet to be finalized. Due to the uncertainty surrounding the implementation of POEM, the Finance Minister has announced its deferral to financial year starting April 1, 2016. The Budget 2016 also proposes to introduce a transition mechanism for a foreign company which is considered, for the first time, as a resident in India under the POEM test. For such companies, the provisions of the ITA relating to computation of income, treatment of unabsobered depreciation, setoff or carry forward of losses, special provisions relating to avoidance of tax and collection and recovery of taxes are intended to apply with exceptions, modifications and adaptations as notified by the Government.

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33. The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 received Presidential assent on 26 May 2015 and is effective from April 1, 2015.
4. Establishing a Presence (Unincorporated and Incorporated Options)

Once the foreign exchange regulations have been complied with, a foreign investor must choose how it wishes to set up its operations in India. The entities that foreign investors may set up in India may either be unincorporated or incorporated.

I. Unincorporated Entities

Unincorporated entities permit a foreign company to do business in India via ‘offices’ of certain types. These options are as follows:

A. Liaison Office

Setting up a liaison office in a sector in which 100% FDI is allowed under the automatic route requires the prior consent of the AD. For the remaining sectors, RBI grants its approval after consultation with the Ministry of Finance. A liaison office acts as a representative of the parent foreign company in India. However, a liaison office cannot undertake any commercial activities and must maintain itself from the remittances received from its parent foreign company. The approval for setting up a liaison office is valid for 3 years. It is an option usually preferred by foreign companies that wish to explore business opportunities in India.

B. Branch Office

Similar to a liaison office the branch office of a foreign company in India must be set up with the prior consent of the AD, for sectors under which 100% FDI is permissible under automatic route, with approval under other sectors accorded after consultation with Ministry of Finance. It can represent the foreign parent company in India and act as its buying or selling agent in India. However, a branch office cannot carry out any retail, manufacturing or processing activities. The branch office is permitted to remit surplus revenues to its foreign parent company subject to the taxes applicable. Operations of a branch office are restricted due to limitation on the activities that it can undertake. The tax on branch offices is 40% plus applicable surcharges and the education cess. It is an option that is useful for companies that intend to undertake research and development activities in India.

C. Project Office

A foreign company, subject to obtaining approval from the AD, may set up a project office in India under the automatic route subject to certain conditions being fulfilled including existence of a contract with an Indian company to execute a project in India. A project office is permitted to operate a bank account in India and may remit surplus revenue from the project to the foreign parent company. The tax on project offices is 40% plus applicable surcharges and the education cess. Project offices are generally preferred by companies engaged in one-time turnkey or installation projects.

D. Partnership

A partnership is a relationship created between persons who have agreed to share the profits of a business carried on by all of them, or any of them acting for all of them. A partnership is not a legal entity.
independent of its partners. The partners own the business assets together and are personally liable for business debts and taxes. In the absence of a partnership agreement, each partner has an equal right to participate in the management and control of the business and the profits/losses are shared equally amongst the partners. Any partner can bind the firm and the firm is liable for all the liabilities incurred by any partner on behalf of the firm. Investment by foreign entities is permitted in Indian partnership firms subject to prior approval of RBI.

E. Trust

A trust arises when one person (the “trustee”) holds legal title to property but is under an equitable duty to deal with the property for the benefit of some other person or class of persons called beneficiaries. Like a partnership, a business trust is not regarded as a legal entity. The trust, as such, does not incur rights or liabilities.

The beneficiaries do not generally obtain rights against or incur liabilities to third parties because of the transactions or actions undertaken by the trustee in exercising its powers and carrying out its duties as a trustee. If the trustee of a business trust is a corporation, the participants may effectively limit their liability to the assets of the corporate trustee and the assets held by the corporation on trust for the beneficiaries. A foreign resident may only be the beneficiary of a trust, which is set up as a venture capital fund and only after receiving the prior consent of the FIPB.

II. Incorporated Entities

Incorporated entities in India are governed by the provisions of the Companies Act / Limited Liability Partnership Act, 2008.

A. Limited Liability Partnership

A LLP is a form of business entity which permits individual partners to be shielded from the liabilities created by another partner’s business decision or misconduct. In India, LLPs are governed by the Limited Liability Partnership Act, 2008. LLP is a body corporate and exists as a legal person separate from its partners. Earlier, FDI in LLPs was permitted only through the government approval route and LLPs were not allowed to make downstream investments. Now, FDI in LLPs has been permitted under the automatic route in LLPs operating in sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance conditions.

B. Companies under the Companies Act

As of April 1, 2014 the Companies Act, 2013 has been enacted and brought into force replacing the previous Companies Act, 1956.37 The rules for most chapters (including those relating to board and its powers, declaration and payment of dividend) have also been notified.

The authority that oversees companies and their compliances is the Registrar of Companies (“RoC”). Companies may either be ‘private limited companies’ or ‘public limited companies’.

i. Private Limited Company

A private limited company has certain distinguishing characteristics. It must, in its articles of association, restrict the right to transfer shares; the number of members in a private limited company is minimum of 2 and a maximum of 200 members (excluding the present and past employees of the company); its Articles of Association must prohibit any invitation to the public to subscribe to the securities of the company.

Under the Companies Act, 2013 a natural person who is an Indian citizen and resident in India can incorporate a one person company. However, it shall be required to convert itself into

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37. All provisions of the 2013 Act have been notified and brought into force except for provisions relating to the National Company Law Tribunal, Registered Valuer etc. The remaining sections and rules will be brought into force as and when notified.
public or private company, in case its paid up share capital is increased beyond INR 5 million or its average annual turnover exceeds INR 20 million.

ii. Public Limited Company

A public limited company is defined as a company which is not a private company (but includes a private company that is the subsidiary of a public company). A public limited company shall have a minimum of 7 members but may have more than 200 shareholders and may invite public to subscribe to its securities. A public limited company may also list its shares on a recognized stock exchange by way of an IPO. Every listed company shall maintain public shareholding of at least 25% (with a maximum period of 12 months to restore the same from the date of a fall).

MCA introduced a major reform for entrepreneurs in India on the occasion of World Labour Day. Effective May 1, 2015, incorporation of a new company will require only one e-form to be filed as against five e-forms. This process is known as Integrated Incorporation Procedure and is an additional procedure apart from regular procedure of incorporation.

A foreign company shall, within a period of 30 days of the establishment of its place of business in India, register itself with the registrar of companies, as either a private or a public company.

Advantages and Disadvantages of a Private Company

* More flexibility than public companies in conducting operations, including the management of the company and the payment of managerial remuneration

* Faster incorporation process

* Restrictions on invitation to public to subscribe to securities.

* Limited exit options

III. Incorporation Process (As per Companies Act, 2013)

The process for incorporating a company in India is not exceptionally different from the processes in other Commonwealth nations. The important steps with an indicative time frame involved in the incorporation process are:

A. PAN – DSC – DIN

- Permanent Account Number (“PAN”), Digital Signature (“DSC”) preferably with PAN encryption and Directors Identification Number (“DIN”) is mandatory for initiating the incorporation process. All forms are now required to be filed electronically.

- No person can be appointed as a Director without DIN and having duplicate DIN is an offence.

- DSC to be PAN encrypted as going forward, all filings relating to Income Tax has to be done by a director whose DSC is PAN encrypted.

B. Name Approval

- The RoC must be provided with 1 preferred name and 5 alternate names which should not be similar to the names of any existing companies. A no-objection certificate must be obtained in the event that the word is not an ‘invented word’.

- The proposed name must not violate the provisions of the Emblems and Names (Prevention of Improper Use) Act, 1950.
MCA has introduced Central Registration Centre having territorial jurisdiction all over India to process and dispose of the name reservation applications.

C. Filing of Charter Documents

- The memorandum and articles of the company will need to be prepared in accordance with the needs of the business and the same must be filed with the RoC.

- The RoC will need to be provided with certain information, such as the proposed first directors of the company and the proposed address of its registered office. The registered office is required to be finalized within 15 days and intimated within 30 days of incorporation.

- Affidavits and declarations to be provided by subscribers and requires notarisation and apostille at the respective home countries.

- A private limited company must have at least 2 shareholders and 2 directors whereas a public limited company must have at least 7 shareholders and 3 directors.

- One of the directors to be a resident of India, for at least 182 days in the previous calendar year.

- Companies that meet certain thresholds must have independent directors and women director on the Board.

D. Certificate of Incorporation

- The Certificate of Incorporation provided by the RoC at the end of the incorporation process acts as proof of the incorporation of the company.

- The company should be capitalized and the corresponding share certificates be issued within a period of 60 days of receiving the certificate of incorporation.

- The process of incorporation, from initiating the name availability application to capitalization should be completed within a window of 120 days.

E. Post Incorporation

Once a company is incorporated, it must undertake certain other actions in order to become fully functional:

- The company must, within 30 days from incorporation, hold its first board meeting.

- The first auditor should be appointed by the Board within 30 days from the date of its incorporation who shall hold the office till the conclusion of it first annual general meeting. If in case, the Board fails to appoint within 30 days, shareholders can appoint the first auditor, within 90 days of incorporation.

- The company may appoint additional directors (if required).

- The company must apply for its PAN and ‘Tax Deduction Account Number’ (“TAN”).

- The company must register itself with statutory authorities such as indirect tax authorities and employment law authorities.

- The company must open a bank account.

- The company must put in place the contracts with suppliers and customers that are essential to running the business.

Pursuant to various reform measures brought in by the MCA, the procedure for incorporation of a company in India has become single-form and single window with a time frame of less than 48 hours after submission of the requisite documents. In certain scenarios it is even possible to incorporate a company from scratch in a day. Additionally with the no-minimum capital requirement, the MCA is looking to attract start-up culture. With many advantages to doing business in India via an incorporated entity, company is definitely one of the leading option.
IV. Types of Securities

Indian companies may issue numerous types of securities. However, companies are required to comply with the Companies (Share Capital and Debentures) Rules, 2014. Further, it is more difficult for a public company to receive the necessary consent from its shareholders that are mandatory in order to issue different classes of securities. The primary types of securities used in foreign investments into India are:

A. Equity Shares

Equity shares are normal shares in the share capital of a company and typically come with voting rights and dividend rights.

B. Preference Shares

Preference shares are shares which carry a preferential right to receive dividends at a fixed rate as well as preferential rights during liquidation as compared to equity shares. Convertible preference shares are a popular investment option. Further the preference shares may also be redeemable. An Indian company can issue only compulsorily convertible preference shares to a non-resident.

C. Debentures

Debentures are debt securities issued by a company, and typically represent a loan taken by the issuer company with an agreed rate of interest. Debentures may either be secured or unsecured. Like preference shares, debentures issued to non-residents are also required to be compulsorily convertible to equity shares.

For the purposes of FDI, fully and compulsorily convertible preference shares and debentures are treated on par with equity and need not comply with the external commercial borrowings guidelines (“ECB Guidelines”).

The ECB Guidelines place certain restrictions and requirements on the use of ECB. Indian companies are permitted to avail ECB, which limits are in the range of USD 100 to USD 750 per company per year in under automatic routes depending on the sectors the companies are doing business. For example, Indian companies involved in the software development sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year under the automatic route. In order to raise ECB, the Indian company and the foreign financier must fulfill the criteria of an eligible borrower and a recognized lender respectively, under the ECB Guidelines. Further, there remain restrictions on average maturity period and the permitted end-uses of foreign currency expenditure such as for the import of capital goods and for overseas investments.

V. Return on Investments

Extracting earnings out of India can be done in numerous ways. However it is essential to consider the tax and regulatory issues around each mode of return / exit:

A. Dividend

Companies in India, as in other jurisdictions, pay their shareholders dividends on their shares, usually a percentage of the nominal or face value of the share. For a foreign investor holding an equity interest, payment of dividend on equity shares is a straightforward way of extracting earnings. However, the dividend distribution tax borne by the company distributing such dividend may not necessarily receive credit against any direct tax payable by the foreign investor who receives such dividend in its home jurisdiction.

B. Buyback

Buyback of securities provides an investor the ability to extract earnings as capital gains and consequently

39. Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000

take advantage of tax treaty benefits. However, buy-backs in India have certain restrictions and thus need to be strategically planned. For instance, a company may not, except with a special resolution, buy back more than 25% of its outstanding equity shares in a year.

### C. Redemption

Preference shares and debentures can both be redeemed for cash. While redemption is perhaps the most convenient exit option for investors, optionally convertible securities, which are effectively redeemable, have been classified as ECB. This entails greater restrictions. Also, there is a restriction on issuing preference shares redeemable beyond a period exceeding 20 years from their issue (except in the case of infrastructure companies).

### D. IPO

An IPO is the first offer for sale of the shares of a company to the public at large via listing the company’s stock on a stock exchange. While an initial public offering may usually be regarded as a long term exit option, it is also usually included as an exit option in transaction documents as it may provide investors with large returns. IPOs are discussed in further detail in the next chapter.

### E. Put Options

The use of ‘Put Options’, wherein foreign investors retain a right to ‘put’ or sell securities to Indian promoters as an exit option, has been a contentious issue for some time. The issue was settled to a certain extent by SEBI recognizing put and call options in shareholders’ agreement, subject to certain prescribed restrictions. The RBI has also allowed put options to foreign investors, with certain conditions. In this regard non-resident persons holding shares of an Indian company containing an “optionality clause” and exercising the option / right shall be allowed to exit, without any assured return, subject to the following conditions:

- **i. Lock-in Period**

  Exit can be achieved only after fulfilling a minimum lock-in of 1 year;

- **ii. Pricing Restriction**

  Exit price will be arrived at using any of the internationally accepted pricing methodology at the time of exit duly certified by a chartered accountant or a SEBI registered merchant banker.

### VI. Impact of Companies Act, 2013

The Companies Act, 2013 proposes a number of changes in the corporate law that was existing in India since 1956. We have briefly discussed few important provisions which will have an impact on doing business in India.

- **A. Mandatory Resident Director**

  Under the Companies Act, 2013 it is mandatory for a company to have at least 1 resident director, at the time of incorporation itself. A resident director is one who has stayed in India for a period of at least 182 days in the previous calendar year.

- **B. Duties and Liabilities of Director**

  The general duties of a director have been specifically provided for, which include:

  - to act in accordance with the articles of association of the company;
  - to act in good faith in order to promote the objects of the company and in best interest of stakeholders;
  - to exercise his duties with due and reasonable care, skills and independent judgment;
• to not involve in a situation in which his interest conflicts with the interest of the company;
• to not achieve or attempt to achieve any undue gain or advantage tither himself or through his relatives, partners or associates;
• to not assign his office and any assignment so made shall be void.

It may be noted that if a director fails in performing his duties mentioned above, he shall be punishable with fine of INR 100,000 to INR 500,000.

Further, every director of a company, who is aware of a contravention of the Companies Act or had consented to any such contravention, shall be liable for the punishment prescribed for the contravention. It is also important to note that the penalty for the directors has increased and a fine of upto INR 20 million may be imposed for certain offences.

C. Director’s Report

The Director’s Report is quite detailed and is required to include amongst other statements:

• a statement, on the performance and financial position of subsidiaries, associate companies and joint venture companies, included in consolidated financial statement;
• that directors have devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively;
• on the risk management policy for the company including identification of elements of risk, if any, which may threaten the existence of the Company;
• on the manner in which formal evaluation has been made by the board of its own performance, committees and individual directors (for listed and public companies with Paid up cap of INR 25 crores (USD 250 million). The liability for contravention includes fine on the Company upto INR 25 lakhs (USD 2.5 million) and every officer of the Company shall be punishable with imprisonment upto 3 years or fine upto INR 5 lakhs or both.

D. Liability of Directors

Every director of a company who is aware of a contravention of the Companies Act or if the contravention was done with his / her consent, shall be liable for the punishment prescribed for the contravention. It is also important to note that the penalty for the directors has increased and a fine of upto INR 20 million may be imposed for certain offences.

E. Merger of an Indian Company with a Foreign Company

The Companies Act, 2013 provides for a merger of an Indian company with a company incorporated in certain notified jurisdictions. The merger will be subject to prior approval of the RBI. The consideration for the merger can be in the form of cash, depository receipts or both.

F. Related Parties Transactions

The Companies Act, 2013 has expanded the scope of the provisions relating to transactions with directors and introduced them within the concept of “Related Party Transactions”. Further such transactions require consent of the board and ordinary resolution of the shareholders in relation to certain transactions.

Definition of “related party” now includes a key managerial personnel or his relative; a public company in which a director / manager is a director or holds along with his relatives more than 2% of its paid up share capital; any body-corporate of which a director or manager of the company is a shadow director; shadow director of the company; a company which is a holding, subsidiary or an associate company of such company (only for public companies).
The contracts that are covered under these transactions have been widened to include selling or disposing of or buying or leasing of property of any kind, availing or rendering of any services, appointment of agents for purchase or sale of goods materials, services or property, the related party’s appointment to any office or place of profit in the company, its subsidiary or associate company etc.

It excludes only those transactions which are entered into by the company in its ordinary course of business and which are on an arm’s length basis.

The exemption limit for contracts or arrangements in which directors are interested in, that need to be entered in the Register of contracts or arrangements has been increased to INR 5 lakhs.

Transactions in the nature of loans to and guarantees on behalf of directors and their related parties are prohibited, unless the same is pursuant to a scheme approved by the shareholders or if the company provides loans in its ordinary course of business. Related parties of directors also include companies in which director holds common directorship. However, providing guarantee by holding company on behalf of subsidiaries, if they have common directors, has been specifically excluded.

**G. Corporate Social Responsibility**

Every company with a net worth of INR 5 billion or more, or turnover of INR 10 billion or more or a net profit of rupees INR 50 million or more during any financial year will spend at least 2% of the average net profits of the company made during the three immediately preceding financial years towards its corporate social responsibility obligations.  

**H. Class Action suits**

Any class of members or depositors, in specified numbers, may initiate proceedings against the company, or its directors if they are of the opinion that its affairs are being carried out in a manner unfairly prejudicial to the interests of the company. Damages as a result of the suit may be claimed against directors, auditors, expert or advisor or consultant. “Expert” includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.

**VII. Companies (Amendment) Act, 2015 and further changes to the Companies Act, 2013**

There have been amendments to certain sections of the Companies Act, 2013 vide the Companies (Amendment) Act, 2015. Further, notification on exemptions to private companies dated June 5, 2015  has provided certain important exemptions to private companies bringing in relief to the business community. Some of the important changes are as follows:

- Requirement of having a minimum paid up share capital has been done away with for public and private companies
- The requirement of filing a declaration before commencement of business has been done away with
- A private company can now freely issue hybrid instruments including preference shares with differential rights by virtue of its articles. The issuance of shares with differential rights by a private company are not subject any conditions.

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41. Section 135 of the Companies Act, 2013. Sectors in which spending under corporate social responsibility obligations should be made has been provided in Schedule VII and include, eradication of poverty, malnutrition, environment protection, protection of national heritage promoting education, rural sports, nationally recognized sports, setting up homes and hostels for women, orphans and senior citizens, reducing inequalities in socially and economically backward groups and support to technology incubators in academic.

42. [http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf](http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf)
Relaxation is provided with respect to ESOPs i.e. obtaining ordinary resolution for approval of ESOP Scheme from shareholders in place of special resolution required earlier.

The creation of charge/mortgage on assets of the company to secure borrowings will not require shareholders’ approval.

Section 185 of CA 2013 prohibits companies from advancing loan including in form of book debt, giving guarantee or security to its directors and to persons in whom directors are interested. However, the provisions of Section 185 are not required to be complied with by a private company satisfying the following conditions:

a. in whose share capital, no other body corporate has invested any money; and

b. its borrowings from banks, financial institution or body corporate do not exceed twice the amount of paid up share capital or INR 50 Crores – whichever is lower and there are no subsisting defaults in repayment of such borrowings at the time of making transaction; and

c. there are no subsisting defaults in repayment of such borrowings at the time of making transaction.

The compliance of Section 185 is exempted for all companies when the transaction is between holding company and its wholly owned subsidiary and between holding company and its subsidiary as stated below:

A. Holding Company and Wholly Owned Subsidiary

Any loan, made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company is exempted from the compliance of Section 185.

B. Holding Company and Subsidiary

Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company is exempted from the requirements of Section 185 provided that such loans made are utilized by the subsidiary company for its principle business activities.
5. Mergers and Acquisitions

The term ‘merger’ is not defined under the Companies Act, the ITA or any other Indian law. A merger in normal parlance means a combination of two or more companies into one. Sections 230 to 232 of the Companies Act, 2013 deal with the analogous concept of schemes of arrangement or compromise between a company, its shareholders and/or its creditors.

An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offeror company’s approach, and may be affected through agreements between the offeror and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree’s shares to the entire body of shareholders. Acquisitions may be by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target.

The modes most commonly adopted are a share acquisition or an asset purchase:

1. **A share acquisition** may take place by purchase of all existing shares of the target by the acquirer, or by way of subscription to new shares in the target so as to acquire a controlling stake in the target.

2. **An asset purchase** involves the sale of the whole or part of the assets of the target to the acquirer.

There are several laws and regulations that govern a merger or acquisition in India, either directly or indirectly. Given below is a brief on the same.

### A. Companies Act, 2013

The Companies Act 2013 has introduced a number of changes relating to mergers and acquisitions in India; however not all such provisions are in effect presently. We have discussed some of the significant provisions applicable to mergers and acquisitions in India introduced vide the Companies Act 2013.

#### i. Mergers / Demergers

Sections 230 to 232 (the “Merger Provisions”) of the Companies Act, 2013 govern a merger of two or more companies under Indian law. Merger provisions were set out in Companies Act, 1956 under Sections 390 to 394. The most significant changes, relating to mergers, introduced under the Companies Act, 2013 are:

a. **National Company Law Tribunal (“NCLT”)** to assume the powers of the High Court

Companies which intend to merge must make an application to the NCLT having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors. The NCLT may then order a meeting of the creditors / shareholders of the company. If the majority in number representing 3/4th in value of the creditors and shareholders present and voting at such meeting agree to the merger, then the merger, if sanctioned by the NCLT, is binding on all creditors and shareholders of the company.

b. **Provisions for fast track mergers / amalgamations / demergers introduced**

Under this process, no approval from the NCLT will be required. Only private companies having a paid up capital of less than INR 5 million or turnover of less than INR 20 million as per last audited financial statements can apply for a fast track merger.

c. **Provisions for merger of an Indian company into a foreign company introduced**

This is in addition to the exiting provision for merger of a foreign company into an Indian company. However, mergers only with foreign companies in

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43. These provisions are yet to be notified and hence the provisions of the Companies Act, 1956 will continue to govern the mergers.

44. NCLT is yet to be constituted and the provisions regarding NCLT are not notified as yet.
notified jurisdictions shall be permitted and prior RBI approval will be required for such cross border merger.

ii. Acquisitions

In case the acquisition of a public company which involves issuance of new shares or securities to the acquirer, it would be necessary for the shareholders of the company to pass a special resolution under the provisions of Section 62 of the Companies Act 2013. A special resolution is one that is passed by at least 3/4th of the shareholders present and voting at a meeting of the shareholders. A private company is not required to pass a special resolution for the issue of shares, and a simple resolution of the board of directors should suffice.

RBI has required that all NBFCs will have to take prior approval of the central bank in case (i) there is any takeover or acquisition of control of a NBFC which may or may not result in change in management; (ii) any shareholding pattern changes which results in acquisition/ transfer of 26% or more of the shareholding (iii) any change in the management of the NBFC which results in change of more than 30% of the directors excluding independent directors through mergers and acquisitions.\(^{45}\) Earlier, NBFCs had to take prior approval from RBI if the shareholding crossed 10%.\(^{46}\)

iii. Purchase of an undertaking or part of an undertaking

The Companies Act 2013 allows for disposal (including sale) of a specific undertaking of the business, in which the investment of the company exceeds 20% of company’s net worth or which generates 20% of the total income of the company. This can be done by passing a resolution by atleast 75% of the shareholders who cast their vote. This is also applicable in case of disposal of 20% or more of the value of any undertaking.

B. Takeover Code

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Takeover Code”) governs the acquisition of shares in an Indian public listed company.

The main objective of the Takeover Code is to regulate direct or indirect acquisition of shares or control and takeovers of Indian listed companies through a system of disclosure of information and exit opportunity for the public shareholders.

The Takeover Code requires an acquirer to, *inter alia*, disclose its aggregate shareholding to the company and the stock exchanges whenever the acquirer becomes entitled to more than 5% of the shares or voting rights in a company. Thereafter, there are additional disclosure requirements based on shareholding thresholds.

Acquisition of, voting rights in excess of 26% and/or control of the target company will require the acquirer to offer a mandatory exit to the public shareholders by offering to acquire at least additional 26% shares of the target. The offer price will be determined on the basis of the parameters laid down in the Takeover Code.

C. Listing Regulations

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the “Listing Regulations”) regulates all listed Indian companies and prescribes the mandatory conditions to be complied with by listed companies for ensuring continuous listing. This includes fair, prompt and adequate disclosure of material information for the benefit of the public shareholders. The Listing Regulations also require the companies to execute a listing agreement with a stock exchange for the purpose of listing its shares with the stock exchange and agreeing to abide by the provisions of the Listing Agreement.

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D. Insider Trading Regulations

Akin to insider trading regulations in other jurisdictions, SEBI (Prohibition of Insider Trading Regulations) 2015 (“Insider Trading Regulations”) is intended to restrict insiders from trading in securities to the disadvantage of the public shareholders. Use and dissemination of price sensitive information are regulated by the Insider Trading Regulations.

Under the Insider Trading Regulations, an ‘insider’ has been defined to mean any person who is (i) a connected person; or (ii) in possession of or having access to unpublished price sensitive information (“UPSI”). Every connected person is an ‘insider’ under the Regulations. An outsider i.e. a person who is not a ‘connected person’ would qualify as an ‘insider’ if such person was ‘in possession of’ or ‘having access to’ UPSI.

The Insider Trading Regulations prohibit (i) communication of unpublished price sensitive information (ii) procurement of unpublished price sensitive information and (iii) trading in securities when in possession of unpublished price sensitive information.

The Insider Trading Regulations also mandate continual disclosures by the promoters, key managerial persons and directors.

E. Competition Law

The Government of India enacted the Competition Act, 2002 (“Competition Act”) to replace the Monopolies and Restrictive Trade Practices Act, 1969. The Competition Act takes a new look at competition altogether and contains specific provisions on (i) anti-competitive agreements, (ii) abuse of dominant positions and (iii) mergers, amalgamations and take-overs (“Combinations”). The Competition Commission of India (“CCI”) has been established to monitor, regulate, control and adjudicate on anti-competitive agreements, abuse of dominant position and Combinations.

Combinations which meet certain thresholds have to be notified under the Competition Act. The Competition Act requires mandatory pre-transaction notification to the CCI of all Combinations that exceed any of the asset or turnover thresholds which apply to either the acquirer or the target or both; or to the group to which the target / merged entity would belong post acquisition or merger within 30 days from the date of execution of the transaction documents. For the purposes of the Competition Act, ‘acquisitions’ would mean direct or indirect acquisition of any shares, voting rights or assets of any enterprise, or control over management or assets of an enterprise. A filing/ notification will be required if the merger/ acquisition satisfies the following criteria and does not fall within one of the specified exceptions.47

<table>
<thead>
<tr>
<th>Person/ Enterprise</th>
<th>In USD (1 USD= INR 65)</th>
<th>In USD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In India</td>
<td>Outside India (Including in India)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>Turnover</td>
</tr>
<tr>
<td>Parties to the Combination</td>
<td>&gt;INR 2000 crores</td>
<td>&gt;INR 6000 crores</td>
</tr>
<tr>
<td>Group to which the enterprise would belong after the acquisition, merger or amalgamation.</td>
<td>&gt;INR 8000 crores</td>
<td>&gt;INR 24000 crores</td>
</tr>
</tbody>
</table>

[47. http://www.cci.gov.in/sites/default/files/notification/SO%20673%28E%29-674%28E%29-675%28E%29.pdf]
However, for a period of 5 years (from March 2016 being the date of notification), enterprises that have assets of not more than INR 3.5 billion or turnover of not more than INR 10 billion will be exempt from application of the regulation.

F. Exchange Control Regulations

Cross border mergers and acquisitions are required to be in conformity with the FDI Regulations. Please refer to Chapter 2, where the FDI Regulations have been elaborated upon.

G. Overseas Direct Investment

An Indian company that wishes to acquire or invest in a foreign company outside India must comply with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (the “ODI Regulations”). Such an investment can be made by Indian Companies in overseas joint ventures/ wholly owned subsidiaries, of a total financial commitment 48 of up to 400% of the net worth 49 of the Indian company, which is calculated as per the latest audited balance sheet of the Indian company.

I. Taxes and Duties

A. Income Tax

A number of acquisition and restructuring options are recognized under Indian tax laws, each with different set of considerations:

- Amalgamation (i.e. a merger which satisfies the conditions specified in the ITA);
- Asset sale / Slump sale (which satisfies the conditions specified in the ITA);
- Transfer of shares; and
- Demerger or spin-off (which satisfies the conditions specified in the ITA).

Share transfers may give rise to capital gains tax at rates which depend on holding period 50 of the securities (rates mentioned in Chapter 6 of this report). Capital gains income is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset.

Mergers and spin-offs may be structured as tax neutral transfers provided conditions specified under the ITA are met with respect to transfer of assets / liabilities and continuity of shareholding. There are also provisions for carry forward of losses to the resulting entity.

Transfer of foreign securities may be taxed if the securities substantially derive value from assets situated in India (indirect transfers discussed in Chapter 6 of this Report). This adds an additional element of complication in cross-border M&A with underlying assets or subsidiaries in India. Transfer pricing rules also have to be considered in relation of share transfers as part of a group re-structuring exercise.

Persons acquiring shares of unlisted companies in India may be subject to tax if the consideration paid for the shares is lower than the fair market value of the shares computed using a prescribed formula. Additional tax considerations arise when the deal consideration is structured as earn-outs. Further, withholding tax obligations also create challenges especially in a cross-border context.

48. “Financial commitment” for the purposes of the ODI Regulations includes remittances by market purchases, capitalization of export proceeds, value of guarantees issued by the India company to or on behalf of the joint venture / wholly owned subsidiary and external commercial borrowings of the company.
49. “Net worth” has been defined in the ODI Regulations to mean paid up capital and free reserves.
50. Budget 2016 has proposed changes in the holding period for assets to qualify as long term capital assets. Please refer to Chapter 6 of this Report.
As an alternative to a share transfer, acquisitions may be structured in the form of an asset sale or slump sale.

A slump sale is a transaction where the seller transfers one or more of its undertakings on a going concern basis for a lump sum consideration, without assigning values to the individual assets and liabilities of the undertaking. The advantage of undertaking a slump sale is that the business as a whole (and not individual assets) qualifies as a long term capital asset so long as the undertaking as a whole is held for more than 3 years. The consideration received for slump sale of a business is characterized as a capital receipt chargeable to tax as capital gains.

In an asset sale, the acquirer only purchases specific assets or liabilities of the seller. It does not involve a transfer of the business as a whole. The capital gains tax payable by the seller will depend on the period that the seller has held each of the assets that are transferred.

In light of the uncertainties in the tax environment, negotiation of tax indemnities has become a vital component in most M&A deals. Cross-border movement of intangibles may also give rise to potential tax exposures which have to be carefully considered and structured.

When there is a conveyance or transfer of any movable or immovable property, the instrument or document effecting the transfer is liable to payment of stamp duty. Stamp duty is also required to be paid on the order of the Tribunal approving a merger / demerger of two or more companies. The stamp laws of most states require the stamping of such orders.

Stamp duty may be payable on an agreement that records the purchase of shares / debentures of a company and on the transfer deeds executed in this regard.

**D. Other Taxes**

Other taxes that may have to be considered in structuring M&A include potential service tax obligations. For instance, this could be an issue in cases where the seller procures that its employees accept offers of employment with the acquirer. A question may arise as to whether this may be viewed as manpower recruitment services which could be subject to service tax.

While structuring any investment it is necessary to adopt a holistic approach and integrate all possible legal and tax considerations in a manner that best achieves the strategic and business objectives.

**B. Value Added Tax / Sales Tax**

Value added tax ("VAT") or sales tax, as the case may be, may be payable on purchase of movable assets or goods of the target by the acquirer. VAT is a state level legislation and is payable by the seller of goods.

**C. Stamp Duty**

Stamp duty is a duty payable on certain specified instruments / documents. The amount of the stamp duty payable would depend on the state specific stamp laws. An insufficiently stamped document is not admissible as evidence in a Court of law of India.
6. Capital Markets in India

Indian companies are allowed to raise capital and access financial markets through public issues of shares and other instruments within the regulatory confines of SEBI. The most active stock exchanges in India are the BSE Limited ("BSE") and the National Stock Exchange of India Limited ("NSE"). BSE is the 11th largest stock exchanges with more than 5500 companies publicly listed on it.51

I. Public Issues

Public issues in India can be classified into two types: an IPO or a further public offer ("FPO").

An IPO is the process through which an issuer company allots fresh securities ("Fresh Issue") or offers for sale securities ("OFS") held by its existing shareholders or a combination of both Fresh Issue and OFS to the public for the first time. This paves the way for the listing and trading of the issuer company’s securities on SEBI-approved stock exchanges in India. In the case of an FPO, an existing publicly listed company makes an additional issuance of its securities to the public or offer for sale of its existing securities to the public, through an offer document.

The ICDR Regulations govern the process of an IPO or an FPO by an Indian company, besides other offerings such as qualified institutional placement, preferential allotment, and Indian depository receipts.

In addition to ICDR Regulations, IPOs or FPOs are governed by the Companies Act, the Securities Contracts (Regulation) Rules, 1957 ("SCRR") and the Listing Regulations. The ancillary legislations that may be applicable to an IPO are the FEMA and the various regulations, press releases and circulars issued thereunder from time to time by the RBI and the FDI Regulations.

II. Eligibility Requirements for IPO

An unlisted company may undertake an IPO of its equity shares and any convertible securities if it satisfies the following eligibility requirements:

- The issuer company has net tangible assets of at least INR 30 million in each of the 3 preceding years, of which not more than 50% is held in monetary assets.52 However, the limit of 50% on monetary assets shall not be applicable in case the public offer is made entirely through offer for sale;

- The issuer company has minimum average pre-tax operating profit of INR 150 million, calculated on a restated and consolidated basis, during the 3 most profitable years out of the immediately preceding 5 years;

- The issuer company has a net worth of at least INR 10 million in each of the 3 preceding full years;

- The proposed issue size and all previous issues in the same financial year does not exceed 5 times its pre-issue net worth as per the audited balance sheet of last financial year; and

- If the issuer company has changed its name within the last 1 year, at least 50% of the revenue for the preceding 1 year is earned from the activity indicated by the new name.

An unlisted public company cannot undertake an IPO, if the company has less than 1,000 prospective allottees and there are outstanding convertible securities.

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52. If more than 50% of the net tangible assets are held in monetary assets, the issuer should have made firm commitments to utilise such excess monetary assets in its business or project
III. Minimum Offer Requirements

The issuer company is required to offer:

i. at least 10% of each class or kind of securities to the public, in an IPO, provided:
   - the post issue capital of the company calculated at offer price is more than INR 40,000 million; and
   - the company shall increase its public shareholding to at least 25%, within a period of 3 years from the date of listing of the securities, in the manner specified by SEBI.

ii. at least 25% of each class or kind of securities to the public, in an IPO.

IV. Promoters’ Contribution

A promoter, under the ICDR Regulations, is defined as a person or persons who are in control of the issuer company and who are instrumental in the formulation of a plan or programme pursuant to which securities of the issuer company are offered to the public and those whose names are mentioned in the prospectus for the offering as a promoter of the issuer company.

As per the ICDR Regulations the promoters are required to contribute in the IPO, not less than 20% of the post-IPO share capital of an issuer company. The promoters have to bring the full amount of the promoters’ contribution including premium at least 1 day prior to the issue opening date and such amount is to be kept in an escrow account specially opened for this purpose.

V. Lock-in Restrictions

A “lock-in” means a freeze on dealing in the securities. The ICDR Regulations specify certain lock-in restrictions with respect to the holdings of the promoters as well as other shareholders in the issuer company. The lock-in applicable to securities held by promoters is necessary to ensure that the promoters retain some interest in the issuer company post-IPO and to avoid fly-by-night operators. The entire pre-issue capital of the issuer company (other than the securities locked-in for 3 years as minimum promoters’ contribution) remains locked-in for a period of 1 year from the date of allotment. Certain exceptions include shares held by domestic and foreign venture capital investors (who have obtained the necessary registrations and have held shares at least for a period of 1 year prior to filing of the prospectus) and shares issued to employees prior to IPO under an employee stock option plan.

VI. Offer for Sale

Strategic investors, in order to participate in an offer for sale of the securities of an investee company, should have held the equity shares in the investee company for a period of at least 1 year prior to the date of filing of the draft prospectus with SEBI. In case of equity shares issued upon conversion of convertible instruments, the period of holding of such convertible instruments should also be counted towards the 1 year holding period.

The strategic investors are exempt from this pre-requisite 1 year holding period, if either one of the following conditions is met:

- The IPO is of securities of a government company or statutory authority or corporation or

There are certain securities which by the nature of their existence are ineligible for the computation of the promoter contribution, including certain bonus shares, pledged securities and shares acquired for consideration other than cash.
any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;

- The investors had acquired shares pursuant to any scheme approved by the High Court under Sections 391 to 394 of the Companies Act 1956, in lieu of business and invested capital which had been in existence for a period of more than 1 year prior to such approval.

VII. Credit Rating

The issuer company should have obtained a grading from at least one credit rating agency registered with SEBI prior to the date of registering prospectus or red herring prospectus with the RoC.

VIII. Pricing

The issuer company may freely price its equity shares or any securities convertible into equity shares at a later date in consultation with the lead managers (i.e. the merchant bankers) or through book building process.

IX. Disclosure Requirements

The ICDR Regulations stipulate the disclosure requirements in relation to promoters and members of the promoter group which has to be made in the offer documents that is to be filed with SEBI. The offer documents include sections such as issue details, risk factors (internal and external), capital structure of the issuer company, objects of the offering, terms of the issue, interest of the directors, financial information of the issuer company, charter documents of the company, business of the issuer company, regulatory approvals, outstanding litigations, the issue procedure, etc.

X. Filing of the Offer Document

The issuer company has to file a draft red herring prospectus with SEBI and stock exchanges (where securities are proposed to be listed) prior to the filing of the prospectus with RoC. SEBI and the recognised stock exchanges can specify changes / observations on the draft red herring prospectus. At this stage, the issuer company also has to obtain in-principle approval from all the stock exchanges on which the issuer company intends to list the securities through the prospectus. Thereafter, the issuer company has to carry out such changes or comply with such observations in the draft red herring prospectus before filing the prospectus with the ROC.

Overall, doing an IPO is not only a plausible but also a preferred option for exit for strategic investors in Indian companies. However, as mentioned above, they have to be mindful of certain regulatory requirements, compliances and disclosures. In addition to the key pre-issue obligations discussed herein, issuer companies have to comply with a comprehensive list of post-issue obligations as well.

XI. Listing on Exchanges Outside India

Indian Companies are permitted to list instruments linked to their securities on stock exchanges outside India. This may be achieved through the issue of depository receipts – known commonly as ‘American Depository Receipts’ (‘ADR’) or ‘Global Depository Receipts’ (‘GDR’) depending on the location where the Company chooses to list.

An ADR is a stock that trades in the United States but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on American markets just like regular stocks, and are issued / sponsored in the U.S. by a bank or brokerage. A GDR is similar to an ADR but is issued and traded on stock exchanges in countries other than the United States.
The 'Depository Receipts Scheme, 2014' ("DR Scheme 2014") \(^{53}\) effective December 15, 2014 for investments under ADR/ GDR which repeals the extant guidelines for Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 except to the extent relating to foreign currency convertible bonds ("FCCBs")\(^ {54}\).

The salient features of the DR Scheme 2014 are:

- The securities in which a person resident outside India is allowed to invest under Schedule 1, 2, 2A, 3, 5 and 8 of FDI Regulations shall be eligible securities for issue of Depository Receipts in terms of DR Scheme 2014;

- A person will be eligible to issue or transfer eligible securities to a foreign depository for the purpose of issuance of depository receipts as provided in DR Scheme 2014;

- The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the extant FEMA regulations, as amended from time to time;

- The eligible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors under FEMA;

- It is to be noted that if the issuance of the depository receipts adds to the capital of a company, the issue of shares and utilization of the proceeds shall have to comply with the relevant conditions laid down in the regulations framed and directions issued under FEMA;

- The domestic custodian shall report the issue / transfer of sponsored / unsponsored depository receipts as per DR Scheme 2014 in "Form DRR" as given in annex within 30 days of close of the issue / program.

Currently, the law allows issue of GDR only against underlying asset being equity shares. Further, the conversion of GDR to shares and the transfer of GDR outside India between two non-residents are specifically exempted from tax. Apart from these, all other transactions pertaining to GDRs are taxed. Although a special tax regime has been framed, there is disparity as compared to certain concessional tax treatment that is available under normal provisions of the ITA.

Finance Act, 2015 notes that a new depository regime has been put in place, but that the tax benefits would only apply to cases valid under the old one. This means that non-residents trading in certain DRs could now be subject to the same taxes as those imposed on people trading in shares of unlisted companies here, besides creating tax ambiguities when such DRs are converted to shares. Finance Act, 2015 indicates that tax benefits under the domestic law were intended to be provided only in respect of sponsored issuances of GDRs by Indian listed companies; that the government does not intend on extending the tax provisions of the old scheme to other forms of transactions in depository receipts.

### XII. Foreign Companies Listing in India

Similar to the ability of Indian Companies to raise capital abroad, foreign Companies are permitted to raise money on Indian capital markets by issuing ‘Indian Depository Receipts’ ("IDRs"). However, a foreign Company intending to issue IDRs must meet the following eligibility requirements to list in India:


1. **Mandatory Listing in Home Country:** The Company must be listed in its home country;

2. **No Prohibition:** The Company must not be prohibited from issuing securities by any regulatory body;

3. **Net-worth and Capitalization Ceilings:** The Company should have a pre-issue paid up capital and free reserves of at least USD 100 million with a minimum average turnover of USD 500 million in its home country, during the last 3 financial years preceding the issue;

4. **Compliance Track Record:** The Company must have a good track record of compliance with securities market regulations in its home country;

5. **Trading Track Record:** The Company is required to have a continuous trading record or history on a stock exchange in its home country for at least 3 years immediately preceding the issue; and

6. **Profit Track Record:** The Company should have been making profits for atleast 5 years preceding the proposed IDR listing and has been declaring dividend of not less than 10% each year for the said period.

A foreign Company must then comply with the provisions of the following statutes, rules and regulations after listing:

- The Companies Act;
- The ICDR Regulations; and

The Budget 2014 is proposing the introduction of a much more liberal Bharat Depository Receipt in order to achieve the desired objective of increasing the exposure of foreign companies to Indian capital markets.

### XIII. Small and Medium Enterprises (SME) Listing

In order to facilitate capital raising by SME’s and to provide an exit option for angel investors, Venture Capital (“VC”) and Private Equity (“PE”) funds, SEBI has allowed SME’s to list their securities without an IPO and permit trading of specified securities on Institutional Trading Platform (“ITP”) in SME Exchanges. SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 govern the process of listing of SMEs without undertaking an IPO.

A SME being a public company should satisfy the following requirements to be eligible to list on the ITP:

- whose promoter, group company or director does not appear in the wilful defaulters list of RBI as maintained by Credit Information Bureau (India) Limited (“CIBIL”);  
- there is no winding up petition admitted against the company in a competent court;
- neither the company nor its group companies and subsidiaries have been referred to the Board for Industrial and Financial Reconstruction (“BIFR”) within a period of 5 years prior to the date of application for listing;
- no regulatory action has been taken against it, its promoter or director, by SEBI, RBI, IRDA or MCA within a period of 5 years prior to the date of application for listing;
- company has at least 1 full year’s audited financial statements, for the immediately preceding financial year at the time of making listing application;
- company has been in existence for not more than 10 years and its revenues have not exceeded INR 1 billion in any of the previous financial years;
With Special Reference to Tax Treaties between India and

- whose paid up capital has not exceeded INR 250 million in any of the previous financial years;

The following additional conditions should be satisfied by the company:

- at least 1 AIF, venture capital fund ("VCF") or other category of investors / lenders approved by SEBI has invested a minimum amount of INR 5 million in equity shares of the company, or

- at least 1 angel investor / group which fulfills specified criteria has invested a minimum amount of INR 5 million in the equity shares of the company, or

- company has received finance from a scheduled bank for its project financing or working capital requirements and a period of 3 years has elapsed from the date of such financing and the funds so received have been fully utilized, or

- a registered merchant banker has exercised due diligence and has invested not less than INR 5 million in equity shares of the company which shall be locked in for a period of 3 years from the date of listing, or

- a qualified institutional buyer ("QIB") has invested not less than INR 5 million in the equity shares of the company which shall be locked in for a period of 3 years from the date of listing, or

- a specialized international multilateral agency or domestic agency or a public financial institution as defined under Section 2(72) of the Companies Act, 2013 has invested in the equity capital of the company.

XIV. Capital Raising

The company may raise capital only through private placements and rights issue. Such companies shall not make an IPO while being listed on the ITP.

XV. Promoter’s Contribution and Lock-in

The promoters are required to contribute for listing not less than 20% of the post-listing share capital of the company for listing on ITP. Such shares shall be subject to a lock-in for a period of 3 years from date of listing.
7. Tax Considerations in Structuring Investments

Any person investing or doing business in India has to consider various direct (income) and indirect (consumption) taxes which are levied and collected by the Union Government and the State Governments. Below are some indicative lists of taxation heads in India.

A. Corporate tax

Income tax in India is levied under the ITA. Resident companies are taxed at approximately 33% (if net income is in the range of INR 1 crore – 10 crores) and around 34.5% (if net income exceeds INR 10 crores). However, recently the Finance Minister has proposed that for financial year 2016-17 small companies with turnover in the financial year 2014-15 not exceeding INR 1 crore shall be taxed at the rate of 29% (plus surcharge and cess). Further, it has also been proposed that companies which are set up on or after March 1, 2016, and which engage solely in the business of manufacturing or production, will be given the option to be taxed either at the rate of 30% or at the rate of 25% in which case they will not be able to claim any profit or incentive linked benefits under the ITA. This reduction in corporate tax rates has been the Government’s first step towards meeting their promised goal of reducing corporate tax rates from 30% to 25% (excluding surcharge and cess) over the next 4 years, coupled with rationalization and removal of various exemptions and rebates.

Non-resident companies are taxed at the rate of about 42% (if net income is in the range of INR 1 crore – 10 crores) and 43.26% (if net income exceeds INR 10 crores). While residents are taxed on their worldwide income, non-residents are only taxed on income arising from sources in India. A company is said to be resident in India if it is incorporated in India or has POEM in India. A minimum alternate tax is payable at the rate of around 20% (18.5% plus surcharge and education cess).

Recently, Budget 2016 has proposed to allow ‘eligible start-ups’ meeting certain specified criteria a 100% tax holiday for any 3 consecutive assessment years out of 5 years beginning from the year in which such start up is incorporated.

B. Dividends and share buy-back

Dividends distributed by Indian companies are subject to a dividend distribution tax (“DDT”) at the rate of 15% (exclusive of surcharge and cess) payable by the company on a gross basis. Currently, no further Indian taxes are payable by the shareholders on such dividend income once DDT is paid. However, Budget 2016 has proposed amending the ITA to provide that dividends declared by a domestic company and received by a resident individual, limited liability partnership or partnership firm, in excess of INR 1 crore, shall be chargeable to tax at the rate of 10% (on a gross basis) in the hands of the recipient.

Further an Indian company would also be taxed at the rate of 21.63% on gains arising to shareholders from distributions made in the course of buy-back or redemption of shares.

C. Capital Gains

Tax on capital gains depends on the period of holding of a capital asset. Short term gains may arise if the asset is held for a period lesser than 3 years. Long term gains may arise if the asset is held for a period more than 3 years. Gains from listed shares which are held for a period of more than 12 months are categorized as long term. Unlisted shares are treated as long term only when they are held for more than 36 months. If the holding period for unlisted shares is lesser than 36 months, then it is in the nature of short term gains.
Long term capital gains earned by a non-resident on sale of unlisted securities may be taxed at the rate of 10% (provided no benefit of indexation has been availed) or 20% (if benefit of indexation has been availed) depending on certain considerations. Long term gains on sale of listed securities on a stock exchange are exempted and only subject to a securities transaction tax ("STT"). Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares is 40%.

Recently, Budget 2016 has proposed to reduce the holding period for an investment to qualify as long term capital asset from 36 months to 24 months. Additionally, the Government has also proposed to reduce the long term capital gains tax rate levied on the sale of shares of unlisted private companies to 10% from 20% for foreign investors.

RBI has notified certain caps on investments made by FPIs. Now, all future investment by FPIs in the debt market in India will be required to be made with a minimum residual maturity of three years. Accordingly, all future investments within the limit for investment in corporate bonds, including the limits vacated when the current investment by an FPI runs off either through sale or redemption, shall be required to be made in corporate bonds with a minimum residual maturity of three years. Furthermore, FPIs will not be allowed to invest incrementally in short maturity liquid / money market mutual fund schemes. There will, however, be no lock-in period and FPIs shall be free to sell the securities (including those that are presently held with less than three years residual maturity) to domestic investors.

India has introduced a rule to tax non-residents on the transfer of foreign securities the value of which are substantially (directly or indirectly) derived from assets situated in India. To provide some comfort to investors, the Finance Minister in the 2014-15 budget had clarified that all cases arising from the indirect transfer rule would henceforth be scrutinized by a high level Government body. The Finance Act, 2015 amended the ITA to clarify that shares or interests of a non-resident company are deemed to derive their value substantially from assets (tangible or intangible) located in India, if:

a. the value of the Indian assets exceeds INR 10 crores; and
b. the Indian assets represent at least 50% of the value of all the assets owned by the non-resident company.

There are also circumstances where an investor acquiring shares of an Indian company may be taxed if the shares are acquired at a price lesser than the fair market value as prescribed.

D. Interests, Royalties & Fees for Technical Services

Interest earned by a non-resident may be taxed at a rate between 5.26% to around 42.02% depending on the nature of the debt instrument.

Royalties and fees for technical services earned by a non-resident would be subject to withholding tax at the rate of 10% (on a gross basis and exclusive of surcharge and cess). These rates are subject to available relief under an applicable tax treaty. The scope of royalties and fees for technical services under Indian domestic law is much wider than what is contemplated under most tax treaties signed by India.

E. Withholding taxes

Tax would have to be withheld at the applicable rate on all payments made to a non-resident, which are taxable in India. The obligation to withhold tax applies to both residents and non-residents. Withholding tax obligations also arise with respect to specific payments made to residents. Failure to withhold tax could result in tax, interest and penal consequences.

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F. Wealth tax

Pursuant to the notification of the Finance Act, 2015, the Government has abolished wealth tax as the tax was proving to be a low yield high cost revenue measure.

G. Personal Income Tax

Individuals are taxed on a progressive basis, with a maximum marginal rate of tax of around 34%. An individual may be treated as a resident if he is in India for a period of at least 182 days in a specific year or 60 days in the year and 365 days in the 4 preceding years. A separate category of persons is considered to be ‘resident but not ordinarily resident’, with tax consequences similar to that of a non-resident.

The Finance Act, 2015 increased the rate of surcharge by 2% applicable on individuals having income in excess of INR 1 crore (about USD 0.17 million), thereby increasing the effective maximum rate to 34.61%.

India currently does not impose any estate or death taxes. Although there is no specific gift tax, certain gifts are taxable within the framework of income tax.

H. Double Tax Avoidance Treaties

India has entered into more than 80 treaties for avoidance of double taxation. A taxpayer may be taxed either under domestic law provisions or the tax treaty to the extent it is more beneficial. A non-resident claiming treaty relief would be required to file tax returns and furnish a tax residency certificate issued by the tax authority in its home country. The tax treaties also provide avenues for exchange of information between States and incorporate measures to curb fiscal evasion.

I. Anti-Avoidance

A number of specific anti-avoidance rules apply to particular scenarios or arrangements. This includes elaborate transfer pricing regulations which tax related party transactions on an arm’s length basis.

India has also introduced wide general anti-avoidance rules (“GAAR”) which provide broad powers to the tax authorities to deny a tax benefit in the context of ‘impermissible avoidance arrangements’. GAAR will come into effect from April 1, 2017 and will override tax treaties signed by India.

Further, investments made upto March 31, 2017 will be grandfathered in, and GAAR will only be applicable prospectively, i.e. to investments made after April 1, 2017.

J. Obtaining certainty and Risk mitigation

Foreign investors seeking certainty on the Indian tax implications of a specific transaction or structure may seek an advance ruling. The rulings are pronounced by the Authority for Advance Rulings which is chaired by a Supreme Court judge. The rulings are binding on the taxpayer and tax department, and may be sought in relation to proposed or completed transactions. Rulings have to be provided within a period of 6 months and substantially reduces the overall time and costs of litigation. An advance ruling may also be sought in relation to GAAR cases.

For transfer pricing matters, companies may enter into advance pricing agreements (“APAs”) which may be unilateral, bilateral or multilateral. APAs provide certainty for a period up to 5 years and the Finance Act 2014 has provided for a 4 year look back for application of APAs.

In terms of risk mitigation, care also has to be taken while drafting documents and implementing structures along with a coordinated strategy for tax compliance.
Recently, the Government has made an effort to provide foreign investors some certainty with respect to the retrospective application of indirect tax on share transfers. The Finance Minister has proposed to set up a Direct Tax Dispute Resolution Scheme (“DTDRS”) which is to address pending litigation arising out of retrospective taxation. Under the DTDRS, a taxpayer will be required to pay only the amount of tax as determined. However, in lieu of the forgone interest and penalties, the taxpayer will be required to furnish proof of withdrawal from all pending litigation including proceedings filed before any court, appellate authority, arbitration tribunal, etc. at the time making a declaration under the DTDRS, and any payment made pursuant to such declaration will be non-refundable, and the decision un-appealable without exception. The DTDRS will also be available more generally to all taxpayers whose appeals are pending before the Commissioner of Income Tax (Appeals) or the Commissioner of Wealth Tax (Appeals).

While choosing a holding company jurisdiction it is necessary to consider a range of factors including political and economic stability, investment protection, corporate and legal system, availability of high quality administrative and legal support, banking facilities, tax treaty network, reputation and costs.

Over the years, a major bulk of investments into India has come from countries such as Mauritius, Singapore and Netherlands, which are developed and established financial centers that have favorable tax treaties with India. Some of the advantages offered by these treaties are highlighted in the table below:

### I. Structuring Investments

Investments into India are often structured through holding companies in various jurisdictions for number of strategic and tax reasons. For instance, US investors directly investing into India may face difficulties in claiming credit of Indian capital gains tax on securities against US taxes, due to the conflict in source rules between the US and India. In such a case, the risk of double taxation may be avoided by investing through an intermediary holding company.

While choosing a holding company jurisdiction it is necessary to consider a range of factors including political and economic stability, investment protection, corporate and legal system, availability of high quality administrative and legal support, banking facilities, tax treaty network, reputation and costs.

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<th>MAURITIUS</th>
<th>CYPRUS</th>
<th>SINGAPORE</th>
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<td><strong>Capital gains</strong></td>
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<td>10% shareholding in Indian</td>
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<td><strong>Withholding</strong></td>
<td><strong>tax on out-bound interest</strong></td>
<td>No relief. Taxed as per Indian</td>
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<td>domestic law.</td>
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<td>10%</td>
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57. [http://dipp.nic.in/English/Publications/FDI_Statistics/2015/FDI_FactSheet_OctoberNovemberDecember2015.pdf](http://dipp.nic.in/English/Publications/FDI_Statistics/2015/FDI_FactSheet_OctoberNovemberDecember2015.pdf)
### II. Indirect Taxation

India does not have a central value added tax regime in the conventional sense; although a Central Sales Tax ("CST") is levied on the movement of goods between states, and a Central Value Added Tax ("CENVAT") is levied on the production or manufacture of goods in India.

Efforts are being made to replace the existing indirect tax system which provides for separate levy for goods and services with a unified Goods and Services Tax system ("GST"). Steps have been undertaken by the Government to implement GST, the first being the introduction of a uniform Value Added Tax regime across all states in India. GST is proposed to be implemented from April 1, 2016.\(^{59}\)

#### A. Central Sales Tax

CST is imposed on the sale of goods in the course of inter-state trade or commerce. Sale of goods are deemed to take place in the course of inter-state trade if they involve movement of goods from one state to another, or if such sales are effected by the transfer of documents of title to the goods during their movement from one state to another. No CST is levied on direct imports or exports or the purchase or sale effected in the course of imports or exports. The process of phasing out CST commenced with a reduction in the CST rate from 4\% earlier to 2\%.

#### B. Value Added Tax

VAT is levied on the sale of goods within a particular state and rates may vary from 0\%, 1\%, 4\%, to 15\% although there may be further variations depending on the state. VAT is a state specific levy and most states in India have introduced specific legislations for VAT. Under the VAT regime, a system of tax credits on input goods procured by the dealer is also available, to avoid the cascading effect of taxes that was prevalent under the erstwhile sales tax regime.

#### C. CENVAT

CENVAT is a duty of excise which is levied by the Central Government on all goods that are produced or manufactured in India, marketable, movable and covered by the excise legislation. The peak duty rate was reduced from 16\% to 14\% and has further been reduced to 8\% from 12.36\%, although there are other rates ranging upwards, or based on an ad valorem / quantity rate. The rate of CENVAT varies depending on the product description. In order to avoid the cascading effect of excise duty and double taxation, a manufacturer of excisable goods may avail of credit of duty paid on certain inputs and capital goods bar-

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\(^{58}\) Fees for Technical Services

\(^{59}\) GST Bill has been passed by the Lok Sabha and is now awaiting to be passed by the Rajya Sabha for it to become an Act.
E. Customs Duty

Customs duty is a duty that is levied on goods that are imported into India and exported from India. Customs duty is levied by the Central Government. The Customs Act, 1962 (“Customs Act”) provides for the levy and collection of duty on imports and exports, import / export procedures, prohibitions on importation and exportation of goods, penalties, offences, etc.

While export duties are levied occasionally to mop up excess profitability in international prices of goods in respect of which domestic prices may be low at the given time, levy of import duties is quite wide. Import duties are generally categorized into basic duty, additional customs duty, countervailing duty, safeguard duty and education cess. While the highest rate of customs duty for import of goods is 28.85%, the actual rate may vary according to the product description.

In Budget 2016, the Finance Minister has proposed to levy a new kind of tax called the equalization levy. This proposed levy is a 6% tax on consideration in excess of INR 1 crore for online advertising revenues earned by non-residents from India. By imposing this levy the Government proposes to tax revenue streams which were previously not considered taxable in India on the basis of physical-presence based permanent establishment tests.

The chapter on the equalization levy exists as a separate code in itself (and not as part of the ITA) and outlines separate provisions governing charge of tax, collection and recovery, interest and penalties, appeal, etc. Failure to deduct equalization levy may result in a disallowance of expenditure claimed by the person making payment to the non-resident.

60. For further details please refer to Chapter 12 of this paper.
8. Human Resources

The labour sector in India is highly heterogeneous and segmented. Unlike other countries, where the economic growth has led to a shift from agriculture to industries, India has witnessed a shift from agriculture to the services sector. The services sector in India started to grow in the mid-1980s but accelerated in the 1990s when India had initiated a series of economic reforms, after the country faced a severe payment crisis. Reforms in the services sector were part of the overall reform process, which led to privatization and streamlining of the approval procedures, among others. Existing studies show that liberalization and reforms have been some of the important factors contributing to the growth of services sector in India. The rapid growth of Indian economy in response to the improvement in the service sector is a clear cut evidence of the cumulative growth of human capital in India.

With approximately a million people entering the labour market every month in India, the Indian government has been taking steps for the development of its human capital. Ease of doing business being the key for promotion of manufacturing and creating jobs, the government has proposed the consolidation of approximately 44 central laws into four or five broad category codes. The multiplicity of labour laws and overlapping provisions create bottlenecks and a not-so-conducive atmosphere for business growth. Hence the Government has been focusing largely on amendment of the existing laws to make it less onerous and for the creation of an investment friendly environment.

Additionally the Government has the e-business portal - “Shram Suvidha Portal” 61, which has the facility for allotment of labour identification number (“LIN”) and the transparent inspection scheme. Also the Government has activated the facility for filing online single annual return under the eight central acts. 62 Recently the Labour Ministry integrated registration process under 5 labour Acts 63 with its e-business portal so that various registrations required by a company can be obtained through a single window. 64 The Modi Government’s initiative on Start-up India has also proposed to have an overriding effect on many employment legislations. 65

I. Employment Legislations

Employment laws in India do not stem from any single legislation and there are over 200 laws governing subjects ranging from conditions of employment to social security, health, safety, welfare, trade unions, industrial and labour disputes, etc. We have set out below an overview of the key employment laws in India:

62. The central Acts covered are Payment of Wages Act, Minimum Wages Act, CLRA Act, Maternity Benefits Act, ID Act, Payment of Bonus Act, BOCW Act and the Inter-State Migrant Workmen (Regulation of Employment & Condition of Services) Act, 1979
63. The labour Acts covered in this process include the EPF Act, ESI Act, CLRA Act, BOCW Act and the Inter-State Migrant Workmen (Regulation of Employment & Condition of Services) Act, 1979
65. The employment legislations include PF Act, ESI Act, ID Act, Payment of Gratuity Act, Trade Unions Act, the Inter-State Migrant Workmen (Regulation of Employment & Condition of Services) Act, 1979, Apprentice Act, CLRA Act and the BOCW Act.
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<th>STATUTE</th>
<th>APPLICABILITY</th>
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<td>Factories Act, 1948 (“Factories Act”)</td>
<td>Factories Act is one of the earliest welfare legislations, which embodies the law relating to regulation of labour in factories. The statute prescribes, <em>inter alia</em>, terms of health, safety, working hours, benefits, overtime and leave. The statute is enforced by state governments in accordance with the state specific rules framed under the Factories Act.</td>
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<td>Shops and Commercial Establishments Acts (“S&amp;E Acts”)</td>
<td>S&amp;E Acts are state specific statutes which regulate conditions of work and employment in shops, commercial establishments, residential hotels, restaurants, eating houses, theatres, places of public amusement / entertainment and other establishments located within the state. These statutes prescribe the minimum conditions of service and benefits for employees, including working hours, rest intervals, overtime, overtime wages, holidays, leave, termination of service, employment of children, young persons and women and other rights and obligations of an employer and employee.</td>
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<tr>
<td>Industrial Employment (Standing Orders) Act, 1946 (“Standing Orders Act”)</td>
<td>This statute applies to factories, railways, mines, quarries and oil fields, tramway or motor, omnibus services, docks, wharves and jetties, inland steam vessels, plantations and workshops, where 100 or more persons are employed. In certain States in India, such as Maharashtra, the applicability of the Standing Orders Act has been extended to shops and commercial establishments as well. The statute mandates every employer of an establishment to lay down clear and precise terms and conditions of service which is to be certified by the concerned labour department and thereafter enacted.</td>
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| Contract Labour (regulation and Abolition) Act, 1970 (“CLRA Act”) | CLRA Act applies to:  
- all establishments employing 20 or more persons (or that have employed 20 or more persons) on any day of the preceding 12 months.  
- contractors employing (or have employed) 20 or more workmen on any day of the preceding 12 months.  
The statute does not govern establishments where work of a casual or intermittent nature is carried out. It regulates the conditions of employment of contract labour, the duties of a contractor and principal employer and provides for abolition of contract labour in certain circumstances. |
| Maternity Benefit Act, 1961 (“Maternity Act”) | Maternity Act is applicable to:  
- all shops and establishments in which 10 or more persons are employed; and  
- factories, mines, plantations and circus.  
It prescribes conditions of employment for women employees, before and after childbirth and also provides for maternity benefits and other benefits. |
| Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 (“Sexual Harassment Act”) | The Sexual Harassment Act aims at providing women, protection against sexual harassment at workplace and prescribes detailed guidelines for employers and employees for the prevention and redressal of complaints of sexual harassment. The statute applies to the organized and unorganized sector- including government bodies, private and public sector organisations, non- governmental organisations, organisations carrying on commercial, vocational, educational, entertainment, industrial, financial activities, hospitals and nursing homes, educational and sports institutions and stadiums used for training individuals. For the purpose of the statute, the term ‘workplace’ is also interpreted to include all places visited by an employee during the course of employment or for reasons arising out of employment. The statute also mandates employers to constitute an internal complaints committee to investigate into complaints of sexual harassment occurring at workplace. |
| Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 (“BOCW Act”) | BOCW Act applies to establishments employing 10 or more building workers in any building/ construction work and regulates the conditions of employment and service of the workers and imposes obligations on the employer, with respect to health, safety and welfare of the construction workers. |
| Minimum Wages Act, 1948 (“Minimum Wages Act”) | Minimum Wages Act provides for the fixing and revising of minimum wages by the respective state governments. State governments periodically prescribe and revise the minimum wage rates for both the organized and unorganized sectors. |

66. Subject to state specific amendments

67. Subject to state specific amendments
<table>
<thead>
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<th>Act</th>
<th>Description</th>
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| Payment of Wages Act, 1936  
("Payment of Wages Act") | Payment of Wages Act regulates conditions of payment of wages. The statute applies to factories, railways, tramways, motor transport services, docks, wharves, jetties, inland vessels, mines, quarries and oil fields, workshops, establishments involved in construction work and other establishments as notified by the appropriate state governments. |
| Equal Remuneration Act, 1976  
("Remuneration Act") | Remuneration Act applies to all factories, mines, plantations, ports, railways companies, shops and establishments in which 10 or more employees are employed. The statute provides for the payment of equal remuneration to men and women workers for the same work / work of a similar nature and prohibits discrimination on grounds of sex against women, in matters of employment. |
| Payment of Bonus Act, 1965  
("Bonus Act") | Bonus Act applies to every factory and establishment in which 20 or more persons are employed on any day during an accounting year. It further provides for the payment of bonuses under certain defined circumstances, thereby enabling the employees to share the profits earned by the establishment. |
| The Payment of Gratuity Act, 1972  
("Gratuity Act") | The Gratuity Act is applicable to every factory, mine, oil field, plantation, port, railway company, shop and commercial establishment where 10 or more persons are employed or were employed on any day of the preceding 12 months. Employees are entitled to receive gratuity upon cessation of employment, irrespective of the mode of cessation. An employee is eligible to receive gratuity only in cases where he has completed a ‘continuous service’ of at least 5 years (interpreted to mean 4 years and 240 days) at the time of employment cessation. |
| Employees' Provident Funds and Miscellaneous Provisions Act, 1952  
("EPF Act") | EPF Act is one of India’s most important social security legislations which provides for the institution of provident funds, pension fund and deposit-linked insurance fund for employees in factories and other prescribed establishments. The statute envisages a contributory social security mechanism and applies to establishments having at least 20 employees. An employee whose basic salary is less than INR 15,000 per month, or who has an existing provident fund membership based on previous employment arrangement is eligible for benefits under the EPF Act. |
| Employees' State Insurance Act, 1948  
("ESI Act") | It applies to all factories, industrial and commercial establishments, hotels, restaurants, cinemas and shops. Only employees drawing wages below INR 15,000 per month are eligible for benefits under this statute. The statute provides for benefits in cases of sickness, maternity and employment injury and certain other related matters. |
| The Apprentices Act, 1961  
("Apprentices Act") | Apprentices Act provides for the regulation and control of training of technically qualified persons under defined conditions. |
| Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959  
("EECNV Act") | EECNV Act is applicable to establishments in the public and private sector, having a minimum of 25 employees. The statute mandates the compulsory notification of vacancies (other than vacancies in unskilled categories, vacancies of temporary duration and vacancies proposed to be filled by promotion); to employment exchanges in order to ensure equal opportunity for all employment seekers. |

68. The Bonus Act was amended on Jan 01, 2016, inter alia revising the wage threshold for applicability of the statute from INR 10,000 to INR 21,000.

69. The wage ceiling for mandatory subscription under the EPF Act has been increased from INR 6,500 per month to INR 15,000 per month by way of the Employees' Provident Fund (Amendment) Scheme, 2014. Further, the minimum pension payable under the Employees’ Pension Scheme, 1995 has been fixed as INR 1,000.
With Special Reference to Tax Treaties between India and

II. Employment Documentation

While there is no particular requirement under the central labour statutes to have written employment contracts, certain state specific S & E Acts such as the Karnataka Shops & Commercial Establishments Act, 1961 require an employer to issue an 'appointment order' to employees, within thirty days from the date of appointment. It is however recommended that the terms and conditions of employment, remuneration and benefits be clearly documented in order to ensure that the rights of both parties are adequately documented. Documents that are typically executed with an employee at the time of commencement of employment include (i) offer letter; (ii) employment agreement; (iii) non-disclosure agreement; (iv) Intellectual property and inventions assignment agreement; (v) training bonds etc.

**A. Employment Agreements**

In India, it is a general practice that employers issue offer letters to employees at the time of appointment. This document briefly outlines the terms and conditions of employment including probationary period, remuneration and other documents required to be produced at the time of joining. While many employers prefer to limit the employment documentation with an offer letter, it is recommended that employers execute detailed employment contracts out

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* The list of employment laws is not exhaustive and does not reflect labour laws specific to certain industries and/or activities. The list also does not provide the details of compliances to be undertaken by the employer for each applicable labour law. Further, the applicability of each labour law (for the employer as well as its employees) needs to be determined based on various aspects including (i) the exact nature of activities/work performed, (ii) nature of establishment, (iii) number of employees, (iv) role and responsibilities of the employees, (v) salary/compensation, (vi) duration of employment etc. For example, the ID Act one of India’s most important laws governing industrial relations in India, applies only to individuals falling within the category of ‘workmen’ and specifically excludes persons who are employed in a managerial or administrative capacity, or a supervisor who draws a monthly salary exceeding INR 10,000. There are also specific legislations governing terms and conditions of employment of individuals working in factories (Factories Act), commercial establishments (S & E Acts), mines (Mines Act, 1952), plantation workers (Plantations Labour Act, 1951) etc. Finally, it must be noted that under certain circumstances Indian states have the right to amend the labour laws enacted by the central (federal) government and accordingly it is important to check for any state-specific amendments that may be relevant to a central (federal) labour law.

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70. The Child Labour (Prohibition and Regulation) Amendment Bill, 2012 has been approved by the Union Cabinet and is awaiting approval of the Houses of the Parliament and the President of India to become law.
lining all terms and conditions of employment. While drafting the offer letter and employment agreements it is critical for employers to ensure that the applicable employment laws are being complied with.

Although there is no prescribed format for an employment contract, some of the commonly found and preferred clauses in such contracts include:

- Term of employment and termination of employment (including as a result of misconduct);
- Compensation structure – remuneration and bonuses;
- Duties and responsibilities of the employee;
- Conflict of interest;
- Confidentiality and non-disclosure;
- Intellectual property and assignment;
- Non-compete and non-solicitation obligations; and
- Dispute resolution.

**B. Confidentiality & Non-Disclosure Agreement**

A non-disclosure agreement (“NDA”) is an agreement in which one party agrees to give the second party confidential information about its business or products and the second party agrees not to share this information with anyone else for a specified period of time. Some common clauses in NDA’s include:

- definition of ‘confidential information’ and exclusions thereof;
- term, if any, for keeping the information confidential.
- provisions regarding obligations on the use / disclosure of confidential information includes:
  - use information only for restricted purposes;
  - disclose it only to persons with a ‘need to know’ the information for specified purposes;
  - adhere to a standard of care relating to confidential information;
  - ensure that anyone to whom the information is disclosed further abides by the recipient’s obligations.

**C. Non-Compete & Non-Solicit Agreements**

Employers may choose to enter into non-competition and non-solicitation agreements with their employees. Alternately, these obligations may be included in the employment agreement. While non-compete clauses during the term of employment are generally enforceable in India, a post-termination non-compete clause is not enforceable since they are viewed to be in ‘restraint of trade or business’ under Section 27 of the Indian Contract Act, 1872 (“Contract Act”). Courts in India have time and again reiterated that a contract containing a clause restricting an employee’s right to seek employment and/or to do business in the same field beyond the term of employment is unenforceable, void and against public policy. An employee cannot be confronted with a situation where he has to either work for the present employer or be forced to idleness. Though the stance of Indian courts on the question of restraint on trade is clear, such clauses are commonly included in the terms of employment for their deterrent effect. With respect to non-hire restrictions, courts have viewed the arrangement as an extension of a post-termination non-compete clause and therefore unenforceable.

The trend of incorporating restrictions on solicitation of employees, customers or clients during or after the term of employment has become common

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71. Wipro Limited v. Beckman Coulter International S.A; 2006(3) ARBLR 118 (Delhi)
72. Pepsi Foods Ltd. and Ors. v. Bharat Coca-Cola Holdings Pvt. Ltd. and Ors. 81 (1991) DLT 122; Wipro Ltd. v. Beckman Coulter International S.A 2006(3) ARBLR 118 (Delhi)
in recent times, especially with the increasing usage of social media and professional networking sites. A non-solicit clause is essentially a restriction on the employees from directly/indirectly soliciting or enticing an employee, customer or client to terminate his contract or relationship with the company or to accept any contract or other arrangement with any other person or organization. In determining the enforceability of a non-solicit clause, the courts have generally taken the view that such clauses shall be enforceable, unless it appears on the face of it to be unconscionable, excessively harsh or one-sided.73

D. HR Policy / Employee Handbook

It is recommended that all employers clearly set out the various policies and procedures applicable to employees and circulate such policies to employees periodically. Many subjects covered in a company’s employee handbook are governed by laws which may be specific to the state in which the workplace is located. Hence it is recommended that the employee handbook be drafted in accordance with the state specific applicable laws as well.

The general provisions incorporated in an employee handbook include (but not limited to):

- Employee benefits;
- Leave policies including paid leave, casual leave, sick leave, maternity leave etc;
- Compensation policies;
- Code of conduct and behaviour policies;
- Anti-discrimination and sexual harassment policies;
- Immigration law policies;
- Complaint procedures and resolution of internal disputes;
- Internet, email and computer use policies;
- Conflict of interest policy;
- Anti-drugs, smoking and alcohol policy;
- Accident and emergency policies;
- Travel and expense policy;
- Prohibition from insider trading.

E. Stock Options

Employee stock option plans (“ESOPs”) are designed to give an employee participation in the equity of the company. ESOPs may be granted upon the joining of a company or thereafter, and shall continue to be an important tool for attracting and retaining talent. This is a popular strategy adopted by companies at large, who may not be able to afford larger or more competitive compensation packages. However, it is necessary that all companies comply with the necessary regulatory requirements under applicable laws in framing their stock option plans.

73 Wipro Limited v. Beckman Coulter International S.A; 2006(3) ARBLR 118(Delhi)
9. Intellectual Property

With the advent of the knowledge and information technology era, intellectual capital has gained substantial importance. Consequently, Intellectual Property and the Rights / IPRs attached thereto have become precious commodities and are being fiercely protected. Keeping in line with the world, India also has well-established statutory, administrative, and judicial frameworks for safeguarding IPRs. It becomes pertinent to mention here that India has complied with its obligations under the Agreement on Trade Related Intellectual Property Rights ("TRIPS") by enacting the necessary statutes and amending its existing statutes.

Well-known international trademarks have been afforded protection in India in the past by the Indian courts despite the fact that these trademarks were not registered in India. Computer databases and software programs have been protected under the copyright laws in India, thereby allowing software companies to successfully curtail piracy through police and judicial intervention. Although trade secrets and know-how are not protected by any specific statutory law in India, they are protected under the common law and through contractual obligations.

I. International Conventions and Treaties

India is a signatory to the following international conventions and treaties:

<table>
<thead>
<tr>
<th>CONVENTION</th>
<th>DATE</th>
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<tbody>
<tr>
<td>Berne Convention</td>
<td>April 1, 1928 (Party to convention)</td>
</tr>
<tr>
<td>Rome Convention for the Protection of Performers, Producers of Phonographs</td>
<td>October 26, 1961 (Signature)</td>
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<tr>
<td>and Broadcasting Organization</td>
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<tr>
<td>Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms</td>
<td>October 29, 1971 (Signature)</td>
</tr>
<tr>
<td>Universal Copyright Convention</td>
<td>January 7, 1988 (Ratification)</td>
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<tr>
<td>Paris Convention</td>
<td>December 7, 1998 (Entry into force)</td>
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<tr>
<td>Convention on Biological Diversity</td>
<td>June 5, 1992 (Signature and ratification)</td>
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<tr>
<td>Patent Cooperation Treaty</td>
<td>December 7, 1998 (Entry into force)</td>
</tr>
<tr>
<td>Madrid Protocol</td>
<td>July 8, 2013 (Member to treaty)</td>
</tr>
</tbody>
</table>
By virtue of India’s membership to these multi-lateral conventions and treaties applications for the registration of trademarks, patents, and designs are accepted with the priority date claim; copyright infringement suits can be instituted in India based on copyright created in the convention countries.

II. Patents

Patent rights protect workable ideas or creations known as inventions. A patent is a statutory right to exclude others, from making, using, selling, and importing a patented product or process without the consent of the patentee, for a limited period of time. Such rights are granted in exchange of full disclosure of an inventor’s invention.

The term “invention” is defined under Section 2(1) (j) of the Patents Act, 1970 (“Patents Act”) as “a new product or process involving an inventive step and capable of industrial application.” Thus, if the invention fulfills the requirements of novelty, non-obviousness (inventive step), and industrial application then it would be considered a patentable invention.

There are certain innovations that are specifically excluded from patentability even if they meet the criteria of an invention as defined under Section 2(1) (j) of the Patents Act. These inventions are listed in Section 3 and Section 4 of the Patents Act.

India grants patent rights on a first-to-apply basis. The application can be made by either (i) the inventor or (ii) the assignee or legal representative of the inventor.

Any person who is resident of India cannot first file for a patent application outside India unless a specific permission has been obtained from the patent office. However, a person resident in India can file a patent application outside India after 6 weeks of date of filing the patent application in India. This rule does not apply in relation to an invention for which a patent application has first been filed in a country outside India by a person resident outside India.

The inventor, in order to obtain registration of a patent, has to file an application with the Patent Office in the prescribed form along with the necessary documents as required. A patent application usually contains the following documents:

1. an Application Form in Form 1
2. a Provisional or Complete Specification in Form 2
3. a Declaration as to Inventorship in Form 5
4. Abstracts
5. Drawings, if any
6. Claims,
7. a Power of Attorney in Form 26, if a patent agent is appointed.

<table>
<thead>
<tr>
<th>Innovations</th>
<th>Inventions</th>
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<tr>
<td>Section 3 exclusions</td>
<td>Section 4 exclusions</td>
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</table>
Once the patent application has been filed, it gets published in the patent office Journal. The patent application is examined by the patent office when a request for examination has been filed by the patent applicant. The patent office examines the patent application and issues an office action with procedural and substantive objections. A response to the office action has to be filed by the applicant and subject to the satisfaction of the responses the patent may be granted or refused by the patent office.

Once a Patent is granted, it gives the inventor the exclusive right to exclude third parties from making, using, selling, and importing a patented product or process without the consent of the patentee. In the event someone uses a patented invention without the permission or consent of the patent owner, then the same would amount to patent infringement and the owner of the patent can approach the court of law for obtaining remedies not limited to injunctions, damages etc. For infringement of a patent, only civil remedies are available.

In order to claim damages in a patent infringement suit it is important to note that the product should be marked with the word “patent” or “patented” and should specify the patent number through which the patent protection is being claimed. Failure to do so can result in the defendant in the patent infringement suit claiming that he was not aware and had no reasonable grounds for believing that the patent existed.

Section 107A in the Patents Act, incorporates Bolar provision and provision for parallel imports. Bolar provision allows manufacturers to begin the research and development process in time to ensure that affordable equivalent generic medicines can be brought to market immediately upon the expiry of the patent without any threat of patent infringement by the patentee.

Under the parallel imports exception a machine, though patented in India, can be imported (without the consent of the patentee) from the patentee’s authorized agent, say, in China, who manufactures it at a lower cost with the consent of the patentee then the act of importation would not amount to patent infringement.

It is mandatory under Indian patent laws to file a statement as to the extent of commercial working in Indian Territory of a patent granted by Indian Patent Office. The statement embodied in Form 27 of the Patents Rules, 2003 (“Patent Rules”) is required to be filed in respect of every calendar year within 3 months of the end of each year (i.e. before March 31 of every year). Non-compliance with this requirement may invite penalty of imprisonment which may extend to 6 months, or with fine, or with both, as provided under section 122(1) (b) of the Patents Act.

Upon an application made by any person the Controller of Patents (“Controller”) may grant a compulsory license at any time after 3 years of the grant of a patent on the grounds that the reasonable requirements of the public with respect to the patented inventions have not been satisfied, or the patented invention is not available to the public at reasonably affordable prices, or the invention is not exploited commercially to the fullest extent within the territory of India.

III. Copyrights

Copyright Act, 1957 (“Copyright Act”), supported by the Copyright Rules, 2013 (“Copyright Rules”), is the law governing copyright protection in India. Copyright Act provides that a copyright subsists in an original literary, dramatic, musical or artistic work, cinematograph films, and sound recordings.

A copyright grants protection to the creator and his representatives to certain works and prevents such works from being copied or reproduced without his/their consent. The rights granted under the Copyright Act to a creator include the right to stop or authorize any third party from reproducing the work, using the work for a public performance, make copies / recordings of the work, broadcast it in various forms and translate the work to other
languages. The term of copyright in India is, in most cases, the lifetime of the creator plus 60 years thereafter.

Under Indian law, registration is not a prerequisite for acquiring a copyright in a work. A copyright in a work is vested when the work is created and given a material form, provided it is original. Unlike the US law, the Indian law registration does not confer any special rights or privileges with respect to the registered copyrighted work. India is also a member to the Berne and Universal Copyright Convention, which protects copyrights beyond the territorial boundaries of a nation. Further, any work first published in any country - which is a member of any of the above conventions - is granted the same treatment as if it was first published in India.

Under Section 57 of the Copyright Act an author is granted “special rights,” which exist independently of the author’s copyright, and subsists even after the assignment (whole or partial) of the said copyright. The author has the right to (a) claim authorship of the work; and (b) restrain or claim damages with respect to any distortion, mutilation, modification, or other act in relation to the said work if such distortion, mutilation, modification, or other act would be prejudicial to his honor or repute. These special rights can be exercised by the legal representatives of the author.

A copyright is infringed if a person without an appropriate consent does anything that the owner of the copyright has an exclusive right to do. However, there are certain exceptions to the above rule (e.g., fair dealing). The Copyright Act provides for both civil and criminal remedies for copyright infringement. In the event of infringement, the copyright owner is entitled to remedies by way of injunction, damages, and order for seizure and destruction of infringing articles.

IV. Trademarks

Trademarks are protected both under statutory law and common law. The Trade Marks Act, 1999 (“TM Act”) along with the rules thereunder govern the law of trademarks in India.

Under the TM Act the term ‘mark’ is defined to include ‘a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or, combination of colors, or any combination thereof.’ Thus, the list of instances of marks is inclusive and not exhaustive. Any mark capable of being ‘graphically represented’ and indicative of a trade connection with the proprietor is entitled to registration under the Act. This interpretation opens the scope of trademark protection to unconventional trademarks like sound marks. India follows the NICE Classification of goods and services, which is incorporated in the Schedule to the Trade Marks Rules, 2002 (“TM Rules”). The flowchart below describes the method of obtaining a trademark in India:
V. Obtaining a Trademark in India

Selection of the Mark
Mark should be distinctive and should not be in the prohibited category.

Search Before Application
Carry out a search at the Trade Marks Registry, to find out if same or similar marks are either registered or are pending registration. This is advisable although not compulsory.

Filing of the Application
Under the Trade Marks Act, a single application with respect to multiple classes can be filed.

Numbering of the Application
The application is dated and numbered, and a copy is returned to the applicant / attorney. Once the mark is registered, this number is deemed to be the Registration Number.

Meeting the official Objections
The Trade Marks Registry sends the “Official Examination Report” asking for clarifications, if any, and also cites identical or deceptively similar marks already registered or pending registration. The applicant has to overcome the objections.

Advertising of the Application
The application is thereafter published in the “Trade Marks Journal,” which is a Government of India publication, published by the Trade Marks Registry.

In addition to trademarks, the following categories of marks can also be registered under the TM Act:

A. Certification marks
Certification marks are given for compliance with defined standards, but are not confined to any membership. Such marks are granted to anyone who can certify that the products involved meet certain established standards. The internationally accepted “ISO 9000” quality standard is an example of a widely recognized certification mark.

B. Collective marks
Collective marks can be owned by any association. The members of such associations will be allowed to use the collective mark to identify themselves with a
level of quality and other requirements and standards set by the association. Examples of such associations would be those representing accountants, engineers or architects.

India’s Trade Mark Registry has begun to recognize “unconventional trademarks” and has extended trademark protection to a sound mark. On August 18, 2008, India’s first “sound mark” was granted to Sunnyvale, California-based Internet firm Yahoo Inc.’s three-note Yahoo yodel by the Delhi branch of the Trademark Registry.

C. Internet Domain Names

Indian courts have been proactive in granting orders against the use of infringing domain names. Some of the cases in which injunctions against the use of conflicting domain names have been granted are: www.yahoo.com vs. www.yahooindia.com and www.rediff.com vs. www.radiff.com. In the www.yahoo.com case it has been held that “the domain name serves the same function as a trademark, and is not a mere address or like finding number on the internet, and therefore, it is entitled to equal protection as a trademark”.

D. Assignment of Trademarks

A registered or unregistered trademark can be assigned or transmitted with or without the goodwill of the business concerned, and in respect of either or all of the goods or services in respect of which the trademark is registered. However, the assignment of trademarks (registered or unregistered) without goodwill requires the fulfillment of certain statutory procedures including publishing an advertisement of the proposed assignment in newspapers.

E. Recognition of Foreign Well-Known Marks & Trans-border Reputation

The courts in India have recognized the trans-border reputation of foreign trademarks and trade names and the importance of their protection. Thus, international trademarks, having no commercial presence in India could, be enforced in India if a trans-border reputation with respect to such trademarks can be shown to exist.

Well known Marks such as Whirlpool, Volvo, Caterpillar, and Ocuflox, have received protection through judicial decisions.

Further, infringement actions for a registered trademark along with the claims for passing off for an unregistered mark are recognized by Indian courts. The courts not only grant injunctions but also award damages or an order for account of profits. In addition to the civil remedies, the TM Act contains stringent criminal penalties.

F. The Madrid Protocol

The Madrid System, administered by the International Bureau of World Intellectual Property Organization (“WIPO”), Geneva, permits the filing, registration and maintenance of trademark rights in more than one jurisdiction on a global basis. This system comprises two treaties; the Madrid Agreement concerning the International Registration of Marks, which was concluded in 1891 and came into force in 1892, and the Protocol relating to the Madrid Agreement, which came into operation on April 1, 1996.

India acceded to the relevant treaties in 2005 and in 2007. The new Trademarks (Amendment) Bill to amend the TM Act was introduced in the Parliament to implement the Madrid System in India in 2009. The Trademarks (Amendment) Rules 2013, with provisions relating to the international registration of trademarks under the Madrid Protocol, came into force in India from 8th July, 2013.

G. Trade Secrets

It deals with rights on private knowledge that gives its owner a competitive business advantage. Confidential information and trade secrets are protected under common law and there are no statutes that specifically govern the protection of the same. In order to protect trade secrets and confidential information, watertight agreements should be agreed
upon, and they should be supported by sound policies and procedures.

H. Designs

Industrial designs in India are protected under the Designs Act, 2000 ("Designs Act"), which replaced the Designs Act, 1911. The Designs Act incorporates the minimum standards for the protection of industrial designs, in accordance with the TRIPS agreement. It also provides for the introduction of an international system of classification, as per the Locarno Classification. As per the Designs Act, "design" means only the features of shape, configuration, pattern, ornament or composition of lines or colors applied to any "article" whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye.

The Designs Act provides for civil remedies in cases of infringement of copyright in a design, but does not provide for criminal actions. The civil remedies available in such cases are injunctions, damages, compensation, or delivery-up of the infringing articles.

A company in India needs to ensure that it fully leverages the intellectual property developed by it as this may often be the keystone of its valuation. Further, it needs to establish systems to ensure that such intellectual property is adequately recorded, registered, protected and enforced. It needs to conduct IPR audits to ensure that any intellectual property developed by the company is not going unnoticed or unprotected. The company also needs to ensure that its employees do not violate any third party’s intellectual property rights knowingly or unknowingly. A company must ensure that its intellectual property is not only protected in India, but also in the country where it carries on its business, where its products are exported, or where it anticipates competition.
10. Environmental Laws

The tremendous growth of the Indian economy has resulted in a lot of pressure on its finite natural resources. In order to prevent indiscriminate exploitation of natural resources, the Government regulates the development of industrial projects / activities through environmental approvals and compliances. The approvals may be required at the Central or State levels, depending on the type of activity undertaken. Most of the compliances are mandatory in nature and consequences of non-compliance could result in criminal liability. However, the Modi Government’s initiative on Start-up India proposes to have an overriding effect on the Water (Prevention and Control of Pollution) Act, 1974 (“Water Act”) and Air (Prevention and Control of Pollution) Act, 1981 (“Air Act”).

Various environmental legislations including State specific legislations may be applicable, depending on the type of industrial activity undertaken and the State that they are operating or proposing to operate from. Primarily, however, it is the Environment (Protection) Act, 1986 (“EPA”), Water Act and Air Act which require compliance.

I. Environment (Protection) Act, 1986

EPA is an umbrella legislation enabling the government to control, prevent and abate environmental pollution. It lays down standards of discharge of environmental pollutants through various rules and notifications particularly in the areas of controlling chemical and hazardous waste management, noise pollution, coastal development among others.

Any industry which causes ‘injury to the environment’ comes within the purview of the EPA. The EPA has defined the environment as - includes water, air and land and the inter-relationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organisms and property.

Various notifications and rules have been laid down under the EPA, some of which have been tabulated below:

<table>
<thead>
<tr>
<th>Objective</th>
<th>Notification / Rules under the EPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulations on development</td>
<td>Costal Regulation Zone (CRZ) Notification, 2011</td>
</tr>
<tr>
<td>Noise Pollution</td>
<td>Noise Pollution (Regulation and Control) Rules, 2000</td>
</tr>
<tr>
<td>Chemical Management</td>
<td>• Manufacture Storage and Import of Hazardous Chemicals Rules, 1989</td>
</tr>
<tr>
<td></td>
<td>• Chemical Accidents (Emergency Planning, Preparedness and Response) Rules, 1996</td>
</tr>
<tr>
<td></td>
<td>• Manufacture, Use, Import, Export and Storage of Hazardous Micro Organisms, Genetically Engineered Organisms or Cells Rules, 1989</td>
</tr>
<tr>
<td>Waste Management</td>
<td>• Hazardous Waste (Management, Handling and Transboundary Movement) Rules, 2008</td>
</tr>
<tr>
<td></td>
<td>• Bio-Medical waste (Management &amp; Handling) Rules, 1998</td>
</tr>
<tr>
<td></td>
<td>• Municipal Solid Wastes (Management &amp; Handling) Rules, 2000</td>
</tr>
<tr>
<td></td>
<td>• E-waste (Management and Handling) Rules, 2011</td>
</tr>
</tbody>
</table>
II. Environmental Impact Assessment (“EIA”) Notification

The EIA Notification has made it mandatory to obtain prior Environmental Clearance (“EC”) for a wide range of developmental projects, from mining, power plants, cement plants, storage facilities of hazardous substances to construction projects and townships. Such project would require submission of an application which would include an EIA Report. The application would undergo scrutiny at four stages - Screening, Scoping, Public Consultation and Appraisal. EC may be granted subject to certain terms and conditions. After having obtained the EC, the project management is mandated to comply with certain post clearance reporting in respect of the terms and conditions of the EC.

III. Coastal Regulation Zone (“CRZ”) Notification

The CRZ Notification classifies the coast into categories depending on the ecological sensitiveness and prohibits from the establishment of new industries and the expansion of existing industries, except activities that require direct water front and fore-shore facilities. Projects within the CRZ also require prior EC and post clearance reporting.

IV. Hazardous Substances

In the aftermath of the Bhopal Gas tragedy the Government has laid special emphasis on the handling of hazardous substances by industries. The EPA has defined “hazardous substance” to mean “any substance or preparation which, by reason of its chemical or physico-chemical properties or handling, is liable to cause harm to human beings, other living creatures, plants, micro-organism, property or the environment.” The broad and open definition would bring within its ambit a wide array of manufacturing activities.

Various rules have been formulated for handling and management of hazardous substances under the EPA. Moreover, industries which deal with hazardous substances further require compliance with the Public Liability Insurance Act, 1991, which provides for strict liability in case of an accident.

V. Air & Water Act

Air Act & the Water Act vest regulatory authority in the common Central and State Pollution Control Boards (“PCB”). The PCBs are mandated to issue and revoke consents to operate, require self-monitoring and reporting, conduct sampling, inspect facilities, require corrective action and prescribe compliance schedules.

The Water Act prohibits the discharge of sewage or trade effluents into a stream, well or sewer by any industry, operation or process without the approval of the State PCB.

The Air Act empowers the State PCBs to notify standards of emission of air pollutants by industrial plants and automobiles. The State PCBs have also been authorized to designate areas as ‘pollution control areas’.

Industries are required to obtain the ‘consent to establish (“CtE”) before the construction of a new project from the State PCB. After construction and upon inspection by the PCB, the operator is required to obtain ‘consent to operate (“CtO”) to commence operations. An industry which is non-polluting will still have to obtain consent where it falls within a designated ‘pollution control area’.
The State PCBs, with the approval of the Central PCBs, have the authority to impose fines for the violation of the Rules. Maharashtra is one of the very few states which have used the provisions to impose penalties for unauthorized storage of hazardous waste.  

VI. Municipal Authorities  
Land and Water are State subjects under the Constitution. Therefore, environmental regulations of Municipal Corporations on these aspects might vary depending on the state in which the industry seeks to establish itself.  

VII. Litigation & Penalty  
The Supreme Court has relaxed the standing and procedural requirements for filing a PIL and citizen can enforce environmental laws through a simple letter addressed to the court.  
The National Green Tribunal has been established in 2010 for effective and expeditious disposal of cases relating to environment protection and conservation. It has dedicated jurisdiction on environmental matters and is mandated to dispose applications within 6 months of filing.  
The citizens are empowered to bring legal claims under each of the three laws discussed above. Contravention of the provisions of the EPA, Air Act or the Water Act may lead to imprisonment, or fine or both.  


11. Dispute Resolution

As is the practice world-wide, India also prescribes to judicial, quasi-judicial as well as other alternate dispute resolution methods. Beside courts, in certain cases other forums such as tribunals and administrative bodies may be approached for resolution of disputes. Arbitration is also now a well settled mode for resolving commercial disputes.

I. Judicial Recourse – Courts and Tribunals

The Supreme Court of India is the apex judicial authority in India. The Supreme Court generally receives appeals from the High Courts that occupy the tier below it. Beneath the High Courts are the subordinate civil and criminal courts that are classified according to whether they are located in rural or urban areas and by the value of disputes such courts have jurisdiction to adjudicate upon.

Certain important areas of law have dedicated tribunals in order to facilitate the speedy dissemination of justice by individuals qualified in the specific fields. These include the Company Law Board, the Income Tax Appellate Tribunal, the Labour Appellate Tribunal, the Copyright Board, Securities Appellate Tribunal, Competition Appellate Tribunal, National Green Tribunal and others.

Recently, The Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act, 2015 ("Commercial Courts Act") has been enacted, which provides for establishment of Commercial Courts by notification by the State Government, in consultation with the concerned High Court. For territories where the High Court itself is vested with the original jurisdiction i.e. where particular suits may directly be filed before the High Court, the Chief Justice of such High Court may constitute a Commercial Division within such High Court. These specially notified courts are at the same level as High Courts in terms of hierarchy.

Once the Commercial Division/Commercial Court is established, the Chief Justice of the High Court would be required to constitute the Commercial Appellate Division. As per the Commercial Courts Act, ‘Commercial Disputes’ of a ‘Specified Value’ are to be heard by such Special Courts.

Certain government bodies and government companies also have in-house dispute redressal systems where certain disputes may be referred for adjudication.

II. Jurisdiction

Jurisdiction may be defined as the power or authority of a court to hear and determine a cause, to adjudicate and exercise any judicial power in relation to it. The jurisdiction of a court, tribunal or authority may depend upon fulfillment of certain conditions or upon the existence of a particular fact. If such a condition is satisfied, only then does the authority or Court, as the case may be, have the jurisdiction to entertain and try the matter. Jurisdiction of the courts may be classified under the following categories:

A. Territorial or Local Jurisdiction

Every court has its own local or territorial limits beyond which it cannot exercise its jurisdiction. The legislature fixes these limits.

B. Pecuniary Jurisdiction

The Code of Civil Procedure, 1908 ("CPC") provides that a court will have jurisdiction only over those suits the amount or value of the subject matter of which does not exceed the pecuniary limits of its
jurisdiction. Some courts have unlimited pecuniary jurisdiction i.e. High Courts and District Courts in certain states have no pecuniary limitations.

C. Jurisdiction as to Subject Matter

Different courts have been empowered to decide different types of suits. Certain courts are precluded from entertaining certain suits. For example, the Presidency Small Causes Courts have no jurisdiction to try suits for specific performance of contract or partition of immovable property. Similarly, matters pertaining to the laws relating to tenancy are assigned to the Presidency Small Causes Court and therefore, no other Court would have jurisdiction to entertain and try such matters.

D. Original and Appellate Jurisdiction

The jurisdiction of a court may be classified as original and/or appellate. In the exercise of original jurisdiction, a court acts as the court of first instance and in exercise of its appellate jurisdiction, the court entertains and decides appeals from orders or judgments of the lower courts. Munsiff’s Courts, Courts of Civil Judge and Small Cause Courts possess original jurisdiction only, while District Courts and High Courts have original as well as appellate jurisdictions, subject to certain exceptions.

In addition to the above, the High Courts and the Supreme Court also have writ jurisdiction by virtue of Articles 32, 226 and 227 of the Constitution.

Indian courts generally have jurisdiction over a specific suit in the following circumstances:

- Where the whole or part of the cause of action (the facts on account of which a person gets a right to file a suit for a relief) arose in the territorial jurisdiction of the court.

- Where the subject matter of the suit is an immovable property (real property and items permanently affixed thereto), where such immovable property is situated within the jurisdiction of the court.

III. Interim Relief

Due to heavy case load and other factors, legal proceedings initiated before Indian courts can often take inordinate amounts of time before final resolution. Thus, it is common for the plaintiff to apply for urgent interim reliefs such as an injunction requiring the opposite party to maintain status quo, freezing orders, deposit of security amount etc. Interim orders are those orders which are passed by the court during the pendency of a suit or proceeding and which do not determine finally the substantive rights and liabilities of the parties in respect of the subject matter of the suit or proceeding. Interim orders are necessary to deal with and protect rights of the parties in the interval between the commencement of the proceedings and final adjudication. Hence, interim proceedings play a crucial role in the conduct of litigation between the parties.

Injunctions are a popular form of interim relief. The grant of injunction is a discretionary remedy and in the exercise of judicial discretion, in granting or refusing to grant, the court will take into consideration the following guidelines:

A. Prima Facie Case

The applicant must make out a prima facie case in support of the right claimed by him and should be a bona fide litigant i.e. there is a strong case for trial which needs investigation and a decision on merits and on the facts before the court there is a probability of the applicant being entitled to the relief claimed by him.

B. Irreparable Injury

The applicant must further satisfy the court that if the injunction, as prayed, is not granted he will suffer
irreparable injury such that no monetary damages at a later stage could repair the injury done, and that there is no other remedy open to him by which he can be protected from the consequences of apprehended injury.

C. Balance of Convenience

In addition to the above two conditions, the court must also be satisfied that the balance of convenience must be in favour of the applicant. In order to determine the same the court needs to look into the factors such as:

- whether it could cause greater inconvenience to the applicant if the injunction was not granted.
- whether the party seeking injunction could be adequately compensated by awarding damages and the defendant would be in a financial position to pay the applicant.

IV. Specific Relief

The Specific Relief Act, 1963 provides for specific relief for the purpose of enforcing individual civil rights and not for the mere purpose of enforcing civil law and includes all the cases where the Court can order specific performance of an enforceable contract.

Specific performance is an order of the court which requires a party to perform a specific act in accordance with the concerned contract. While specific performance can be in the form of any type of forced action, it is usually used to complete a previously established transaction, thus, being the most effective remedy in protecting the expectation interest of the innocent party to a contract. The aggrieved party may approach a Court for specific performance of a contract. The Court will direct the offender party to fulfill his part of obligations as per the enforceable contract capable of being specifically performed.

V. Damages

Under the common law, the primary remedy upon breach of contract is that of damages. The goal of damages in tort actions is to make the injured party whole through the remedy of money to compensate for tangible and intangible losses caused by the tort.

The remedy of damages for breach of contract is laid down in Sections 73 and 74 of the Contract Act. Section 73 states that where a contract is broken, the party suffering from the breach of contract is entitled to receive compensation from the party who has broken the contract. However, no compensation is payable for any remote or indirect loss or damage.

Section 74 deals with liquidated damages and provides for the measure of damages in two classes: (i) where the contract names a sum to be paid in case of breach; and (ii) where the contract contains any other stipulation by way of penalty. In both classes, the measure of damages is, as per Section 74, reasonable compensation not exceeding the amount or penalty stipulated for.

VI. Arbitration

Due to the huge pendency of cases in courts in India, there was a dire need for effective means of alternative dispute resolution. India’s first arbitration enactment was the Arbitration Act, 1940 which was complimented by the Arbitration (Protocol and Convention) Act of 1937 and the Foreign Awards Act of 1961. Arbitration under these laws was not effective and led to further litigation as a result of the rampant challenge of arbitral awards.

The legislature enacted the current Arbitration & Conciliation Act, 1996 (the “A&C Act 1996”) to make both, domestic and international arbitration, more effective in India. The A&C Act is based on the UNCITRAL Model Law (as recommended by the U.N. General Assembly) and facilitates Interna
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National Commercial Arbitration as well as domestic arbitration and conciliation. Under the A&C Act, an arbitral award can be challenged only on limited grounds and in the manner prescribed. India is party to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. As the name of the A&C Act 1996 suggests, it also covers conciliation.

Recently, in furtherance to measures taken by the Indian government in support of the ‘ease of doing business in India’, and after two aborted attempts in 2001 and 2010 to amend the arbitration law, on October 23, 2015, the President of India promulgated the Arbitration and Conciliation (Amendment) Ordinance, 2015 (“Arbitration Ordinance 2015”). The Arbitration Ordinance 2015 incorporated the essence of major rulings passed in the last two decades, as well as most of the recommendations of 246th Law Commission Report, and have clarified the major controversies that arose in the recent years.

Thereafter, on December 17, 2015 and December 23, 2015 respectively, the Arbitration and Conciliation (Amendment) Bill, 2015 (“Arbitration Bill 2015”) was passed by the Lok Sabha and Rajya Sabha respectively, with minor additions to the amendments introduced by the Arbitration Ordinance 2015. On December 31, 2015, the President of India signed the Arbitration Bill 2015 and thereafter, gazette notification was made on January 1, 2016. Accordingly, the Arbitration and Conciliation (Amendment) Act, 2015 (“Arbitration Amendment Act 2015”) amends the A&C Act 1996, and came into effect from October 23, 2015. The Arbitration Amendment Act 2015 is applicable prospectively to the arbitral proceedings commenced after October 23, 2015. Some salient features of the Arbitration Amendment Act 2015 are as below:

1. Provides strict timelines for completion of the arbitral proceedings and arbitration related court proceedings.
2. Lays down the mechanism for fast track arbitration (to be completed within 180 days).
3. Introduced certain amendments to the existing provisions with regard to the process of appointment of an arbitrator and clarified the grounds of challenge of an arbitrator for lack of independence and impartiality.
4. Provides for an avenue for seeking interim relief and assistance from Indian courts in foreign-seated arbitrations.
5. Introduction of the ‘cost follow the event’ regime to bring it in line with international standards.
6. The process of enforcement and execution under the A&C Act 1996 has also been streamlined so that challenge petitions do not operate as an automatic stay on the execution process.

Broadly, the A&C Act 1996 covers the following recognized forms of arbitration:

A. Ad-hoc Arbitration

Ad-hoc arbitration is where no institution administers the arbitration. The parties agree to appoint the arbitrators and either set out the rules which will govern the arbitration or leave it to the arbitrators to frame the rules. Ad-hoc arbitration is quite common in domestic arbitration in India and continues to be popular. In cross border transactions it is quite common for parties to spend time negotiating the arbitration clause, since the Indian party would be more comfortable with ad-hoc arbitration whereas foreign parties tend to be more comfortable with institutional arbitration. However, with ad-hoc arbitrations turning out to be a lengthy and costly process, the preference now seems to be towards institutional arbitration as the process for dispute resolution.

B. Institutional Arbitration

As stated above, institutional arbitration refers to arbitrations administered by an arbitral institution. Institutions such as the International Court of Arbitration attached to the International Chamber of Commerce in Paris (“ICC”), the London Court of International Arbitration (“LCIA”) and the American Arbitration Association (“AAA”) are well known
world over and often selected as institutions by parties from various countries. Within Asia, greater role is played by institutions such as the Singapore International Arbitration Centre (“SIAC”), the Hong Kong International Arbitration Centre (“HKIAC”) and China International Economic and Trade Arbitration Commission (“CIETAC”). The Dubai International Arbitration Centre is also evolving into a good center for arbitration. While Indian institutions such as the Indian Council of Arbitration attached to the Federation of Indian Chambers of Commerce and Industry (“FICCI”), the International Centre for Alternative Dispute Resolution under the Ministry of Law & Justice (“ICADR”), and the Court of Arbitration attached to the Indian Merchants’ Chamber (“IMC”) are in the process of spreading awareness and encouraging institutional arbitration, it would still take time for them to achieve the popularity enjoyed by international institutions.

C. Statutory Arbitration

Statutory arbitration refers to scenarios where the law mandates arbitration. In such cases the parties have no option but to abide by the law of the land. It is apparent that statutory arbitration differs from the above types of arbitration because (i) the consent of parties is not required; (ii) arbitration is the compulsory mode of dispute resolution; and (iii) it is binding on the Parties as the law of the land. Sections 24, 31 and 32 of the Defence of India Act, 1971, Section 43(c) of The Indian Trusts Act, 1882 and Section 7B of the Indian Telegraph Act, 1885 are certain statutory provisions which deal with statutory arbitration.

D. Foreign Arbitration

When arbitration proceedings are seated in a place outside India, such a proceeding is termed as a Foreign Arbitration. The seminal judgment of the Supreme Court of India in Bharat Aluminium Co. v. Kaiser Aluminium Technical Service, Inc. (“BALCO Judgment”), had altered the landscape of arbitration in India and has overturned the law laid down in Bhatia International vs. Bulk Trading. The BALCO Judgment, held that provisions of Part I of A&C Act 1996 are not applicable to foreign awards and foreign seated arbitrations where the arbitration agreement was entered into on or after September 6, 2012. This has considerably reduced the level of interference by Indian courts in foreign arbitrations. Awards passed in such foreign seated arbitrations would not be subject to challenge under section 34 of the A&C Act in India. Another consequence of the judgment was that parties to a foreign seated arbitration cannot seek interim reliefs in aid of arbitration from the Indian courts. However, by the Arbitration Amendment Act 2015, the position has been partially reversed and even in a foreign seated arbitration, parties can apply for interim reliefs before Indian Courts, unless they specifically opt out of such a recourse under their contract.

VII. Enforcement of Arbitral Awards

Foreign Award is defined in Section 44 and Section 53 of the A&C Act, 1996. India is a signatory to the Recognition and Enforcement of Foreign Arbitral Awards, 1958 ("New York Convention") as well the Convention on the Execution of Foreign Awards, 1923 ("Geneva Convention"). Thus, if a party receives a binding award from another country which is a signatory to the New York Convention or the Geneva Convention and the award is made in a territory which has been notified as a convention country by India, the award would then be enforceable in India. Reciprocity is only in relation to the place where the award is made and does not bear any real relation to the nationality of the parties or whether the nations to which each of the parties belong have signed or ratified the Conventions. There are about 48 countries (listed below) which have been notified by the Central Government as reciprocating convention countries, with the most recent addition being Mauritius:

76. (2012) 9 SCC 552

77. (2002) 4 SCC 105
Australia; Austria; Belgium; Botswana; Bulgaria; Central African Republic; Chile; China (including Hong Kong and Macau) Cuba; Czechoslovak Socialist Republic; Denmark; Ecuador; Federal Republic of Germany; Finland; France; Germany; Democratic Republic; Ghana; Greece; Hungary; Italy; Japan; Kuwait; Mauritius, Madagascar Republic; Malaysia; Mexico; Morocco; Nigeria; Norway; Philippines; Poland; Republic of Korea; Romania; Russia; San Marino; Singapore; Spain; Sweden; Switzerland; Syrian Arab Republic; Thailand; The Arab Republic of Egypt; The Netherlands; Trinidad and Tobago; Tunisia; United Kingdom; United Republic of Tanzania and United States of America.

Section 48 of the A&C Act deals with the conditions to be met for the enforcement of foreign awards made in countries party to the New York Convention. It stipulates that the only cases where enforcement can be refused are when one party is able to show that:

- the parties were under some incapacity as per the applicable law or that the agreement was not valid under the law of the country where the award was made or the law which the parties have elected;
- that the party against whom the award has been made was not given adequate notice of appointment of arbitrators, arbitration proceedings or was otherwise unable to present his case;
- the award addresses issues outside the scope of the arbitration agreement, and if separable, any issue which is within the ambit of the agreement would remain to be enforceable;
- the composition of the tribunal or the procedure were not in accordance with the agreement of the parties or if there was no such agreement with the law of the country where the arbitration took place; and
- lastly, the award has been set aside or suspended by a competent authority in the country in which it was made or has otherwise not yet become binding on the parties.

Additionally, enforcement may also be refused if the subject matter of the award is not capable of settlement by arbitration under the laws of India or if the enforcement of the award would be contrary to the public policy of India. In this context, the term ‘public policy’ is to be given a narrow meaning. The Supreme Court, in the landmark judgment of Shri Lal Mahal Ltd. v. Progetto Grano Spa 78, has stated that enforcement of a foreign award would be refused on the grounds of public policy only if it is contrary to (i) fundamental policy of Indian law, (ii) the interests of India, or (iii) justice or morality.

Most of the protections afforded to awards which are made in countries that are party to the New York Convention are also applicable to those made in countries party to the Geneva Convention. The A&C Act also provides one appeal from any decision where a court has refused to enforce an award, and while no provision for second appeal has been provided, a party retains the right to approach the Supreme Court.

VIII. Enforcement of Foreign Judgments

The definition of ‘judgment’ as given in Section 2(9) of the CPC is inapplicable to ‘foreign judgment’. A foreign judgment must be understood to mean an adjudication by a foreign court upon a matter before it and not the reasons for the order made by it. The foreign Court must be competent to try the suit, not only with respect to pecuniary limits of its jurisdiction and the subject matter of the suit, but also with reference to its territorial jurisdiction. In addition, the competency of the jurisdiction of the foreign court is not be judged by the territorial law of the foreign state, but rather, by the rule of Private International Law.

A foreign judgment may be enforced by filing a suit upon judgment under Section 13 of CPC or if the judgment is rendered by a court in a “reciprocating
ing territory”, by proceedings in execution under Section 44A of the CPC. Judgments of specified courts in reciprocating countries can be enforced directly by execution proceedings as if these foreign judgments are decrees of the Indian courts.

The following countries have been notified by the Government of India as “reciprocating territories” - United Kingdom, Singapore, Bangladesh, UAE, Malaysia, Trinidad & Tobago, New Zealand, the Cook Islands (including Niue) and the Trust Territories of Western Samoa, Hong Kong, Papua and New Guinea, Fiji, Aden.

Foreign judgments of non-reciprocating countries can be enforced in India only by filing a suit based on the judgment. A foreign judgment is usually recognized by Indian courts unless it is proved that:

- it was pronounced by a court which did not have jurisdiction over the matter;
- it was not given on the merits of the case;
- it appeared on the face of the proceeding to be founded on an incorrect view of international law or a refusal to recognize Indian law (where applicable);
- principles of natural justice were ignored by the foreign court;
- the judgment was obtained by fraud; or
- the judgment sustained a claim founded on a breach of Indian law.

The jurisdiction of foreign courts is decided by applying rules of conflict of laws. Even if the court did not have jurisdiction over the defendant, its judgment can be enforced if the defendant has appeared before the foreign court and not disputed its jurisdiction. While a decision of a foreign court must be based on the merits of a case (i.e. not a summary decision/judgment in default), the mere fact that it was ex-parte (in the absence of a party) does not preclude enforcement. The test is whether it was passed as a mere formality or penalty or whether it was based on a consideration of the truth and of the parties’ claim and defence. For applying the third exception, the mistake or incorrectness must be apparent on the face of the proceedings. Merely because a particular judgment does not conform to Indian law when it is under no obligation to take cognizance of the same does not preclude enforcement. The term ‘natural justice’ in the fourth exception to enforcement refers to the procedure rather than to the merits of the case. There must be something which is repugnant to natural justice in the procedure prior to the judgment. The fifth exception of a judgment being obtained by fraud applies as much to domestic judgments as to foreign judgments. The last exception for instance would ensure that a judgment regarding a gambling debt cannot be enforced in India.

Where any judgment from a ‘reciprocating’ territory is in question, a party may directly apply for execution under Section 44A. A judgment from a non-reciprocating country cannot be enforced under this section. A party approaching the Indian court must supply a certified copy of the decree together with a certificate from the foreign court stating the extent to which the decree has been satisfied or adjusted, this being treated as conclusive proof of the satisfaction or adjustment. Execution of the foreign judgment is then treated as if it was passed by a District Court in India. However, the parties may still challenge the enforcement under the provisions of Section 13 of the CPC.

The courts may refuse enforcement of a foreign award in India on the grounds mentioned above. Further the claims may be barred under the Limitation Act, 1963 (“Limitation Act”), if the suit is instituted after the expiry of the limitation period, which is, in general, a period of 3 years. The Limitation Act will be applicable if the suit is instituted in India on the contracts entered in a foreign country.
12. Trade With India

While some may wish to do business in India, many manufacturers and service providers are interested in doing business with India. With a potential market of over 1 billion people, India is a lucrative export destination.

I. Trade Models

There are many ways in which one can trade with India. While setting up an operation in India and trading through it, is one option, there are numerous ways of trading with India without actually setting up operations. Some of these are discussed below.

A. Marketing

Under this non-exclusive arrangement, a foreign company engages an Indian company to render marketing services on behalf of the foreign company. In the event a customer is identified, the Indian company informs the foreign company and the foreign company directly enters into an agreement and provides the goods to such customer. A commission is paid to the Indian company for the marketing services provided. All obligations to import the goods in India shall vest with the customer. Further, the Indian company does not have the right to conclude any agreements on behalf of the foreign company. A diagrammatic representation of the structure is contained below:

B. Marketing and Distribution

Under this arrangement, a foreign company engages an Indian company for rendering marketing and distribution services on behalf of the foreign company. Under such an arrangement the goods are already stocked with the Indian company and in the event a customer is identified, the Indian company supplies the goods to the customer. All rights and obligations, including payment obligations flow between the foreign company and the customer. A commission is paid to the Indian company for marketing, distribution and stocking of goods. A diagrammatic representation of the structure is contained below:

C. Agency

Under this arrangement, the foreign company appoints an Indian company to act as its agent in India. As the agent, the Indian company markets, stocks and distributes the goods and retains a part of the consideration paid by the customer as an agency fee. This structure is described in the diagram below:
D. Teaming Agreements (Joint Development)

Under this arrangement, a foreign company and an Indian company team up for the development of products for an identified customer. In such situations the foreign company provides its technology, know-how and confidential information to the Indian company which in turn undertakes the manufacturing of the products in India and supplies the same to the customer. The rights and obligations, including payment obligations are mutually agreed between the foreign company, Indian company and the customer. A diagrammatic representation of the structure is contained below:

E. Subcontractor

Under this arrangement, a foreign company engages an Indian company to manufacture certain goods. The goods manufactured by the Indian company are in turn exported to the customers of the foreign company. Although all such exports would be done by the Indian company, the same shall be undertaken on behalf of the foreign company. The foreign company pays the Indian company on a cost-to-cost basis, along with a percentage as commission. The customers pay the foreign company for the goods received. A diagrammatic representation of the structure is contained below:

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79. In India, royalties were capped at 5% of domestic sales in the case of technical collaboration and 2% for the use of a brand name and trademark till April 2010. The caps were removed with retrospective effect from December 2009, to make the country more attractive to foreign investors. However, it appears that the caps on royalty may be reintroduced. See http://www.thehindubusinessline.com/economy/policy/centre-moves-to-plug-the-royalty-outflow-surge/article5953764.ece

II. Implications Under Tax Laws

Some of the above models of doing business with India may lead to the foreign company having a permanent establishment ("PE") for the purposes of taxation laws.

A PE connotes projection of a foreign enterprise into the territory of the taxing state in a substantial and enduring form. In certain circumstances, a foreign entity could be said to have a PE in India if it has a fixed place of business (such as an office or branch), if it is engaged in construction / installation activity in India, deputes employees to provide services in India or conducts business in India through agency arrangements etc.

In general, the income of a foreign entity which arises in India and is attributable to the PE may be taxable in India. Consequently, the income of a foreign entity could possibly be taxed in India and in another jurisdiction. Foreign entities may avail tax benefits contained in treaties and agreements that India has entered into with Governments of various jurisdictions to avoid such double taxation of income.

The business models discussed above could in certain cases result in the foreign entity having a PE in India on account of the mode of operations and scope of activities undertaken in India. Therefore, it is essential for foreign companies engaging in trade with Indian parties to carefully structure their agreements and operations to avoid any adverse tax exposure in India.
III. Customs Duty

The primary tax relevant to the import of goods into a country is customs duty. Customs duties are levied whenever there is trafficking of goods through an Indian customs barrier i.e. levied both for the export and import of goods. Export duties are competitively fixed so as to give advantage to the exporters. Consequently a large share of customs revenue is contributed by import duty.

Customs duty primarily has a ‘Basic Customs Duty’ for all goods imported into India and the rates of duty for classes of goods are mentioned in the Customs Tariff Act, 1975 (the “Tariff Act”), which is based on the internationally accepted Harmonized System of Nomenclature (“HSN”). The general rules of interpretation with respect to tariff are mentioned in the Tariff Act. The rates are applied to the transaction value of goods (for transactions between unrelated parties) as provided under the Customs Act or by notification in the official gazette.

A further duty, known as Additional Customs Duty or the Countervailing Duty (“CVD”) is imposed to countervail the appreciation of end price due to the excise duty imposed on similar goods produced indigenously. To bring the price of the imported goods to the level of locally produced goods which have already suffered a duty for manufacture in India (excise duty), the CVD is imposed at the same rate as excise duty on indigenous goods.

In addition to the above, there are also Additional Duties in lieu of State and local taxes (“ACD”) which are also imposed as a countervailing duty against sales tax and value added tax imposed by States. The ACD is currently levied at the rate of 4%.

Further, the Central Government, if satisfied that circumstances exist which render it necessary to take immediate action to provide for the protection of the interests of any industry, from a sudden upsurge in the import of goods of a particular class or classes, may provide for a Safeguard Duty. Safeguard Duty is levied on such goods as a temporary measure and the intention for the same is protection of a particular industry from the sudden rise in import.

Under Section 9A of the Tariff Act, the Central Government can impose an Antidumping Duty on imported articles, if it is exported to India at a value less than the normal value of that article in other jurisdictions. Such duty is not to exceed the margin of dumping with respect to that article. The law in India with respect to anti-dumping is based on the ‘Agreement on Anti-Dumping’ pursuant to Article VI of the General Agreement on Tariffs and Trade, 1994.

IV. Special Schemes

In light of the liberalization of foreign trade and investment into India, the Indian Government has implemented various special schemes under the Foreign Trade Policy (“FTP”) to incentivize investments into specific sectors or areas. The imports and exports in India are governed by the Foreign Trade (Development and Regulation) Act, 1992. The Central Government has set up the Directorate General of Foreign Trade under the Act which is responsible for formulating and executing the FTP. The current FTP was notified in 2009 and covers the period from 2009 to 2014.

To encourage exports, the FTP enlists various schemes, such as: Export Oriented Units (“EOU”), Electronics Hardware Technology Parks (“EHTP”), Software Technology Parks (“STP”), Bio-Technology Parks (“BTP”) and Special Economic Zones (“SEZ”). 100% FDI in EOUs and SEZs are permitted through automatic route. Units registered under STP/ EHTP Scheme of the Government of India is permitted to have foreign equity participation up to 100% under automatic route without any prior regulatory approvals.

We have highlighted few schemes here:
A. EOU Scheme

EOUs are governed by the provisions of Chapter 6 of the FTP which have also been made applicable to STPs, EHTPs and BTPs. Hence the scheme is for EOU / STP / EHTP / BTP and is referred in common parlance as the EOU Scheme.

Projects undertaking to export their entire production of goods and services may be set up under the EOU Scheme for manufacture of goods, including repair, remaking, reconditioning, re-engineering and rendering of services. Trading units are not covered under the scheme.

To be considered for establishment as an EOU, projects must have a minimum investment of INR 1 crore in building, plant and machinery. EOUs are allowed duty-free import of capital goods, raw materials, components, consumables, intermediates, spares and packing materials, etc. required for the manufacture of the product. These items can also be procured from within India free from all internal taxes.

New and second hand capital goods and spares, required for the unit, can be imported without a license. For services, including software units, sale in the domestic tariff area in any mode, including online data communication, is permissible up to 50% of value of exports and/or 50% of foreign exchange earned, where payment for such services is received in free foreign exchange.

Some of the other salient features under the EOU Scheme are:

- EOUs shall be permitted to retain 100% of export earnings in exchange earners foreign currency (“EEFC”) accounts
- Export loans from banks are available at special concessional rates
- Exemption from service tax in proportion to their exported goods and services
- Central excise duty is not payable on exported products and a refund can be claimed of any customs or excise duty paid on raw materials used in the manufacture of the exported goods.

- Import facilities have been liberalized and are worked out on the basis of the free on board (FOB) value of goods to be exported.
- There are several state level incentives such as infrastructure, waiver of sales tax, reduction of stamp duty etc. that are made available to EOUs

B. SEZ Scheme

The SEZ Scheme was first introduced through the Export Import (EXIM) Policy in April, 2000 to provide an internationally competitive and hassle-free environment for exports. The Special Economic Zones Act, 2005 has been enacted to provide for the establishment, development and management of the SEZ for the promotion of exports. Units may be set up in SEZs for manufacture, reconditioning and repair or for service activity. All the import / export operations of the SEZ units will be on self certification basis.

The units in the Zone have to be a net foreign exchange earner but they shall not be subjected to any predetermined value addition or minimum export performance requirements.

Some of the distinguishing features and facilities of an SEZ are:

- SEZ is a designated duty free enclave and is to be treated as foreign territory for trade operations and duties & tariffs.
- No license requirement for import
- 100% service tax exemption and from securities transaction tax.
- 100% exemption from customs duty on import of capital goods, raw materials, consumables, spares, etc. However, any goods removed from the SEZ into a domestic tariff area will be subject to customs duty.
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- 100% exemption from Central excise duty on procurement of capital goods, raw materials, consumables, spares, etc from the domestic market
- Supplies from domestic tariff area to SEZ units are treated as exports
- 100% tax exemption for a block of 5 years, 50% tax exemptions for a further two years and upto 50% of the profits ploughed back for the next three years for SEZ units which begin operations on after 1, 2006. However, SEZ units and developers which were earlier exempted from liability to the minimum alternate tax ("MAT") at the rate of 18.5% are subject to MAT.
- Exemption from the levy of taxes on the sale or purchase of goods other than newspapers under the Central Sales Tax Act, 1956 if such goods are meant to carry on the authorized operations by the Developer or entrepreneur.

The Government through an amendment to the SEZ Rules in August 2013 has provided for significant relaxations in area requirements of SEZ, extending duty exemption benefits on upgradation of structures in SEZ area, reducing the minimum land area requirement for both multi brand and sector specific SEZs by half and providing for an exit from the SEZ scheme at the option of the SEZ unit.

The Finance Minister in his Budget 2014 speech has also expressed commitment to revive SEZs and "effective steps" to be taken by the Government to make them instruments of industrial production, economic growth, export promotion and employment generation.

A new scheme to establish Free Trade and Warehousing Zones (FTWZs) was introduced in the 2004–09 Foreign Trade Policy to create trade-related infrastructure to facilitate the import and export of goods and services, with the freedom to carry out trade transactions in free currency. An FTWZ is a special type of SEZ, with an emphasis on trading and warehousing, and is regulated by the provisions of the SEZ Act and Rules. It is aimed at making India a global trading hub. FDI is permitted up to 100% in the development and establishment of the zones and their infrastructural facilities. Each zone would have minimum outlay of INR 100 crores and a 5 lakh sq. m built-up area. Units in the FTWZs would qualify for all other benefits as applicable to SEZ units.

The country's first FTWZ was launched in Panvel, Mumbai in 2010.
13. Conclusion

Historically, India has had a poor track record with its rate of growth subsisting through much of the period from independence until 1991. For decades, India was a semi-socialist state. The system of securing licences and permits to produce goods placed restrictions on internal production. Many industrial sectors were housed in unwieldy and unproductive public sector undertakings, which effectively had a monopoly in their respective sectors. Bureaucracy was rampant and the polity highly corrupt; even the private sector was largely subject to their whims and vagaries causing huge inefficiencies in business operations.

Furthermore, some aspects of the legal system in India continue to be archaic. For example, the labour laws find their origin in the British laws of the early 20th century and have since undergone only minor amendments, even though the same laws in Britain have changed significantly. As a result, sectors such as manufacturing have been dogged by strikes and lock-outs. Additionally, it is very difficult to terminate the services of blue-collar employees in India due to extensive protections under various laws.

India’s import policies, despite the recent relaxations, continue to remain unfriendly with very high import duties charged on many imported goods. India’s tax and corporate laws are complex and outdated, though both are proposed to be amended in the near future. The notification of Companies Act, proposal to implement unified GST regime from April 1, 2016 and prospective applicability of GAAR, when introduced, are indeed positives step in this direction.

Following the liberalization of India’s economy in 1991, a broad sweep of reforms were introduced to its financial and trade policies. These changes have made positive impact on its sizable Indian populace. India’s middle class, its prime consumer market and responsible for over half of Indian economy’s GDP in the form of private spending, is estimated to cross 250 million in number. Furthermore, India’s population remains largely of working age and relatively young, unlike China, which with its ‘one-child’ policy has resulted in a smaller working population supporting a growing number of retirees.

Liberalization provided the much needed proverbial shot in the arm for the entrepreneurial spirit of India’s people and it found a new lease of life after years of being stifled. For instance, the IT/ITES sector is one of the few that has seen the introduction of a large number of friendly policies which have enabled the sector to grow by leaps and bounds in the last two decades and give rise to brands like Infosys, Tata Consultancy Services (“TCS”) and Wipro that have achieved globally recognition.

While corruption still exists, the computerization of numerous public bodies has led to an increased level of efficiency and institutions such as the RBI and SEBI have become increasingly proactive and professional in dealing with foreign investment into India. Furthermore, some state governments have taken proactive steps to improve efficiency in public offices such as the RoC. While caution exercised by them may seem draconian; it has helped India tremendously in avoiding any major internal impact
of the ongoing financial crisis. Modi government’s policies of smart cities, Digital India, single window policy has given the correct signals to all. Also the Government’s mantra of “ease of doing business” has brought about many reforms which will work towards changing the perception about doing business in India. More and more ministries are moving towards online access for seeking licenses/approvals/registrations/reporting etc. and single window clearance.

One of the big steps taken by the government is the promulgation of the Right to Information Act, 2005 (“RTI Act”), which grants a right to every citizen of India to seek information from a “public authority” 80, which information is required to be supplied expeditiously or within 30 days. The RTI Act not only empowers the citizen, but also puts an obligation on every public authority to computerise their records for wide dissemination and to also to ensure that the citizens have minimum recourse to request for information formally.

To conclude, whilst it is apparent that India still has a long way to go, it is and will continue to be an attractive destination for investment and trade. Whilst its expanding levels of intellectual capital and large English-speaking population are likely to make it a global hub for services, high levels of domestic consumption coupled with significant cost competitiveness will also make it an attractive destination for investments in services and manufacturing. All in all “Acche Din” awaits all in India.

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80. Public authority means a Government body or instrumentality
Investing Into India: Considerations From a Canada - India Tax Perspective

I. Canada - India Relations: Background

Canada and India have longstanding bilateral relations, built upon shared traditions of democracy, pluralism and strong interpersonal connections with an Indian diaspora of more than one million in Canada. After the liberalization of the Indian economy in 1991, Canada identified India as the largest market for commercial cooperation in the South East Asian region. The major areas of trade between these countries include infrastructure, organic chemicals, energy, food, education, science and technology.

Canada and India have entered into a number of bilateral agreements which bear testimony to the strengthening of ties between the two countries. The ninth round of negotiations toward a Comprehensive Economic Partnership Agreement (“CEPA”) between Canada and India was held in March, 2015, at New Delhi. The negotiations made good progress on goods and services. Canada continues to be intent on signing an ambitious agreement with India.

According to the RBI, the total FDI equity inflow from Canada to India during from April 2000 - February 2015 is US $522.21 million and in 2014-15 (up to February, 2015) alone it was US $ 85.22 million. The Indian Government is taking special measures to open up foreign direct investment in many sectors by improving ease of doing business and consequently enhance investment inflows from these investors.

The key areas of Canadian investment in India include banking, engineering, consultancy and financial services. In addition to CEPA a number of bilateral agreements and institutional arrangements have also been executed between Canada and India. Listed below are some of the key agreements:

- Reciprocal Protection of the Priority of Patents Invention (1959)
- Agreement for Scientific and Technological Cooperation (2005)
- MoU concerning cooperation in road transportation (2012)
- MoU in the field of Civil Aviation (2015)

During the Canadian Prime Minister’s visit to India in 2012, the Memorandum of Understanding on cooperation in Information and Communication Technologies and the Social Security Agreement between the two countries was also signed. The Social Security Agreement has come into force from 1 August 2015.

The countries are keen on developing a focused strategy to strengthen the bilateral ties and have committed to increase the bilateral trade to USD 15 billion by 2015 which appears to have paid off by the increase in FDI flows.

II. Canada - India Tax Treaty: Special Considerations

A. Residency of Partnerships and Hybrid Entities

Benefits under the Canada-India tax treaty ("Canada-India Treaty") are available to residents liable to tax in Canada. Canada based LLPs may face difficulties in claiming treaty relief since Canadian LLPs are fiscally transparent entities and even the partners of the partnership cannot also take advantage of the Canada-India Treaty since they are not direct recipients of the income. Interestingly, in the case of Canoro Resources Ltd., In re the Authority for Advance Ruling ("AAR") held that residential status of a partnership firm is not relevant as every firm would be taxed at a rate of 30%. It observed that in a case when a partnership was being formed under the partnership laws of Canada which were similar to that of India and the individual shares of the partners could be clearly ascertained, the partnership should be assessed as a partnership firm under Section 184 of the ITA.

B. PE Risks

Canadian residents having a PE in India would be taxed to the extent of income attributable to such PE and from sales of goods and merchandise of the same or similar kind as those sold through such PE or from other business activities of the same or similar kind as those effected through such PE. It is necessary to take into account specific PE related tax exposure in the Canada-India context.

Article 7 of the Canada India Treaty has incorporated the limited force of attraction rule. Thus, apart from profits directly attributable to the Indian PE, the Canadian entity would also be taxed for profits from sales in India of similar goods as sold through the PE or profits from business activities in India similar to those undertaken through the PE.

A PE may be constituted if a Canadian based enterprise has a fixed base, office, branch, factory, workshop, etc. in India. The enterprise is deemed to have a PE in India if it has an installation or structure which is used for the extraction or exploitation of natural resources in India and such installation or structure is used for more than 120 days in any twelve month period. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in a twelve-month period.

The Canada-India Treaty is also one of the few tax treaties signed by India which have a service PE clause. A service PE may be constituted if a Canadian enterprise provides services through its employees or other personnel who spend more than 90 days in India in a twelve-month period (or even 1 day if the services are provided to a related enterprise). However, if the services are of the nature of included services as under the Canada-India Treaty, then such entity in India should not constitute a PE of the Canadian entity. In this regard the protocol to the Canada-India Treaty provides that in a case where a Canadian entity has either an installation PE, construction PE or service PE in India for a period extending to over two taxable years, a PE shall not be deemed to exist in a year, if any, in which the use, site, project or activity, as the case may be, continues for a period or periods aggregating less than 30 days

86. [2012] 114 FTR 2 (ITA)
87. 2009] 313 ITR 2 (AAR)
in that taxable year. However, a PE will exist in the other taxable year, and the enterprise will be subject to tax on income arising during that other taxable year.

A dependent agent in India of the Canadian enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders wholly or almost wholly on behalf of the Canadian enterprise. The AAR in *Centrica India Offshore Private Ltd. v. CIT* held that seconded employees of a Canadian company give rise to a PE in India as the Canadian entity had the right to dismiss the seconded employees and provide salaries and other perquisites or allowances and all employment benefits to the seconded employees. The AAR observed that even though the Indian company controlled and supervised the work of the seconded employees it did not have the right to terminate their employment. The AAR also rejected the argument of the taxpayer that the payment to Canadian entity could not be considered as income as it is a case of diversion of income by overriding title. It observed that the Canadian entity, after fulfilling its obligations to pay, was entitled to recover from the Indian company the payroll costs related to the seconded employees. This decision has now been affirmed on appeal both by the High Court and the Supreme Court.

### C. Taxation of Capital Gains

Gains arising to a Canadian resident from the sale of shares of an Indian company may be taxable in both countries. However, in such a case, the Canadian resident is eligible to relief under Article 23 of the Canada-India Treaty which provides for methods for elimination of double taxation.

Capital gains, under the ITA are categorized as short term and long term depending upon the time for which they are held. Gains from listed shares which are held for a period of more than twelve months are categorized as long term. Thus, unlisted shares would be treated as long term only when they are held for more than 36 months. If the holding period for unlisted shares is lesser than 36 months, then it is in the nature of short term gains. Although the Finance Minister proposed reducing the qualifying term for long term capital gains from 36 months to 24 months, no such provision has been made in the Finance Bill, 2016 or the Memorandum.

Long term capital gains arising out sale of listed shares on the stock exchange are tax exempt (but subject to a nominal securities transaction tax). Long term gains arising from the sale of unlisted shares are taxed at the rate of 10%. Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while the tax rate for such gains arising to a non-resident from sale of unlisted shares is 40%. (The rates mentioned herein are exclusive of surcharge and cess that may be applicable).

In this context, it is interesting to note that the AAR in the case of *AAR No. P. 3 of 1994*, where under a vertical merger, a Canadian subsidiary, transferred shares in an Indian company to its Canadian holding company, the transfer of shares was held to be not taxable in India unless it was taxable in Canada. The AAR observed that though the Canada-India Treaty authorized India to tax the capital gains, as per the ITA, capital gains were exempt from tax in India if, (a) at least 25% of the shareholders of the amalgamating foreign company continued to remain shareholders of the amalgamated foreign company (this condition was satisfied); and (b) the transfer did not attract tax (on capital gains) in the country in which the amalgamating company was incorporated (i.e. Canada). Since Canadian tax law granted a roll-over relief in respect of the capital gains, the AAR concluded that, the capital gains were not taxable in India.

The AAR in the case of *Royal Bank of Canada v. DIT* held that profits / losses from derivative transactions are in the nature of business income and not capital gains and shall not be taxable in India in the absence of PE. The AAR observed that the case was similar

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88. [2012] 348 ITR 45 (AAR)
89. 1999 240 ITR 518 AAR.
90. [2010] 323 ITR 380 (AAR)
to that in case of Morgan Stanley\textsuperscript{91} wherein the AAR had ruled that income from exchange traded derivatives being short-term in nature was business income and was not taxable in India as per the provisions of Article 7 the India-UK tax treaty.

D. Taxation of Royalty and Fees for Included Services (“FIS”)

Interest, royalties and FIS arising in India and paid to a Canadian resident may be taxed in Canada. However, if the Canadian resident is the beneficial owner of the royalties or FIS, the tax so charged shall not exceed 20% of the gross amount that is paid. The domestic withholding tax rate on royalty and FIS can be as high as around 27%.

Interest covers income from debt-claims of every kind. Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or work on film tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof and the use of, or the right to use, any industrial, commercial or scientific equipment, other than payments derived by an enterprise from (i) the rental of ships or aircraft, incidental to any activity directly connected with such transportation; or (ii) the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) in connection with the operation of ships or aircraft in international traffic. The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments.

In \textit{Sahara India Financial Corporation Ltd. v. DIT}\textsuperscript{92}, the Delhi High Court held that the payment by the taxpayer company to IMG Canada for title sponsorship benefits did not amount to royalty within the meaning of royalty under the Canada-India Treaty. For the payment to be royalty, it has to be in connection with the right to use any copyright of literary, artistic, scientific work, cinematographic films or radio / television broadcasting.

In the case of \textit{DDIT v. Reliance Industries Ltd}\textsuperscript{93} where an Indian company purchased software from a Canadian company, the Mumbai tribunal held that where there is a transfer of copyrighted Article and not a transfer of the copyright itself the payment received by the taxpayer in respect of the software cannot be considered as royalty under the ITA. It further observed that once it is not royalty under the ITA, the question of examining whether it is royalty under the Canada-India Treaty does not arise. Once it is not royalty, it is business income and as the taxpayer does not have a PE in India it is not taxable in India. In this regard it should also be noted that the definition of royalty under the ITA has been amended retrospectively to bring within its ambit license of software.

FIS refers to payments of any amount in rendering of any technical or consultancy services, including the provision of services by technical or other personnel, if such services:

\begin{itemize}
\item[a.] are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment is in the nature of royalties; or
\item[b.] make available technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design;
\end{itemize}

In \textit{SNC Lavalin International Inc. v. DIT}\textsuperscript{94}, the Delhi High Court held that fees received for services rendered in relation to infrastructure projects involving transfer of drawing or designs for use by another party would be classified as FIS under the ‘make-available’ clause under the Canada-India Treaty.

\textsuperscript{91} 272 ITR 46
\textsuperscript{92} [2010] 321 ITR 459 (Delhi)
\textsuperscript{93} ITA Nos. 5468/M/08
\textsuperscript{94} [2011]352 ITR 314 (Delhi)
Treaty. The Court held that the expression ‘transfer’ included in the clause does not refer to absolute transfer of right of ownership. Even where technical design or plan is transferred for mere 1 USD by the recipient the condition of “making available” technical knowledge would be applicable.

E. Non Discrimination

Article 24 of the Canada India Treaty provides for a non-discrimination clause wherein Canadian Nationals shall not be subjected in India to any taxation or any requirement connected therewith, which is other than or more burdensome than the taxation and connected requirements to which Indian Nationals in the same circumstances are or may be subjected.

In this context, the AAR in the case of Canoro Resources Ltd., In re95 rejected the contention of the taxpayer that the transfer pricing provisions under the ITA conflict with Article 24 of the Canada-India Treaty as a similar transaction between two nationals of India would not have invoked the transfer pricing provisions under the ITA and held that transfer pricing provisions under the ITA would apply based on the residential status of the entity and not by reference to its nationality as envisaged in Article 24 of the Canada India Treaty.

F. Elimination of Double Taxation

Article 23 of the Canada-India Treaty provides elimination of double of taxation. It provides specific methods by which double taxation can be eliminated in both countries. In regard to deduction of tax paid in a territory outside Canada from the tax payable in Canada, unless a greater deduction or relief is provided under the laws of Canada, tax payable in India on profits, income or gains arising in India shall be deducted from any Canadian tax payable in respect of such profits, income or gains. In relation to the exempt surplus of a foreign affiliate a company which is a resident of Canada shall be allowed to deduct in computing its taxable income any dividend received by it out of the exempt surplus of a foreign affiliate which is a resident of India. In case a resident of Canada owns capital which may be taxed in India under the Canada-India Treaty Canada shall allow as a deduction from the tax on capital of that resident an amount equal to the capital tax paid in India. However, such deduction shall not exceed that part of the capital tax (as computed before the deduction is given) which is attributable to the capital which may be taxed in India.

G. Exchange of Information

With a view to curb tax evasion and money laundering, India has been actively entering into arrangements for exchange of information with other countries. The Canada-India Treaty has the older provisions for exchange of information. The clause provides that the Governments of both countries shall exchange such information as is necessary for either for carrying out the provisions of the Canada-India Treaty or as provided under the domestic laws of the country. Information received by any of the countries shall be treated as secret in the same manner as information obtained under the domestic laws of that country and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement in respect of, or the determination of appeals in relation to, the taxes covered by the Canada-India Treaty. Canada has not yet officially adopted the CbC reporting requirements. However, the Canadian government reaffirmed its commitment to the Base Erosion and Profit Shifting (“BEPS”) project, from which the CbC requirements originated. India meanwhile has gone ahead and begun implementation of the same by incorporating suitable provisions into municipal law.

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95. [2009] 313 ITR 2 (AAR)
Investing Into India: Considerations From a Germany-India Tax Perspective

I. German - India Relations: Background

India and Germany have enjoyed long-standing historic and cultural ties due to strong shared values of democracy, rule of law, pluralism, tradition and culture. Germany is India’s biggest trading partner in Europe and the second largest technology partner.  

The relations between India and Germany date back to the early 16th century when German trading companies from Augsburg and Nuremberg started operating in India. The depth of the Indo-German relations is reflected in the fact that Werner Von Siemens, founder of Siemens, personally supervised the laying of telegraph line between Kolkata and London, which was completed in 1870. Further, the first wholly-owned subsidiary of Bayer in Asia “Farbenfabriken Bayer and Co. Ltd.” was set-up in Mumbai as far back as 1896. Since then, there has been a continuous advancement in trade and investment flow between the two countries.

Germany is the 8th largest foreign direct investor in India since January 2000. FDI from Germany into India has significantly increased. The cumulative FDI inflows from Germany into India in the period from April 2000 to June 2015 has been USD 8.19 billion. Industries which have attracted the highest inflow from Germany include services, IT & telecommunications, real estate, automobile, energy & chemicals.

A cross section of German companies regularly participate in India’s infrastructure projects, one of the prominent recent transactions being loan agreement signed by KfW Bankengruppe (a German state owned development bank) to provide Euro 500 million (INR 37.50 billion) worth of loan to finance the proposed Nagpur metro rail project. Major German automobile giants such as BMW, Mercedes, Daimler, Audi, Volkswagen and Porsche have set up manufacturing and assembly units in India. Other German companies that have made significant investments into India include Siemens, Bosch, Bayer, SAP, Deutsche Bank, Kion Group, Munich Re, Luftansa, Merck and others.

Similarly, Indian companies too have been making significant investments in Germany. In the last few years, Indian corporates have invested over USD 6 billion in Germany. Sectors such as IT, automotive, pharma and biotech have received the majority of the Indian investments. Some well-known Indian family run companies such as Ranbaxy, Hinduja Group, Biocon, Hexaware Technologies, Dr. Reddy’s Laboratories, Suzlon, Reliance, Kalyani Steels, Endurance Technologies, Bharat Forge, Mahindra & Mahindra etc. have established presence in Germany. Further, some well-known Indian software companies such as Infosys, Wipro and TCS have set up

97. India-Germany bilateral relations, available at: http://www.ficci.com/international/75179/Project_docs/India-Germany-Bilateral-Relations-21-12-2.pdf
103. Ibid
operations in Germany as well. There are more than 1,600 Indo-German collaborations and over 600 Indo-German joint ventures in operation, and about 215 Indian companies operate in Germany.

The German economy’s success is largely defined by the role played by the Mittelstandt companies, which specialize in their niche product offering, invests into research and development, and are family owned. This last characteristic of Mittelstandt companies is what strikes a common chord with Indian companies who are family owned deeply valuing the culture and traditions along with their conservative approach towards borrowing. Thus, the commonality of philosophy and the complementary nature of offerings which Mittelstandt and the Indian companies share, such as Mittelstandt companies bring in their specialized technology and Indian companies bring in their local market expertise to provide for a great opportunity for mutual cooperation. With changing global outlook, these German Mittelstandt companies are showing greater interest in India.

A number of bilateral agreements and institutional arrangements have been executed between India and Germany. Listed below are some of the key agreements:

- Income and Capital Tax treaty entered on June 19, 1995 which became effective on January 01 1997 (for Germany) and on April 01, 1997 (for India);
- Bilateral Investment Promotion and Protection Agreement entered on July 10, 1995 and became effective on July 13, 1998;
- Social Security treaty entered on October 08, 2008, became effective on October 08, 2008.
- MoU entered into on October 5, 2015 for setting up a fast-track system in India for German companies investing in India. The fast-track system is expected to be fully operationalized by March 2016.

- A Joint Announcement was made at the 3rd Intergovernmental Consultations in October 2015 on setting up a Fast-Track System for German companies in India.

II. German - India Tax Treaty: Special Considerations

A. Residency

Issues have arisen when German-India tax treaty (“German-India Treaty”) benefits are claimed by hybrid entities.

Benefits under the German-India Treaty are available to residents liable to tax in Germany. The tax authorities sought to deny treaty benefits to a German Kommanditgesellschaft (KG) or limited partnership on the basis that it was a transparent entity. However in DIT v. Chiron Bhering, the Bombay High Court noted that although a German limited general partnership does not pay income tax, it is subject to Gewerbesteuer or trade tax which is specifically covered under the German-India Treaty. On this basis, it was held that the German KG cannot be denied treaty benefits.

In contrast, the AAR held that a Swiss general partnership (Schellenberg Wittmer) is not entitled to German-India Treaty benefits since it is a fiscally transparent entity. It was further held that the Swiss resident partners of the partnership could also not take advantage of the German-India Treaty since they were not direct recipients of the income, and because the Swiss-India tax treaty does not recognize partnerships.

Another issue that arises is when an entity is treated as a tax resident under the laws of both countries. Tax residence in a particular jurisdiction generally attracts taxation of the worldwide income of the individual/ entity concerned in that jurisdiction. The

104. Supra 6
105. Supra 8
106. TS-12-HC-2013 (BOM)
107. [2012] 210 TAXMAN 319 (AAR)
India-Germany DTAA provides a tie-breaker rule to address situations where an entity is a resident of both countries under their domestic laws, i.e., the entity will be treated as a resident of the jurisdiction where its POEM is situated.

These tie-breaker rules in the India-Germany DTAA becomes important in light of the amendment introduced in 2015 in India with respect to criteria for determination of tax residence of companies incorporated outside India. Prior to this amendment, i.e., up to financial year 2014-15, a company incorporated outside India qualified as an Indian tax resident in a financial year (April 1 to March 31) only if the entire control and management of its affairs was located in India during that financial year. From financial year 2015-16 onwards, a foreign company qualifies as tax resident in India if its POEM in the relevant financial year is in India. The Indian domestic law and the India-Germany DTAA prescribe the same criteria (i.e., POEM) for determining tax residence of companies However, it is important to note that the jurisprudence which has evolved globally for determining where POEM of a company is situated is somewhat different as compared to the draft guidelines issued by the Indian government in December 2015 for determination of POEM under domestic law. This could create ambiguities and uncertainty in determining existence of POEM. Having said that, it may be noted that the final guidelines for determination of POEM have not yet been issued. The Finance Bill, 2016 (part of the annual budget) proposes to defer the commencement of POEM by one year – i.e., from financial year starting April 1, 2016 onwards.

B. PE Risks

German companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the German-India context.

A PE may be constituted if a German enterprise has a fixed base, office, branch, factory, workshop, etc. in India. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 6 months. A German enterprise is also deemed to have a PE in India if it provides services or facilities in connection with, or supplies plant and machinery on hire used for or to be used in the prospecting for or extraction or exploitation of mineral oils in India.

In the early case of CIT v. Visakhapatnam Port Trust\textsuperscript{108}, the Andhra Pradesh High Court held that mere supply of a plant by a German company whose assembly and erection are undertaken by purchaser under supervision of engineer deputed by supplier does not result in a PE in India. However, the Delhi Tribunal in the case of Steel Authority of India Ltd. v. ACIT\textsuperscript{109} held that a building site or construction, installation or assembly project need not be that of the taxpayer and supervisory activities carried out in connection therewith becomes a PE of the taxpayer if they continue for a period exceeding 6 months. Therefore, even if the installation or assembly project does not belong to the taxpayer, the fact that he has been providing supervisory services for installation purposes for a period exceeding six months would make it a PE.

A dependent agent in India of the German enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders on behalf of the German enterprise.

The Protocol to the treaty clarifies that any direct and independent supply of equipment or machinery from the German head office should not be attributable to profits arising from the building site, construction, assembly or installation project in India. Income derived by a German enterprise from planning, project, construction or research activities as well as income from technical services exercised in India in connection with a PE situated in India, shall not be attributed to that PE.

\textsuperscript{108} 1983 144 ITR 146 AP
\textsuperscript{109} (2006) 10 SOT 351 (Del)
C. Taxation of Capital Gains

Gains arising to a German resident from the sale of shares of an Indian company would be taxable in India. The German-India Treaty does not provide any relief in this regard.

Capital gains are categorized as short term and long term depending upon the time for which they are held. Gains from listed shares which are held for a period of more than twelve months are categorized as long term. In case of unlisted shares, they would be treated as long term only when they are held for more than 36 months. If the holding period for unlisted shares is lesser than 36 months, then it is in the nature of short term gains. The Finance Bill, 2016 proposes to reduce the holding period to 24 months for such gains to be treated as long term gains.

Long term capital gains arising out of sale of listed shares on the stock exchange are tax exempt (but subject to securities transaction tax). However, long term capital gains from transfer of listed shares off the floor of the stock exchange are taxable at

In case of non-residents, long term gains arising from the sale of unlisted shares are taxed at the rate of 20% in case of unlisted shares of public companies (with benefit of adjustment for foreign exchange fluctuation) and at 10% in case of unlisted shares of private companies (without benefit of adjustment for foreign exchange fluctuation). The Finance Bill, 2016 proposes to harmonize the position on long term gains on sale of unlisted shares by taxing such gains at 10% (without benefit of adjustment for foreign exchange fluctuation) in all cases.

Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident company from sale of unlisted shares or sale of listed shares off the floor of the stock exchange is 40%.

In this context, it is interesting to note that the Authority for Advance Ruling in the case of RST, In Re held that even in a case where a German company was holding 99.99% of the shares of a subsidiary in India, the Indian company could not be regarded as a wholly-owned subsidiary of the German company and therefore the capital gains tax relief which was allowed under Section 47(iv) (for parent-subsidiary transfers) of the ITA could not be applied.

D. Taxation of Interest, Royalty and FTS

Interest, royalties and FTS arising in India and paid to a Germany resident may be taxed in Germany. However, if the German resident is the beneficial owner of the interest, royalties or FTS, the tax so charged shall not exceed 10% of the gross amount that is paid. The domestic withholding tax rate can be as high as 40% on interest and 10% (on a gross basis) for royalties and FTS.

Interest covers income from debt-claims of every kind. Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments. FTS refers to payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel respectively.

The Mumbai Tribunal in the case of Siemens Ltd. v CIT held that payments made to laboratories, for conducting certain tests by using highly sophisticated technology without using human intervention for the purpose of certification does not fall within the meaning of FTS under Section 9(1)(vii) of the ITA.

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110. [2012] 348 ITR 368 (AAR)
111. [2013] 30 taxmann.com 200 (Mum)
E. Relief from Double Taxation

Under the German-India treaty, an exemption should be allowed in Germany for any income that arises in India which may be taxed in India in accordance with the treaty. With respect to dividends, the exemption applies only if the German company holds at least 10% of the share capital of the Indian company. Other income not covered by the exemption is subject to available foreign tax credit with respect to taxes paid in India.

F. Exchange of Information

With a view to curb tax evasion and money laundering, India has been actively entering into arrangements for exchange of information with other countries. The German-India treaty also provides a framework for exchange of information between the two Governments. In Ram Jethmalani & Ors. vs Union of India\textsuperscript{112} the Indian Supreme Court noted that while there is a requirement for confidentiality, the German-India treaty permitted disclosure of information in Court proceedings. The Government was accordingly directed to reveal details of accused individuals with Liechtenstein bank accounts, the details of which were shared by the German Government.

G. German – India: Bilateral Investment Promotion and Protection Agreement

Bilateral investment promotion and protection agreements (“BIPAs”) are agreements between two States for the reciprocal encouragement, promotion and protection of investments in each other’s territories by individuals and companies situated in either State.

India entered into a BIPA with Germany on July 10, 1995 which came into force July 13, 1998. The India-Germany BIPA states that investments and investors would be provided “all times fair and equitable treatment and full protection and security”. BIPA provides legal basis for enforcing the rights of the investors of both the countries and provides for fair and equitable treatment, full and constant legal security and dispute resolution through international mechanism.

\textsuperscript{112} [2011] 339 ITR 107 (SC)
Investing Into India: Considerations From a Japan-India Tax Perspective

I. Japan - India Relations: Background

India and Japan share a common vision of global peace, stability and shared prosperity, based on sustainable development. India and Japan have taken major strides in developing strategic, defence, economic and cultural relations.

During the period between April 2000 and February 2015, India has received USD 19.43 billion FDI from Japan, making Japan the fourth largest source of investment into India after Mauritius, Singapore and the United Kingdom. The bilateral commerce between the countries has increased significantly since 2002 and stood at USD 15.52 billion for the financial year 2014-15. India has also been one of the largest recipients of the Japanese Official Development Assistance loans in recent times, which have been utilized to stimulate several upcoming Indian infrastructure projects in India, some notable examples being the Mumbai Metro Line-III project; the Campus Development Project of Indian Institute of Technology; Hyderabad (Phase 2); Delhi–Mumbai Industrial Corridor Project and the Chennai–Bengaluru Industrial Corridor Project.

In pursuance of the spirit of the September 2014 Tokyo Declaration for India – Japan Special Strategic and Global Partnership, in October 2014, the DIPP in India set up a special management team known as ‘Japan Plus’ to facilitate and fast track investment proposals from Japan and to support the Government of India in initiating, attracting, facilitating and handholding Japanese investments across sectors. The team comprises four professionals from India and two representatives of the Government of Japan and as of March 2015, has guided over 120 Japanese companies on various aspects of business.

Recently, India and Japan have also entered into a Memorandum of Cooperation for the introduction of Japan’s High Speed Railways (“HSR”) technologies (the Shinkansen system) to Mumbai-Ahmedabad route and a highly concessional yen loan for this project has been provided by Japan.

Significantly, two bilateral agreements have been entered into between Japan and India that might have a tremendous impact on economic relations between Japan and India:

- CEPA between Japan and India (2011); and
- Agreement Between Japan And India On Social Security (2012) (“Social Security Agreement”)

While Indian exports to Japan primarily include mineral fuels, mineral oils, pearls and other precious and semi-precious stones, iron and steel, sea food and fodder, Japan primarily exports machinery, optical, medical and surgical instruments and articles of iron and steel to India. Under the CEPA, India has committed to reduce or eliminate tariffs from 87% of its tariff lines, whereas Japan has committed to reduce or eliminate tariffs from 92% of its tariff

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lines with fifteen years\textsuperscript{116}. India offered 17.4\% of the tariff lines to be reduced to zero with immediate effect. Tariffs on 66.32\% of tariff lines are likely to be brought down to zero in the next ten years.

Further, the Social Security Agreement exempts employees posted to the host country under short term contracts (upto 5 years) from making social security payments in such host country insofar as social security contributions have been made in the home country and certificate of coverage in respect of the same has been obtained. This is an important step in furthering economic interactions and facilitating movement of talent and knowhow between the two countries.

II. Japan - India Tax Treaty: Special Considerations

A. Residency

Companies or individuals that are resident in Japan, in that, they are liable to tax in Japan therein by reason of their domicile, residence, place of head or main office or any other criterion of a similar nature, can avail of relief under of the India-Japan Double Taxation Avoidance Agreement ("India-Japan DTAA").

Therefore relief may be claimed by Japanese corporations and entities that are liable to tax as residents of Japan. With respect to partnerships limited by shares (gomei kaisha or goshi kaisha) or special types of trusts, treaty relief may be available if these entities are taxed as a regular corporate taxpayer. However, certain fiscally transparent entities may have difficulties in obtaining treaty relief. For instance, issues may be faced by entities such as general or limited partnerships (kumiai) or silent partnerships (tokumei kumiai), which are not treated as a taxable entity in Japan. Unlike certain other tax treaties entered into by India, the India-Japan DTAA does not expressly provide that fiscally transparent entities can claim treaty relief, if the income of the entity is subject to tax in the treaty jurisdiction either in its own hands or in the hands of its partners, beneficiaries, etc. Having said that, in Linklaters LLP v. ITO, International Taxation 117 and Deputy Director of Income Tax (International Taxation)-1 v. A.P. Moller\textsuperscript{118}, the Mumbai tribunal has ruled that a fiscally transparent entity should not be denied treaty benefits if the income in respect of which it claims such benefits is liable to tax in the state of its residence. In both these cases, the question of eligibility to treat benefits has been decided on the basis of the taxability of the income, as opposed to the mode of taxability.

Another issue in the context of residence is that unlike most treaties signed by India, the India-Japan DTAA does not have a tie-breaker clause to deal with situations where a person may be treated as resident of both India and Japan. In such a case, the tax authorities of both States will have to discuss the issue by way of mutual agreement. Tax residence in a particular jurisdiction generally attracts taxation of the worldwide income of the individual / entity concerned in that jurisdiction. Therefore, the OECD model convention has tie-breaker rules to determine residence of entities in situation where such entities qualify as a resident of both jurisdictions (between which the tax treaty is entered into).

The absence of tie-breaker rules in the India-Japan DTAA in relation to companies becomes important in light of the amendment introduced in 2015 in India with respect to criteria for determination of tax residence of companies incorporated outside India. Prior to this amendment, i.e., up to financial year 2014-15, a company incorporated outside India qualified as an Indian tax resident in a financial year (April 1 to March 31) only if the entire control and management of its affairs was located in India during that financial year. From financial year 2015-16 onwards, a foreign company qualifies as tax resident in India if its POEM in the relevant financial year is in India. Therefore, if a Japanese company has its POEM in India, its worldwide income could be tax-


\textsuperscript{117} [2010] 40 SOT 51 (Mumbai)

\textsuperscript{118} [2014] 64 SOT 30
ble in both in India and in Japan without any credit being available in either country for taxes paid in the other country. This issue becomes aggravated by the concern around how existence of POEM is proposed to be determined by Indian tax authorities. In December 2015, the government issued draft guidelines in relation to determination of POEM. However, the final guidelines have not yet been issued. The Finance Bill, 2016 (part of the annual budget) proposes to defer the commencement of POEM by one year – i.e., from financial year starting April 1, 2016 onwards.

**B. PE Issues**

The India-Japan DTAA has a more expansive definition of PE than prescribed under the OECD Model Convention. A Japanese resident may have a PE in India if it has a ‘fixed place of business’ in India through which a part or the whole of its business is carried on. Such fixed place may be constituted through a branch, an office, factory, workshop, warehouses, constructions, place of effective management, or structure for exploration of natural resources (for a period exceeding 6 months) in India. Further, a building site, construction, installation or assembly project, or supervisory services in connection therewith may give rise to a PE if the project or activity exceeds a period of 6 months. A PE may also be constituted if a Japanese resident dependent agent in India concluding contracts, maintaining a stock of goods in India for making deliveries, or securing orders in India on behalf of the foreign enterprise.

In many cases activities that are preparatory or auxiliary to the main business activities should not create a PE even if these are carried out in India. Therefore in the cases of *Mitsui & Co.*[^119^], *Sumitomo Corporation*[^120^] and *Metal One Corporation*[^121^] it was held that a liaison office in India would not be treated as a PE since they only carried out ancillary activities such as collection of information, submission of bids and served as a mere communication channel.

[^119^]: [2008] 114 TaxJ 903 (DELHI)
[^120^]: [2007] 110 TaxJ 302 (DELHI)
[^121^]: [2012] 22 TAXMAN 77 (Delhi)

All profits attributable to a PE will be taxable in India. In *Ishikawajima Harima Heavy Indus. Company Limited v. DIT*[^122^] it was held that for attribution of profits to a PE of a Japanese company in India, it is necessary to consider the activities actually carried out by the PE. It was also held that activities carried outside India could not be attributed to the PE. In *Nippon Kaiji Kyokoi v. ITO*[^123^] it was further held that fees for inspection and survey services provided by a Japanese company would be taxable in India to the extent attributable to its PE in India. It was further held that services not connected to the PE could not be separately taxed as fees for technical services. The Protocol to the India-Japan DTAA however clarifies that attribution shall be made with respect to the PE’s activities even if the order for purchase is placed directly with the head office.

**C. Taxation of Interest, Royalties and FTS**

Interest, royalties and FTS earned by resident of Japan from sources in India would be subject to a lower withholding tax rate of 10%. The domestic withholding tax rate on interest can be as high as around 40%, while the rate for royalty and FTS has been reduced to around 10% with effect from April 1, 2015. The India-Japan DTAA therefore provides significant relief with respect to interest income.

Under the treaty, interest covers income from debt-claims of every kind. Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments. FTS refers to payments of any amount in consideration

[^122^]: 288 ITR 408
[^123^]: [2011] 12 TAXMAN 477 (Mum)
for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel respectively.

In *Uniflex Cables Ltd. v. DCIT*\(^\text{124}\), a Mumbai tribunal held that “usance interest” paid by the Indian company to Japanese vendors (among vendors from other jurisdictions) on letters of credit furnished to them for purchase of raw materials amount to interest under the DTAA and was hence taxable in India.

In *Dassault Systems K.K. v. Director of Income-tax (International Taxation)*\(^\text{125}\) the company marketed licensed software products through independent agents with whom it entered into a general value added reseller agreement (GVA) that merely allowed them to receive and subsequently sell the software products to the end users at a price independently determined by them and upon such purchase from the independent intermediary, the end users were required to enter into a tri-partite end-user license agreement (EULA) with the Japanese company and the intermediary, which enabled them to use a license key (which could function only on the end user’s designated machine) to activate the software and register the license, the Indian Authority for Advance Rulings (“AAR”), New Delhi held that the income derived by the company did not amount to royalty under the ITA or the India-Japan DTAA because the copyright continued to vest in the Japanese company.

However, in *Acclerys K K v. DIT*\(^\text{126}\) the AAR on similar facts held that since the company had specifically granted a right to use the copyright in the software to the customers through the vendor license key, the income from such software supply transaction amounted to royalty and was hence taxable in India. The Supreme Court of India, in *Ishikawajima Harima Heavy Indus. Company Limited v. DIT*\(^\text{127}\) held that offshore services may not be taxable in India unless they are rendered outside India, insofar as they are utilized in India, they may be taxed in India. However, when the issue was referred to a Tribunal for a decision in light of this amendment in *IHI Corporation v. ADIT (IT)-3*\(^\text{128}\), the Tribunal noted that while the position had changed with respect to the domestic law, there had been no change in the position of law under the India-Japan DTAA. Therefore, income from offshore services not being attributable to Indian PE cannot be taxed in India under the India-Japan DTAA. Applying the principle that in case of inconsistency in the position under the domestic law and Treaty law, whichever is more beneficial to the taxpayer shall apply, the Tribunal ruled that income from services rendered offshore may not be taxable in India. Recently, this was re-affirmed by the Tribunal in another case involving the same taxpayer.\(^\text{129}\)

### D. Taxation of Capital Gains

Gains arising to a Japanese resident from the sale of shares of an Indian company would be taxable in India. The treaty does not provide any relief in this regard.

Capital gains are categorized as short term and long term depending upon the time for which they are held. Gains from the transfer of listed shares which are held for a period of more than 12 months are categorized as long term, while gains from the transfer of unlisted shares would be treated as long term only when they are held for more than 36 months. The Finance Minister, in his speech for the Budget 2016, has proposed to reduce this holding period for unlisted securities to 24 months\(^\text{130}\). Long term capital gains arising out sale of listed shares on the stock exchange are tax exempt (but subject to a nominal securities transaction tax). Long term gains arising from the sale of unlisted shares are taxed at the rate of 20% in case of unlisted shares of public companies (with benefit of adjustment for foreign exchange fluctuation) and at 10% in case of unlisted shares of

\(^\text{124}\) [2012] 136 ITD 374 (Mum)

\(^\text{125}\) [2010] 322 ITR 125 (AAR)

\(^\text{126}\) [2012] 345 ITR 304 (AAR)

\(^\text{127}\) 288 ITR 408

\(^\text{128}\) [2013] 32 TAXMAN 132

\(^\text{129}\) IHI Corporation v. ADIT (IT)-3 [2015] 63 TAXMAN 100

\(^\text{130}\) This announcement by the Finance Minister does not find mention in the Finance Bill, 2016. It is expected that this will be included before this Bill is enacted by Parliament.
private companies (without benefit of adjustment for foreign exchange fluctuation). The Finance Bill, 2016 proposes to harmonize the position on long term gains on sale of unlisted shares by taxing such gains at 10% (without benefit of adjustment for foreign exchange fluctuation) in all cases.

Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares are taxed at 40%.

E. Exchange of Information

The India-Japan DTAA has been amended in December 2015, to facilitate exchange of information on tax matters as per the internationally accepted standards, including bank information and information without domestic tax interest. Further, this amendment also provides for the sharing of information received from Japan with other law enforcement agencies, subject to the authorization of the competent authority in Japan and vice versa.

Indian and Japan have also agreed to assist each other with the collection of the revenue claims.

F. Mutual Agreement Procedure

The India-Japan DTAA has clauses similar to those of the OECD Model Convention for Mutual Agreement Procedure (“MAP”) for resolution of situations here a taxpayer considers that actions of the Indian and Japanese Tax authorities result or may result in taxation which is not in accordance with the provisions of the India Japan DTAA. As discussed above, such a situation could result in cases where there is the Indian and Japanese tax authorities differ in their view regarding the tax residence of a particular taxpayer.

India has recently demonstrated its commitment to resolve pending cross border tax disputes through the use of MAP and has resolved 175 cases under MAP with residents of various countries in 2015-16 so far. 331

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I. Mauritius - India Relations: Background

India and Mauritius have shared close economic, political and cultural ties for more than a century. There has been close cooperation between the two countries on various issues including trade, investment, education, security and defense.

Bilateral investment between the two countries has continued to strengthen the ties between the two nations. As of December 2015, the cumulative FDI inflows from Mauritius to India was around USD 93 Billion amounting to 34% of the total FDI inflows, making it India's largest source of FDI. A Several global funds and strategic investors have invested into India from Mauritius due to various commercial, strategic and tax related advantages offered by the country. Mauritius has also emerged as an important gateway for investments into Africa.

India is also Mauritius’s most important trading partner and the largest exporter of goods and services into Mauritius. The combined trade between the two countries stood at USD 1.9 Billion.

The major bilateral agreements between the two nations cover several areas not just restricted to finance, trade and commerce but also including intelligence, cultural ties, environmental protection etc. Some of the key bilateral treaties and institutional agreements between India and Mauritius include:

- The Double Taxation Avoidance Agreement, 1982
- Bilateral Investment Promotion and Protection Agreement, 1998
- MOU on Cooperation in Biotechnology, 2002
- MOU on Cooperation in the Field of Environment, 2005
- MOU Concerning Cooperation in the Exchange of Finance Intelligence Related to Money Laundering & Financing of Terrorism, 2008
- Supply Contract for the Coastal Radar Surveillance System, 2009
- MOU on Science and Technology Cooperation, 2012
- MOU on Textiles, 2012
- MOU on cooperation in MSME Sector (2013)
- MoU in the field of Traditional Systems of Medicine (2015)

II. Mauritius - India Tax Treaty: Special Considerations

A. Residence and Entitlement to Treaty Relief

A person is considered a resident of Mauritius for relief under the tax treaty, as long as it is liable to tax in Mauritius by reason of domicile, residence or place of management. The Indian tax authorities...
issued a Circular (789 of 2000) stating that a tax residency certificate (“TRC”) issued by the Mauritius tax authorities constitutes sufficient proof of residence in Mauritius and entitlement to treaty relief.

This Circular was upheld by the Indian Supreme Court in the landmark Mauritius Case (Union of India v. Aazadi Bachao Andolan\textsuperscript{34} ) where it was held that in the absence of a ‘limitation of benefits’ or anti-abuse clause within the treaty, there was nothing illegal about ‘treaty shopping’ and legitimate tax planning using low tax jurisdictions. The Supreme Court affirmed the time test principle laid down by the UK House of Lords in Duke of Westminster Case\textsuperscript{35} where it was held “every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be”. Therefore, based on this judgment and Circular, any Mauritius based investor with holding a valid TRC should be entitled to treaty relief.

The Supreme Court in Vodafone International Holdings\textsuperscript{36} was also of the view that that treaty benefits cannot be denied to an entity resident in Mauritius having a valid TRC, especially in the absence of a limitation of benefits clause within the treaty.

A number of cases have confirmed treaty benefits for Mauritius based investors including: Dynamic India Fund I\textsuperscript{37} ; DDIT v. Saraswati Holdings Corporation\textsuperscript{38} ; E*Trade; In Re Castleton\textsuperscript{39} and D.B. Zwirn Mauritius Trading\textsuperscript{40} , In re, Ardex Investments Mauritius Ltd.\textsuperscript{41} , In re, SmithKline Beecham Port Louis Ltd.\textsuperscript{42} , DLJMB Mauritius Co.\textsuperscript{43} , Moody’s Analytics Inc.\textsuperscript{44} . Very recently, the Punjab & Haryana High Court in In re, Dow AgroSciences Agricultural Products Ltd.\textsuperscript{45}

Certain proposals in the 2013 Budget, gave rise to doubts on the continued validity of the Circular and availability of relief under the Mauritius treaty. Immediately after the Budget, the Government issued a press release clarifying that the Circular is still valid and that, at the moment, a TRC obtained by a Mauritius company would not be questioned for proof of residence. It is understood that India and Mauritius are in the process of renegotiating the tax treaty and criteria for obtaining relief under the treaty.

B. PE Risks

Mauritius companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Mauritius-India context.

A PE of a Mauritius based entity may be constituted in India if such entity has a ‘fixed place of business’ in India through which a part or the whole of its business here is carried on. Such fixed place may be constituted through a branch, an office, factory, workshop, warehouses, constructions or place of effective management in India. A PE may also be constituted if a Mauritius resident has a building, construction or assembly project in India for a period exceeding 9 months. In GIL Mauritius Holdings Ltd. v. ADIT\textsuperscript{47} the Delhi Tribunal held that presence in India for installation of a pipeline may not per se be a PE but would give rise to a PE only if it extends for a period beyond 9 months. A PE may be constituted if a Mauritius entity has a dependent agent in India concluding contracts or maintaining a stock of goods in India for making deliveries on behalf of the foreign enterprise.

The Mumbai tribunal in DDIT v. B4U International Holdings Limited\textsuperscript{48} held that an Indian entity that did not have the power to conclude contracts on

\textsuperscript{134.} [2005] 263 ITR 706 (SC).


\textsuperscript{136.} [2012] 341 ITR 1.

\textsuperscript{137.} AAR 1016/2010 dated 18th July, 2012.

\textsuperscript{138.} [2009] 121 TT 334.

\textsuperscript{139.} [2010] 324 ITR 1 (AAR).

\textsuperscript{140.} [2011] 335 ITR 32 (AAR).

\textsuperscript{141.} [2012] 340 ITR 272 (AAR).

\textsuperscript{142.} [2012] 348 ITR 956 (AAR).

\textsuperscript{143.} [1997] 228 ITR 268.

\textsuperscript{144.} [2012] 348 ITR 205.

\textsuperscript{145.} WP (C) No. 11307 of 2014 (O&M).

\textsuperscript{146.} AAR No. 252 of 2001.

\textsuperscript{147.} [2012] 348 ITR 492 (Del).

\textsuperscript{148.} [2012] 18 ITR 62 (Mumbai).
D. Taxation of Capital Gains

Capital gains (whether long term or short term) earned by a Mauritian resident from the transfer of securities in India would not be subject to tax in India. Under Indian domestic law, capital gains tax can range from around 10% to 40% depending on the period of holding, the nature of the security involved and the status of the investor. Gains from the transfer of listed securities which are held for a period of more than twelve months are categorized as long term. Gains arising from the transfer of unlisted securities would be treated as long term only when such securities have been held for more than 36 months. If the holding period of such securities is less than 36 months, then the gains arising upon their transfer would be in the nature of short term gains.

The relief from capital gains tax provides significant advantage for Mauritius based funds and other investors. This is particularly beneficial for US investors investing via Mauritius as they are able to avoid double taxation of capital gains income which could have potentially arisen because of conflict in source rules (for capital gains tax) under US and Indian domestic law.

From the Supreme Court decisions in *Azadi Bachao Andolan and Vodafone International Holdings* to the various advance rulings referred to above, Courts have generally held that a Mauritius resident holding a TRC would not be taxable on gains earned from transfer of Indian securities.

There has been some challenge from revenue authorities on entitlement to relief on the basis that the Mauritius entity was not the real beneficial owner of the Indian investments. However, the position of law laid down by the Supreme Court in favor of Mauritius based investors has not changed till date.

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150. ITA Nos. 1274, 1557, 1599 & 1621 of 2013

151. In any case, following amendments to the ITA by the Finance Act, 2015, the withholding tax rate applicable in case of royalty and fees for technical services ("FTS") has been reduced to 10% from the earlier 25%.


153. The Budget 2016 proposes to reduce the holding period for unlisted shares to 24 months. However, this proposal is not reflected in the Finance Memorandum. If this proposal is enacted as law, then gains arising upon the transfer of an unlisted security held for 24 months or more would be treated as long term gains.

One may also note that in the case of *Re: Castleton Investments*\(^{55}\), it was held that although the Mauritius investor may not be liable to capital gains tax, the gains may still be subject to minimum alternate tax at the rate of 18.5%. However, following the recommendations of the Committee on Direct Tax Matters chaired by Justice AP Shah, the Government has issued a Press Release\(^{56}\) clarifying that MAT would not be applicable to Foreign Portfolio Investors as well as foreign companies, provided that the latter category are resident of a country having a treaty with India and do not have a permanent establishment in India within the definition of the term in the relevant treaty. On the basis of the Press Release, the Supreme Court disposed\(^{57}\) the appeal filed by Castleton in terms thereof. The Finance Bill, 2016 has further proposed an amendment (applicable with retrospective effect from April 1, 2001) to the ITA clarifying that the MAT provisions will not be applicable to foreign companies meeting the conditions mentioned above. Consequently, MAT should not be applicable on foreign companies investing into India through Mauritius.

It is expected that the ongoing renegotiation of the Mauritius tax treaty will provide further clarity and certainty as to the circumstances for entitlement of the capital gains tax relief under the treaty

**E. Exchange of Information**

The India-Mauritius tax treaty has the older provisions for exchange of information though India and Mauritius are reported to be entering into a specific tax information exchange agreement containing more elaborate provisions for exchange of information.

Mauritius has also become a signatory to the Convention on Mutual Administrative Assistance and has made a commitment to early implementation of the new global standard for automatic exchange of information purposes (the Common Reporting Standard (CRS) developed by the OECD). It is expected that Mauritius will undertake the first exchanges of information by 2018.

**F. Mauritius - India Bilateral Investment Promotion and Protection Agreement**

Bilateral investment promotion and protection agreements (BIPAs) are agreements between two States for the reciprocal encouragement, promotion and protection of investments in each other’s territories by individuals and companies situated in either State.

The India-Mauritius BIPA is comprehensive and provides several reliefs to investors from Mauritius including fair and equitable treatment, protection against expropriation, repatriability of capital, an efficient dispute resolution framework and other rights and reliefs. Taking advantage of the BIPA is an important strategic reason for investors to invest from Mauritius. It should be noted that India does not have a BIPA with the US and hence, typically US investors investing from Mauritius seek to take advantage of the India-Mauritius BIPA.

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57. CA Nos. 4559 & 4560 of 2013
Investing Into India: Considerations From a Netherlands-India Tax Perspective

I. Netherlands – India Relations: Background

India and Netherlands have historically enjoyed strong commercial ties which have been nurtured by the shared values of democracy, multiculturalism and the rule of law and which have intensified with economic liberalization in India and the recognition of India as an attractive investment destination.

Trade relations between India and Netherlands have continued to remain robust as the Euro zone economy recovers. In 2012, two-way trade between India and the Netherlands reached Euro 6.38 billion, giving India a positive balance of trade. This decreased by 9.73% in 2013 and further dipped by 21.54% in 2014, with a positive balance of trade for India. Further, the cumulative FDI inflows into India from the Netherlands in the period between April 2000 and September 2015 have been $15.769 billion, comprising 6% of the total FDI inflows in India during that period. Many well-known Dutch multinationals like Phillips, KLM, Shell and Unilever have established massive operations in India. Likewise, more than 150 Indian companies are based out of the Netherlands, attracted by the stability of the Dutch tax system and the competitive corporate tax rate of 20 – 25%.\(^\text{158}\)

A number of bilateral agreements and institutional arrangements have been executed between India and Netherlands. Listed below are some of the important agreements on commercial and economic cooperation:

- India and Netherlands Income and Capital Treaty (1988) which became effective on Income and Capital Tax treaty entered on June 19, 1995 which became effective on January 01 1989 (for the Netherlands) and on April 01, 1989 (for India);
- India and Netherlands Bilateral Investment Promotion and Protection Agreement (1995) which came into force on December 01, 1996;
- Agreement on Social Security between the Kingdom of Netherlands and the Republic of India (2009) which came into force and became effective on December 01, 2011.

II. Netherlands – India Tax Treaty: Special Considerations

A. Residency

For a Dutch entity to be entitled to relief under the Netherlands-India tax treaty, it has to be liable to tax in the Netherlands. This may not be an issue for entities such as Dutch BVs, NVs or Cooperatives investing or doing business in India.

In the case of KSPG Netherlands\(^\text{159}\) it was held that sale of shares of an Indian company by a Dutch holding company to a non-resident would not be taxable in India under the India-Netherlands tax treaty. It was further held that the Dutch entity was a resident of the Netherlands and could not be treated as a conduit that lacked beneficial ownership over the Indian investments. The mere fact that the Dutch holding company was set up by its German parent company did not imply that it was not eligible to benefits under the Netherlands-India tax treaty.

It may be noted that difficulties with respect to treaty relief may be faced in certain situations, especially in the case of general partnerships (VOF) and hybrid


\(^{159}\) [2010] 322 ITR 696 (AAR)
entities such as closed limited partnerships, European economic interest groupings ("EEIG") and other fiscally transparent entities.

Another issue that arises is when an entity is treated as a tax resident under the laws of both countries. Tax residence in a particular jurisdiction generally attracts taxation of the worldwide income of the individual / entity concerned in that jurisdiction. The India-Netherlands DTAA provides a tie-breaker rule to address situations where an entity is a resident of both countries under their domestic laws, i.e., the entity will be treated as a resident of the jurisdiction where its POEM is situated.

These tie-breaker rules in the India-Netherlands DTAA becomes important in light of the amendment introduced in 2015 in India with respect to criteria for determination of tax residence of companies incorporated outside India. Prior to this amendment, i.e., up to financial year 2014-15, a company incorporated outside India qualified as an Indian tax resident in a financial year (April 1 to March 31) only if the entire control and management of its affairs was located in India during that financial year. From financial year 2015-16 onwards, a foreign company qualifies as tax resident in India if its POEM in the relevant financial year is in India. The Indian domestic law and the India-Netherlands DTAA prescribe the same criteria (i.e., POEM) for determining tax residence of companies However, it is important to note that the jurisprudence which has evolved globally for determining where POEM of a company is situated is somewhat different as compared to the draft guidelines issued by the Indian government in December 20015 for determination of POEM under domestic law. This could create ambiguities and uncertainty in determining existence of POEM. Having said that, it may be noted that the final guidelines for determination of POEM have not yet been issued. The Finance Bill, 2016 (part of the annual budget) proposes to defer the commencement of POEM by one year – i.e., from financial year starting April 1, 2016 onwards.

B. PE Issues

Dutch companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Netherlands-India context.

A PE may be constituted if a Dutch enterprise has a fixed base, office, branch, factory, workshop, sales outlet, warehouse etc. in India. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 183 days. A dependent agent in India of the Dutch enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders on behalf of the Dutch enterprise.

In the case of DDIT v Dharti Dredging and Infrastructure Ltd.160 the Hyderabad tax Tribunal held that a PE was not constituted where a dredger was leased by a Dutch company to an Indian company and was operated under the direction, control and supervision of the Indian company. In the case of Van Oord Atlanta B.V. v ADIT161, the Kolkata bench of the Income Tax Appellate Tribunal held that since the Dutch enterprise’s dredger was in India for a period much shorter than the 6 month requirement under the Netherlands-India tax treaty, the dredger could not constitute a PE of the Dutch enterprise.

The Protocol to the treaty clarifies that only income that is ‘actually attributable’ to the activities of a PE shall be considered for the purpose of taxation at source. With respect to contracts for the survey, supply, installation or construction of industrial, commercial or scientific equipment or premises, or of public works, it is clarified that the profits of a PE shall not be determined on the basis of the total amount of the contract, but only on the basis of that part of the contract which is effectively carried out by the PE. Further, no profits shall be attributed to a PE by reason of the facilitation of the conclusion

of foreign trade or loan agreements or mere signing thereof.

C. Taxation of Capital Gains

In certain situation, the Netherlands-India treaty provides relief against capital gains tax in India. Normally under Indian domestic law capital gains tax can range between 10% to around 40% depending on the residence of the transferor, status of the transferor (for eg., individual, company, etc.), period of holding, nature of asset and type of transaction. Gains from listed shares which are held for a period of more than twelve months are categorized as long term. In case of unlisted shares, they would be treated as long term only when they are held for more than 36 months. If the holding period for unlisted shares is lesser than 36 months, then it is in the nature of short term gains. The Finance Bill, 2016 has proposed to reduce the holding period for unlisted shares for long term purposes to 24 months.

As per the Netherlands-India treaty, gains arising to a Dutch resident arising from the sale of shares of an Indian company to non-resident buyer would not be taxable in India. Such gains would be taxable if the Dutch resident holds more than 10% of the shares of the Indian company and the sale is made to a resident of India.

The gains however would not be taxable in India if they arise in the course of a corporate organisation, reorganization, amalgamation, division or similar transaction and the buyer or seller owns at least 10% of the capital of the other.

In Re: VNU International B.V., the Authority for Advanced Rulings held that where a Dutch company transfers its holding in an Indian company to a non-resident, the transaction would be eligible for relief against capital gains tax under the tax treaty but the Dutch company would still be required to file a tax return in India.

In other cases, including a recent ruling by the Authority of Advance Rulings in India, it was held that provisions dealing with filing tax returns are not attracted when no income is chargeable to tax in India. However, as there are conflicting rulings on these points, ambiguity may continue till a position is taken by the Supreme Court, particularly, as a 2013 amendment to the income tax rules in India provides that tax returns are required to be filed to claim relief under tax treaties.

The case of Vodafone International Holdings B.V. v Union of India, dealt with the acquisition of a Cayman Island based entity from a Cayman based seller by a Dutch subsidiary of Vodafone. The target entity held various subsidiaries which ultimately held an operating company in India. The Supreme Court of India held that Indian tax authorities did not have the jurisdiction to tax a sale of shares in a Cayman Islands company by a non-resident and hence the Dutch entity was not required to withhold tax on the purchase consideration.

Subsequent to the Vodafone ruling, in 2012, the government introduced a retrospective amendment by way of a clarification. As per the amendment, if an offshore company set up outside India holds assets in India and if the shares of the offshore company are transferred between two non-residents, such transfer could be taxable in India if the offshore company’s value is substantially derived from assets in India. It may be noted that such taxation of indirect transfer is also subject to relief under the Netherlands-India treaty. However, based on the retrospective amendment, proceedings were again initiated against Vodafone. In that context, in May 2014, the Dutch subsidiary of Vodafone initiated arbitration procedures under the India-Netherlands bilateral investment treaty. With the dispute pending arbitration, the tax authorities recently, sent a notice to Vodafone stating that overdue amounts, even from overseas companies, may be recovered “from any assets of the non-resident which are, or may at any time come, within India”. The current government under Prime Minister Narendra Modi, which came into power

162. [2012] 334 ITR 56 (AAR)


that month, had promised to create a more stable
tax regime to make the country more attractive to
foreign investors. This notice by the department
potentially brings back the situation to square one,
frustrating all efforts taken by both sides to arrive at
an amicable decision.

The 2016 Budget makes a weak attempt at resolv-
ing pending litigation arising out of retrospective
taxation as part of the Direct Tax Dispute Resolu-
tion Scheme. As per the proposed scheme, if a tax-
payer makes a declaration on or after June 1, 2016,
he will be required to pay only the amount of tax as
determined (no interest and penalties to be paya-
ble). The taxpayer will be required to furnish proof
of withdrawal from all pending litigation, includ-
ing proceedings by way of any arbitration under a
Bilateral Investment Protection Agreements at the
time of filing such a declaration. This scheme seems
to be more an attempt by the Government to realize
dues expeditiously, rather than providing a prac-
tical resolution to the taxpayers. Although taxpayers
may only be required to pay the determined tax, the
issue is that the very application of retrospective
amendments is questionable. In such a case, it may
be unlikely that a taxpayer would be willing to waive
his rights under Bilateral Investment Treaties in
order to file a declaration under this scheme.

D. Taxation of Interest, Royalty
and FTS

Interest, royalties and FTS arising in India and paid
to a Dutch resident may be subject to a lower with-
holding tax of 10% under the Netherlands-India tax
treaty. This is a significant relief from the withhold-
ing under Indian domestic law which can be as high
as 40% for interest. In case of royalties and FTS also,
the treaty provides relief through a more restricted
definition clause as compared to domestic law.

Under the Treaty, interest covers income from
debt-claims of every kind. Royalties is defined to
mean consideration for the use of or the right to use
any copyright of literary, artistic or scientific work,
including motion picture films or works on films or
 videotapes for use in connection with television, any
patent, trade mark, design or model, plan, secret for-
maula or process, or for the use of, or the right to use,
industrial, commercial or scientific equipment, or for
information concerning industrial, commercial or
scientific experience.

The definition of royalty is more restricted than
under Indian domestic law which has been recently
subject to certain retroactive amendments. It also
does not cover payment for use of equipment unlike
in several tax treaties. On this basis, in Nederland-
sche Overzees Baggermaatschappij BV765, the Mumbai
Tribunal held that payment to a Dutch firm for use
of certain dredging equipment on dry lease was held
not to be in the nature of taxable royalties.

The definition of FTS in the treaty is also more
restricted than the definition under Indian domestic
law. Under the treaty, FTS only covers payments for
services that are ancillary to license that may give
rise to royalties, or if the service involves making
available or transfer of knowledge, skill, know how
or a technical plan or design. If there is no such tech-
ology or knowledge transfer, the fees may not be
taxable unless the Dutch resident has a PE in India.

In the case of Re: Shell Technology India166, the
Authority for Advance Ruling held that payment for
support services rendered by a Dutch affiliate to an
Indian company did not qualify as taxable fees for
technical services under the treaty since the services
did not make available any technical knowledge
or skill. Likewise in De Beers India Minerals 167 the
Karnataka High Court held that fees paid to a Dutch
service provider for conducting geophysical surveys
could not be taxed as fees for technical services in the
absence of knowledge transfer.

The India-Netherlands treaty also has a most

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165. [2010] 39 SOT 556
166. 246 CTR 158.
167. [2012] 346 ITR 467 (Kar)
favoured nation requirement providing that if India (post 1989) enters into a treaty with an OECD member country which provides lower scope of taxation of dividends, interest, royalties or FTS, then the same relief may be available under the India-Netherlands tax treaty. In light of the MFN clause, while interpreting the scope of ‘fees for technical services’ under the India-Netherlands treaty, recently, the Income Tax Appellate Tribunal held that the “make available” requirement in the India - US tax treaty (which limits the scope of what services qualify as “fees for technical services”) was to be read as part of the India-Netherlands treaty. 168

E. Exchange of Information

The Netherlands - India tax treaty was amended in 2012 to provide a more comprehensive framework for exchange of information between the two countries. The amended provisions clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

Investing Into India: Considerations From a Singapore-India Tax Perspective

I. Singapore - India Relations: Background

Building on their centuries-old historical and cultural linkages, Singapore and India have, over the years, developed a very strong strategic partnership, which covers a whole gamut of areas of cooperation including trade, tourism, security and defence. Singapore is an important partner for India, owing to its strategic location, stable government, competitive work-force and a pro-business environment. It is ranked #1 in World Bank’s ease of doing business index. Singapore has a mature and developed financial market with an important stock exchange to facilitate the raising of capital and improve stock liquidity. Singapore also has good connectivity to the rest of Asia, Europe and the United States, thereby making it very convenient for prospective clients to invest there. Several multinational corporations including Indian companies are actively considering setting up regional or international headquarters in Singapore.

Singapore has always been an important strategic trading post, giving India trade access to the Malay Archipelago and the Far East. For India, Singapore has also played an important role with respect to India’s “Look East” Policy for expanding its economic, cultural and strategic ties in Southeast Asia.

FDI of around USD 238.35 billion has been received from Singapore from April 2000 to December 2015, making it the second largest investor in India after Mauritius accounting for 16% of total FDI received by India\(^\text{169}\). The investments from India to Singapore have been equally forthcoming\(^\text{170}\). Singapore has become a preferred centre of operations for Indian companies active in the Asia Pacific region.

Thanks to its enabling environment, access to low cost finance, strong air connectivity, availability of skilled resources and the presence of a large Indian community, Singapore has emerged as a key offshore logistics and financial hub for many Indian corporate/houses.

In 2005, India and Singapore signed the Comprehensive Economic Cooperation Agreement (“CECA”) to promote trade, economic development and partnerships which integrates agreements on trade in goods and services, investment protection, and economic cooperation in fields like education, intellectual property and science & technology.

The CECA eliminated tariff barriers, double taxation, duplicate processes and regulations and provided unhindered access and collaboration between the financial institutions of Singapore and India.

A number of bilateral agreements and institutional arrangements have been executed between Singapore and India. Listed below are some of the key agreements:

- Establishment of Diplomatic Relations (1965);
- Bilateral Air Services Agreement (1968);
- Defence Cooperation Agreement (2003);

India and Singapore are poised to see enhanced economic cooperation as well as an increase in trade and investment flows.

\(^{169}\) http://dipp.nic.in/English/Publications/FDI_Statistics/2015/FDI_FactSheet_OctoberNovemberDecember2015.pdf

\(^{170}\) https://www.hcisingapore.gov.in/pages.php?id=74
II. Singapore - India Tax Treaty: Special Considerations

A. Residency of Partnerships and Hybrid Entities

Tax treaty relief may only be claimed by persons who are residents in accordance with the taxation laws of India or Singapore, as the case may be. Singapore based LLPs may face difficulties in claiming treaty relief in view of the Schellenberg Wittmer case wherein a Swiss general partnership was held not to be entitled to treaty benefits since it is a fiscally transparent entity in Switzerland and does not qualify as a resident of Switzerland under the tax treaty. Further, Swiss resident partners of the partnership could also not take advantage of the treaty since they were not direct recipients of the income. Similarly, in Singapore law, a partnership or an LLP is a fiscally transparent entity and may not be able to claim treaty reliefs in India since it would not qualify as a Singapore resident under the tax treaty. The treaty in this regard needs to be revised.

B. PE Risks

Singapore residents having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Singapore India context.

A PE may be constituted if a Singapore based enterprise has a fixed base, office, branch, factory, workshop, etc. in India. The enterprise is deemed to have a PE in India if it has an installation or structure which is used for the extraction or exploitation of natural resources in India and such installation or structure is used for more than 120 days in a fiscal year. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 183 days in a fiscal year. A Singapore enterprise shall also be deemed to have a PE in India if it provides services or facilities in relation to exploration, exploitation or extraction of mineral oils in India for a period of more than 183 days in a fiscal year.

The Singapore treaty is also one of the few tax treaties signed by India which have a service PE clause. A service PE may be constituted if a Singapore enterprise provides services through its employees who spend more than 90 days in India in any fiscal year (or 30 days if the services are provided to a related enterprise).

A dependent agent in India of the Singapore enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders wholly or almost wholly on behalf of the Singapore enterprise.

The Delhi High Court in Rolls Royce Singapore Pvt. Ltd. v. ADIT held that a sales agent in India providing services to a Singapore company would be treated as giving rise to a dependent agent PE in India. The Court noted that the Indian entity was prohibited from promoting products of competitors, and that the Singapore company exercised extensive control over the Indian entity whose activities were wholly or almost wholly devoted to the Singapore company. However, the Court also accepted the established principle that if the agent is compensated the agent (PE) at arm’s length, there can be no further attribution of taxable income. In WSA Shipping (Bombay) Pvt Ltd. v. ADIT the Mumbai Tribunal held that an Indian service provider which acted on behalf of a Singapore company could not be treated as an agency PE in India since the Indian entity was an independent agent that provided services to multiple clients.

C. Exemption for Capital Gains Tax on Sale of Shares

Gains arising to a Singapore resident from the sale of shares of an Indian company would be taxable only

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172. [2012] 347 ITR 192 (Delhi)
173. [2012] 53 SOT 306 (Mum)
in Singapore, whereas Singapore does not impose a capital gains tax. Hence, the transaction would be tax exempt in both countries. However, in this context, it is essential to note that the capital gains tax benefit available under the Singapore India tax treaty may be denied if the Singapore resident does not satisfy conditions laid down under the Limitation of Benefits (“LoB”) clause in the treaty. As per the LoB clause (contained in Article 3 of the Singapore India treaty protocol), a Singapore resident will be entitled to the capital gains tax exemption on sale of shares of an Indian company only if the following criteria is satisfied:

- Purpose not to be primarily tax driven (Article 3.1 of Singapore India treaty protocol): The affairs of the Singapore enterprise are not arranged with the primary purpose of taking benefit of the capital gains tax relief.

- The Singapore resident is not a shell or conduit (Article 3.2-3.4 of Singapore treaty protocol): A shell / conduit entity is one with negligible or nil business operations or with no real and continuous business activities carried out in Singapore.

A Singapore resident is deemed not to be a shell or conduit if its annual operational expenditure in Singapore is at least SGD 200,000 per year in the two years preceding the transfer of shares giving rise to capital gains.

The Singapore India treaty protocol is a broad anti-avoidance provision within the treaty itself. A Singapore entity will not be entitled to the capital gains tax relief if its affairs are arranged with the primary purpose of taking benefit of such relief. If this is the case, the benefit may be denied even if the Singapore entity incurs annual operational expenditure of SGD 200,000.

The Singapore treaty protocol also clarifies that the capital gains tax exemption shall be applicable only to the extent a similar exemption continues to be available under the Mauritius-India tax treaty.

### D. Taxation of Royalty and FTS

Interest, royalties and FTS arising in India and paid to a Singapore resident may be taxed in Singapore. However, if the Singapore resident is the beneficial owner of the royalties or FTS, the tax so charged shall not exceed 10% of the gross amount that is paid. The domestic withholding tax rate on royalty and FTS paid to non-residents is also 10% on a gross basis (excluding applicable surcharge and cess).

Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information or for the use of, or the right to use, any industrial, commercial or scientific equipment, other than payments derived by an enterprise from (i) the incidental lease of ships or aircraft used in such transportation; or (ii) the use, maintenance or rental or containers (including trailers and related equipment for the transport of containers) in connection with such transportation. The definition of royalty is more restricted than under Indian domestic law which has been subject to certain retroactive amendments in 2012.

The Mumbai Tribunal in Standard Chartered Bank v. DCIT\(^{174}\) held that payment for data processing services provided by a Singapore based company cannot be treated as taxable royalty income since the Indian client did not have possession or control over the mainframe computer in Singapore and could only transmit the data and receive back processed information from the server. This case may be contrasted with In Re: Cargo Community Network Pte. Ltd\(^{175}\) where it was held that payment to a Singapore based service provider for access to an internet based air cargo portal would be characterized as taxable royalty payments.

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174. 2011 TPI 728 (ITAT-Mumbai)
175. [2007] 289 ITR 355 (AAR)
The scope of FTS in the Singapore treaty is more restrictive than most treaties signed by India. FTS refers to payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel if such services:

a. are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment is in the nature of royalties; or

b. make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein; or

c. consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein.

The case of *Bharati AXA General Insurance Co.Ltd v. Director of Income Tax* 176 dealt with the taxability of payments made by an Indian entity for support services provided by a Singapore company, which included strategic advice, marketing support, IT services, choosing re-insurance partners, review of actuarial methodologies, etc. in line with the global practices. The Authority of Advance Ruling (AAR) held that such payments are not FTS as the services do not “make available” any technical knowledge, know-how or skill to the Indian company. However, in *Organisation Development Pte. Ltd. v. DDIT* 177, the Chennai Tribunal held that payments made to a Singapore based service provider for license to a specialized software to enable management based on ‘balanced score card’ techniques and transfer of knowledge and skill would be treated as fees for technical services subject to withholding tax in India.

E. Exchange of Information

The Singapore India tax treaty was amended in 2011 to strengthen the exchange of information framework in line with internationally prescribed norms.

The amended treaty clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person. However, there are safeguards in relation to supply of information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Singapore has also become a signatory to the Convention on Mutual Administrative Assistance and has made a commitment to early implementation of the new global standard for automatic exchange of information purposes (the Common Reporting Standard (CRS) developed by the OECD).

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176. (2010) 326 ITR 477 (AAR)
177. [2012] 50 SOT 421 (Chen)
Investing Into India: Considerations From a Swiss-India Tax Perspective

I. Swiss - India Relations: Background

India’s traditional policy of non-alignment and the Swiss policy of neutrality, coupled with shared values of democracy and rule of law have forged close ties between the two countries. Swiss-India economic relationship dates back to the 1850s, when Volkart Trading Co set up offices in Basel and Bombay. Since then, there has been a continuous rise in trade and investment flow between the two countries.

FDI from Switzerland into India is estimated to be in excess of USD 5 billion. In around 5 years (2007-2012) trade between the two countries tripled from around USD 10 billion to USD 34 billion. Popular sectors of economic cooperation between India and Switzerland include banking & finance, biotechnology, education, clean-tech, infrastructure, research & development, science & technology, engineering, precision instruments, entertainment, tourism and others.

A number of bilateral agreements and institutional arrangements have been executed between India and Switzerland including:

- Swiss-India Joint Economic Commission (1959)
- Swiss-India Collaboration in Biotechnology (1974)
- Agreement for Promotion and Protection of Investments (1997)
- Agreement on Social Security (2009)
- Swiss-India Joint Committee on Science & Technology (2011)

II. Swiss - India Tax Treaty: Special Considerations

A. Residency of Partnerships and Hybrid Entities

Difficulties may arise when treaty benefits are claimed by partnerships and hybrid entities. Benefits under the Swiss-India tax treaty ("Swiss-India Treaty") are available to residents liable to tax in Switzerland.

In Schellenberg Wittmer, a Swiss general partnership was held not to be entitled to treaty benefits since it is a fiscally transparent entity. It was further held that the Swiss resident partners of the partnership could also not take advantage of the treaty since they were not direct recipients of the income. In contrast, the Bombay High Court confirmed that a German partnership (DIT v. Chiron Bhering) should be eligible for German-India tax treaty benefits since the partnership (though fiscally transparent) was subject to a German trade tax, which was listed as a covered tax under the treaty.

By virtue of a Protocol to the Swiss-India Treaty (effective from April 1, 2012), Swiss pension funds or schemes would be treated as residents entitled to treaty benefits even if they are generally exempt...
from tax in Switzerland. This specific clarification provides some relief, considering that in the US-India context, a US pension fund (in the case of Re: General Electric Pension Trust 180) was held not to be entitled to treaty benefits. 181

B. PE Risks

Swiss companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Swiss-India context.

In addition to the standard PE threshold in most treaties (eg: fixed base, office, branch, construction site), the Swiss-India Treaty also has a service PE clause. A service PE may be constituted if services are provided by the Swiss enterprise’s employees who spend more than 90 days (in a 12 month period) in India or 30 days if the services are provided to a related enterprise in India.

A dependent agent in India of the Swiss enterprise that negotiates and concludes contracts on its behalf would be treated as a PE. Unlike in most Indian treaties, an agent in India which manufactures or processes goods belonging to the Swiss enterprise would also be treated as a PE. This could create tax exposure for enterprises having contract research and manufacturing arrangements in India.

In eBay International AG v. ADIT 182, the Tax Tribunal held that Indian company which entered into an exclusive marketing services arrangement with its Swiss parent should not be viewed as a PE. The Tribunal also held that fees received by the Swiss entity from Indian customers who used the online e-commerce platform is not in the nature of technical service fees and hence, not taxable in India in the absence of a PE.

C. Lower Withholding Tax Rate not Available to ‘Conduits’

The Swiss-India Treaty provides some relief for financing arrangements, IP licensing and technology collaborations. Swiss residents should be able to take advantage of the lower withholding tax rate of 10% for interest, royalties and technical service fees available under the Swiss-India Treaty. Ordinarily, India’s domestic withholding tax rate on interest can be as high as around 40%, while the rate for royalty and FTS has been reduced to around 10% with effect from April 1, 2015. 183

The lower withholding tax rate is available only to Swiss residents that are beneficial owners of interest, royalties or technical service fees. Such relief would therefore not be available to conduit companies in Switzerland.

The Protocol to the Swiss-India Treaty defines ‘conduit arrangement’ as one where the Swiss resident “pays, directly or indirectly, all or substantially all” of its income “at any time or in any form” to another person who is resident in a third State, and where the main purpose of the structure was to take advantage of the lower withholding tax rate.

Since the Swiss-India Treaty relief is critical in light of the higher domestic withholding tax rates, it is important to consider the ‘conduit’ limitation while setting up Swiss structures.

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180. (2006) 200 CTR (AAR) 211.
181. Although the US-India treaty unlike most treaties recognizes trusts, in this case it was not possible to establish that all beneficiaries of the trust (policy holders) were resident in the US.
182. [2013] 140 ITD 20 (Mum).
183. All domestic tax rates specified herein are exclusive of applicable education cess and surcharge.
D. Taxation of Capital Gains

Gains arising to a Swiss resident from the sale of shares of an Indian company would be taxable in India. The Swiss-India Treaty does not provide any relief in this regard.

Capital gains are categorized as short term and long term depending upon the time for which they are held. Gains from the transfer of listed shares which are held for a period of more than twelve months are categorized as long term while, gains from the transfer of unlisted shares would be treated as long term only when they are held for more than 36 months. The Finance Minister, in his speech for the Budget 2016, has proposed to reduce this holding period for unlisted securities to 24 months[184]. Long term capital gains arising out sale of listed shares on the stock exchange are tax exempt (but subject to a nominal securities transaction tax). Long term gains arising from the sale of unlisted shares are taxed at the rate of 20% in case of unlisted shares of public companies (with benefit of adjustment for foreign exchange fluctuation) and at 10% in case of unlisted shares of private companies (without benefit of adjustment for foreign exchange fluctuation). The Finance Bill, 2016 proposes to harmonize the position on long term gains on sale of unlisted shares by taxing such gains at 10% (without benefit of adjustment for foreign exchange fluctuation) in all cases.

Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares are taxed at 40%.

Transfer of shares of an Indian company in the course of a merger between 2 non-resident enterprises should not be taxable in India subject to certain conditions being satisfied. In Credit Suisse (International) Holding AG v. DIT[185], the Authority for Advance Rulings held that merger of a Swiss company (having an Indian subsidiary) into its Swiss parent could not be taxable in India on the basis that the merger was sanctioned under Swiss law, the transferor ceased to exist and no gains arose from the merger.

E. Exchange of Information

The Swiss-India Treaty was amended in 2011 to strengthen the exchange of information framework in line with internationally prescribed norms.

The amended Swiss-India Treaty clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

The 2011 Protocol adds some safeguards by clarifying that ‘fishing expeditions' would not be permitted and hence complete details including identity of the person and nature of information and purpose should be provided. It also clarifies that the provisions do not envisage automatic or spontaneous exchange of information. Interestingly, the exchange of information clause also recognizes the administrative rules regarding taxpayer’s rights before any information is transmitted.
Investing Into India: Considerations From a United Kingdom-India Tax Perspective

I. UK - India Relations: Background

Bilateral relations between the UK and India, “the world's oldest and the world's largest democracies” have shaped up significantly in not just commercial or trade relations but also in social and cultural ties owing to the shared colonial past. It would be difficult to outline here the numerous historical records that underscore the importance of India-UK bilateral relations. To avoid reaching too far back into the past, we may reset the clock to September 2004, when a joint declaration titled ‘UK-India: towards a new and dynamic partnership’ was signed. This envisaged annual summits and regular meetings between Foreign Ministers and identified certain areas for future cooperation, such as civil nuclear energy, space, defence, combating terrorism, economic ties, science & technology, education and culture.

Bilateral trade grew in 2008-09 by 7.4% to $12.5 billion. In the year 2009-10 total trade declined by 14.68% as a result of financial/economic crisis, but in 2010 volume of US$ 12.5 billion (+17.36% growth) was registered. In the first two quarters of year 2012-2013 trade of 7.4 billion was registered. However, recent years (after 2014-15) appear to reflect a reduction in the growth of bilateral trade between India and the UK. Further, there has been a gradual decrease in UK’s share in India's global bilateral trade, both in exports and imports during the last five years.

Having said this, as of November 2015, India had invested more in the UK than all of the European Union combined. Further, with investments from India having increased by 65%, it has been the third largest source of FDI. To further bolster the trade relations between India and the UK, Prime Minister David Cameron signed £9.2 billion worth of commercial deals with India on Prime Minister Modi’s visit to London in November, 2015. UK also remains the largest G20 FDI investor into India.

India-UK ties have been strengthened through the execution of a number of agreements and establishment of institutions, such as:

- The India-UK Joint Economic and Trade Committee (“JETCO”);
- The UK-India Business Council (“UKIBC”);
- Bilateral Investment Protection Agreement (“BIPA”)
- Civil Nuclear Co-operation Declaration
- MOUs for collaboration in Chemical Biological, Radiological and Nuclear Defence; on Skills and Development; collaboration in Community Colleges and School Leadership Programmes
- India-UK Double Taxation Avoidance Agreement (“India-UK Treaty”) recently amended as to significant aspects by an amending protocol concluded on 30 October 2012 (“Protocol”);
- India-UK Inheritance Tax Treaty

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189. Data in this paragraph has been sourced from The United Kingdom, Available at [http://www.ficci.com/international.asp?cid=54525](http://www.ficci.com/international.asp?cid=54525)
193. [http://www.hcilondon.in/indiaukbilateral.html](http://www.hcilondon.in/indiaukbilateral.html)
194. Please note that the inheritance tax treaty has not been examined in detail here since India does not currently impose
II. India-UK Treaty: Special Considerations

A. Residence of Partnerships, Estates and Trusts

India-UK Treaty relief may only be claimed by persons who are residents of either India or the UK (or both) in accordance with the taxation laws of the respective countries. Until recently, the India-UK Treaty specifically excluded certain partnerships from the definition of a person (and consequently from being a resident) under the India-UK Treaty. Only such partnerships which were treated as a taxable unit under the ITA were included within the term ‘person’. Unlike India, in the UK, partnerships are considered fiscally transparent and the income of the partnership is directly taxed in the hands of its partners. Consequently, a UK partnership earning Indian-sourced income was ineligible to claim India-UK Treaty relief.

However, in Linklaters LLP vs. ITO95 and Clifford Chance vs. DCIT96 it was held that a UK partnership was eligible to claim benefits of the India-UK Treaty.97 While the cases do not analyze the issue of residence of partnerships, the recent Protocol settles the uncertainty by clearly specifying provisions for taxation of partnerships (along similar lines as in the India-US tax treaty).

The Protocol provides that the definition of person be amended to include “...a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force” of India and the UK. Further, the term ‘resident of a contracting state’ has been amended to provide that for entities such as a partnership, estate or trust, the term ‘resident of a contracting State’ applies only to the extent that the income derived by such entity is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries. The Protocol has also deleted Article 25 (Partnerships) of the India-UK Treaty which addressed the issue of eligibility to tax credits by Indian partnerships.

As regards trusts and estates, prior to the Protocol, such entities were ineligible to claim India-UK Treaty relief unless they were considered separate taxable entities. Following the Protocol, income of a trust or an estate to the extent taxable in the hands of resident beneficiaries would be eligible to benefit from India-UK Treaty relief.

The India-UK Treaty is one of the few treaties signed by India (along with the US treaty) which specially recognizes partnerships and trusts. This provides significant relief to UK firms doing business in India. However, challenges may still arise if a UK based partnership admits partners who are residents of a third country. India-UK Treaty relief may not be available to this extent.

B. PE Issues

In general, business profits of an enterprise are taxable only in its state of residence unless it earns such income through a PE in the source state. Thus, a UK entity earning business profits from India would be taxable in India only if such profits are earned through a PE in India. The India-UK Treaty provides for a PE by way of a fixed place of business, a dependent agent in India entering into contracts or securing orders on behalf of the UK entity or a PE by way of an installation or an assembly project or due to the provision of services beyond a specified number of days.

195. (112 TTJ 20)
196. (82 ITD 106)
197. In Linklaters LLP, the ITAT extended the benefits under the treaty to a UK Limited Liability Partnership (‘LLP’) and observed that where a partnership is taxable in respect of its profits in the hands of partners, as long as the entire income of the partnership firm is taxed in the country of residence (i.e. UK), treaty benefits could not be denied. In Clifford Chance, the ITAT granted benefits of the treaty to a UK partnership firm comprising lawyers but the issue whether a partnership was entitled to treaty benefits was not discussed at length.
In *Airlines Rotables Limited, UK v. Joint Director of Income Tax*\(^{198}\), the Mumbai Tribunal observed that in order to constitute a fixed PE under Article 5(1), three conditions needed to be satisfied: physical criterion, i.e. existence of physical location; subjective criterion, i.e. right to use that place; and function criterion, i.e. carrying out business from that place. The IT Appellate Tribunal further held that the onus was on the tax authorities to show that the taxpayer had a PE in India.

In *Rolls Royce Plc v. Director of Income Tax*\(^ {199}\) the Delhi High Court (affirming a ruling of the Delhi Tribunal)\(^ {200}\) held that the Indian entity was not merely a post office as argued by the taxpayer but it was a PE for the following reasons:

- it was a fixed place of business\(^ {201}\) in India at the disposal of the UK entity and group companies through which their business was carried on;
- the activity of that place was not preparatory or auxiliary. Instead it was a core activity of marketing, negotiating, selling of the product and the court called it a “virtual extension/projection of its customer facing business unit, who has the responsibility to sell the products belonging to the group”;
- the Indian entity acted almost like a sales office of the UK entity and its group companies.
- not only did the Indian entity and its employees work wholly and exclusively for the UK entity and the group, they also solicited and received orders wholly and exclusively on behalf of these entities.

Like the ‘fixed place of business’ PE, an agency PE clause is also commonplace in treaties. In general, a source State considers that a PE is constituted by the offshore enterprise’s dependent agent who has authority to habitually conclude contracts or secure orders on behalf of the offshore enterprise in the source State. Article 5(4) of the India-UK Treaty provides, among others, that an agency PE may arise if the dependent agent has, and habitually exercises in the source State an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.\(^ {202}\) An exchange of notes in 1993 between the UK and Indian Government authorities has clarified the method of income attribution for an agency PE. This is discussed further below.

In contrast to the above PE clauses, the service PE clause is found in very few tax treaties and was given impetus by the UN Model Convention. The OECD Model Convention does not have a specific provision for a service PE. A service PE is created when the foreign entity deputes its employees to India to perform services on its behalf and those activities are performed in the source State for a number of days (usually prescribed in the relevant treaty).

Under Article 5(2)(k) of the India-UK Treaty, provision of services (including managerial services) within the source State by the employees or other personnel of the offshore enterprise will amount to a service PE only if activities are performed for a period aggregating more than 90 days within any 12-month period.

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198. [2011]44SOT368(Mum)
199. [2011]339ITR147(Delhi),
200. (2008) 113 TTJ Delhi 446
201. The Tribunal in its decision had observed that “place of business’ covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not exclusively used for that purpose. A ‘place of business’ can also exist where no premises are available or are required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is not relevant whether the premises, facilities or installations are owned or rented by or is otherwise at the disposal of the concerned enterprise.”
202. Please note the actual text is in greater detail and for that reason has not been reproduced here. The summary principle described here and the clarification given by the exchange of letters must be read against the backdrop of the actual text of the provision.
However, the service PE provision provides for a different rule when the offshore entity deputes employees to an associated enterprise. In such a case, the day count is reduced to a period aggregating more than 30 days in a twelve-month period. This day count threshold, similar to the India-Singapore tax treaty, is liberal compared to the India-US tax treaty (which is triggered immediately). Most service PE clauses also exclude specified types of services. The India-UK Treaty excludes services where consideration is taxable as royalty or fees for technical services under the separate provision applicable to such consideration.

In *Linklaters LLP, UK v. ITO,* a dispute on whether legal services provided by a UK law firm employees for an Indian project gave rise to a service PE, the Mumbai Tribunal rejected the contentions of the taxpayer that: (i) in order for a PE to arise under Article 5(2) of the India-UK Treaty, the basic condition of Article 5(1) (i.e. existence of a fixed place of business) must first be satisfied; and (ii) that Article 5(2) merely provided an illustrative list which could only be applied if there was a fixed place of business. The Tribunal held that while some of the items listed under Article 5(2) were illustrative of Article 5(1), the others, notably a PE due to building site or construction installation under Article 5(2)(j) or a service PE under Article 5(2)(k) were on a stand-alone basis, and they did not require a fixed place of business to exist for a PE to be created, provided the threshold time period prescribed was met.

Article 5(2)(j) of the India-UK Treaty refers to another PE form, the ‘installation PE’. This Article provides that a PE would include a building site or construction, installation or assembly project or connected supervisory activities, where such site, project or supervisory activity continues for a period of more than 6 months, or where such project or supervisory activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding 6 months and the charges payable for the project or supervisory activity exceed 10% of the sale price of the machinery and equipment. An exchange of notes in 1993 between the respective Government authorities provided further clarity on the factors to be considered for determining when an installation/assembly project would come into existence. It has been explained that that for the purpose of determining whether the site, project, activity etc. has continued for a period of more than 6 months, the source State shall not take into account time previously spent by employees of the enterprise on other sites or projects which have no connection with the site or project in question. Further the ‘more than 6 months test’ must be applied separately based on whether other sites or projects are connected or not. That is to say, the test must be applied separately to each site or project which has no connection with any other site or project and to each group of connected sites or projects.

Article 7 of the India-UK Treaty provides that if the enterprise carries on business through a PE, the profits of the enterprise may be taxed in the source State but only so much of them as is directly or indirectly attributable to that PE. In general, only as much income as is attributable to the activities carried out by that PE should be taxable in the source State. Indian Revenue authorities have taken the view that the term ‘indirectly attributable’ is understood as embodying the ‘force of attraction’ principle, that is to say, where the foreign enterprise provides goods or services directly to customers in the source State and its PE in that State is also in the same line of business, then the source State can tax the entire profits that the foreign enterprise derives there regardless of whether the PE had a role in carrying out the profit-generating transactions. This view was affirmed by a decision of a Mumbai Tribunal in *Linklaters LLP v ITO.*

The Tribunal held that relying on Article 7(1) of the UN Model Convention commentary on this issue, a view could be taken that the connotation of “profits indirectly attributable to permanent establishments” extended to incorporation of the ‘force of attraction’ rule being embedded in Article 7(1).

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203. (2010) 132 TTI 20

204. [2010] 40 SOT 51 (Mum).

205. A Miscellaneous Application by the aggrieved taxpayer requesting a re-look of the decision on this ground was rejected, Linklaters & Fines v ITO 56 SOT 116 (Mum).
In a June 2013 decision of ADIT v Clifford Chance, the Mumbai Tribunal has been held that the India-UK Treaty does not embody the force of attraction principle. In this dispute, Indian Revenue authorities sought to tax the entire legal fee received by a UK LLP for legal services rendered from within and outside India for the reason that these legal services were in relation to a project being carried out in India. The Tribunal (a Special Bench whose decision would be binding on all other Tribunals) held that the language of the India-UK Treaty was very clear in its import. There was no necessity to therefore relate the provision to Article 7(1) of the UN Model Convention to understand it as authorizing attribution by way of ‘force of attraction’.

While the decision of the Special Bench would provide clarity on this aspect, the Revenue authorities still have the scope to obtain a favorable judgment in appeal. Considering that India has recently amended treaties with some other nations to remove the force of attraction principle from those treaties, it might be helpful to carry through this change to the India-UK Treaty as well for the sake of complete clarity on this issue.

In relation to income attribution for agency PEs, Article 7(3) of the India-UK Treaty provides that where a permanent establishment takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, regardless of the fact that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the PE to those transactions bears to that of the enterprise as a whole shall be treated as being the profits indirectly attributable to that permanent establishment. In this context, the 1993 exchange of notes has clarified that in applying Article 7(3), for the purpose of determining whether a PE has taken such an active part, the States must take into consideration all relevant circumstances.

In particular, the fact that a contract or order contract or order relating to the purchase or provision of goods or services was negotiated or placed with the head office of the enterprise, rather than with the PE, should not preclude the States from determining that the PE did take an active part in negotiating, concluding or fulfilling that contract.

C. FTS

The scope of taxation of FTS is more restricted than under Indian domestic law. The India-UK Treaty defines FTS to mean payments of any kind in consideration for the rendering of any technical or consultancy services which are ancillary and subsidiary to the application or enjoyment of the right, property or information related to royalty; make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

The interpretation of ‘make available’ has been a source of dispute. In a recent Tribunal ruling, ITO v Veeda Clinical Research Pvt. Ltd., the Tribunal has upheld the principle that ‘make available’ requires that the services must enable the recipient of the service to be able to apply the technology directly without further assistance. In this matter, Indian Revenue authorities sought to bring to tax payments made by an Indian company to a UK Company for provision of ‘in-house training of IT Staff and medical staff’ and ‘market awareness training’. The Revenue argued these were taxable since services were made accessible to recipients for a fee and that it would be absurd to keep the standard such that any service provider would make the recipient an expert in its own area of core competence. If that would be the case, then the expert would be rendered redundant once training was imparted. The Tribunal rejected this contention, relied on previous High Court decisions to hold that general training services would not result

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206. [2013] 33 taxmann.com 200 (Mumbai - Trib.) (SB)
207. The Tribunal also relied on a decision of the Bombay High Court in a previous case involving the same taxpayer whose decision was made ineffective following a legislative amendment. The Bombay High Court had held that, to be taxable, services had to be rendered within India. This decision led to a retrospective amendment in the tax legislation which brought within the tax net even those services rendered from outside India.
in transfer of technology. There must be a transfer such that the recipient is enables to apply technol-
ology itself.

D. Limitation on Benefits

The Protocol has also introduced a ‘limitations of benefits’ (“LoB”) clause. India-UK Treaty benefits
may be denied if the main purpose or one of the main purposes of the creation or existence of such
a resident or of the transaction undertaken by the resident, was to obtain benefits under the India-UK
Treaty. Unlike the India-Singapore or the India-US
tax treaties, the LoB provision in the India-UK Treaty
does not go into further details. It would be perti-
nent to note that both the UK and India provide for
GAAR in their domestic tax regimes. While the UK
GAAR has become operational, the Indian GAAR is
intended to take effect only from 1 April, 2015.

E. Enhanced Measures to Tackle Evasion

The Protocol also provides for a more robust clause
on ‘exchange of information’ and introduces two
new clauses on ‘tax examinations abroad’ and ‘assis-
tance in collection of taxes’. It proposes to widen the
latitude of the provision on exchange of information
currently existing in the India-UK Treaty. The existing
Article provides that a request for exchanging
information would be entertained where ‘necessary
for carrying out the provisions of this Convention or
of the domestic laws’. The Protocol extends the scope
of the Article by allowing a request for the exchange
of information which is ‘foreseeably relevant’ for car-
rying out the provisions of this Convention or of the
domestic laws’.

The Article does not oblige the State to supply infor-
mation which would disclose any trade, business,
industrial, commercial or professional secret or trade
process, or such information whose disclosure would
be contrary to public policy. However, the Article
further clarifies that a State could not refuse to sup-
ply information solely because the information is
held by a bank, other financial institution, nominee
or person acting in an agency or a fiduciary capac-
ity or because it relates to ownership interests in a
person.

The other two provisions were introduced with the
aim of supporting the information gathering process
thereby making tax collection effective. Subject to
prescribed procedural safeguards being followed, rep-
resentatives of the competent authority of the respec-
tive states are permitted to enter the other state’s ter-
ritory to interview persons and examine records. The
respective competent authorities have been empow-
ered to assist in the collection of revenue claims, i.e.
amount owed in taxes, as per the mode of applica-
tion which is mutually agreed between the authori-
ties. Measures of conservancy including an interim
measure of asset freezing has been provided for.
Investing Into India: Considerations From a United States Of America-India Tax Perspective

I. US - India Relations: Background

The inception of market-oriented reforms in India has marked a new phase in the relationship between India and the United States of America ("US"). With the impending shifting of political and economic polarity in the globe to the Asian region, economic and strategic alliances between India and the US are stronger than ever before. Accelerating trade and exchange in technology and investment coupled with improved collaboration in the fields of energy, national security and environmental protection have laid down the foundations in this growing relationship.

India’s flourishing market comprising of a highly educated and skilled populous has resulted in several US companies investing in the country. As per data collected by the DIPP, cumulative FDI into India from the US from April, 2000 to December 2015 amounts to around USD 17 billion which would approximately be 6.2% of total FDI inflows into India. Moreover, the progressive rationalization of the investment regime in India has resulted in more comfort for US players to set up shop in India. Currently, India has become a market that is indispensable to the business plans of any multi-national corporation based in the US.

India’s trade relations with the US have seen substantial improvement in the past decade as well. As reported by the Indian embassy in the US, bilateral trade between the two nations has as of 2015 was close to USD 66 billion, representing more than a 400% increase post-liberalization in India.

In lieu of the continuing co-operation and strong diplomatic and economic relations between the two nations, a number of bilateral agreements and institutional arrangements have been executed between India and US. Listed below are some of the key agreements:

- India-US Double Taxation Avoidance Agreement ("India-US DTAA")
- India-US Agreement to Improve International Tax Compliance and to Implement Foreign Account Tax Compliance Act ("FATCA")
- US-India Civil Nuclear Agreement
- U.S.-India Science and Technology Cooperation Agreement
- Agreement for Cooperation on Joint Clean Energy Research And Development Center ("JCERDC")
- New Framework for India-US Defence Relationship

Going forward, with strengthening dialogue and a constant exchange of synergies in the form of diplomatic visits, the relations between India and the US are accelerating at an exponential pace.

II. US - India DTAA: Special Considerations

A. Residency of Companies

The India US DTAA does not provide any tie-breaker rules in situations where a company is treated as a tax resident of both India and the US under their respective domestic laws. Tax residence in a particular jurisdiction generally attracts taxation of the worldwide income of the individual / entity con-
cerned in that jurisdiction. Therefore, the OECD model convention has tie-breaker rules to determine residence of individuals and entities in situation where individuals/ entities qualify as a resident of both jurisdictions (between which the tax treaty is entered into).

The absence of tie-breaker rules in the India-US DTAA in relation to companies becomes important in light of the amendment introduced in 2015 in India with respect to criteria for determination of tax residence of companies incorporated outside India. Prior to this amendment, i.e., up to financial year 2014-15, a company incorporated outside India qualified as an Indian tax resident in a financial year (April 1 to March 31) only if the entire control and management of its affairs was located in India during that financial year. From financial year 2015-16 onwards, a foreign company qualifies as tax resident in India if its POEM in the relevant financial year is in India. Under US domestic law, all companies incorporated in the US are treated as US tax resident. Therefore, if a US company has its POEM in India, its worldwide income could be taxable in both in India and in the US without any credit being available in either country for taxes paid in the other country. This issue becomes aggravated by the concern around how existence of POEM is proposed to be determined by Indian tax authorities. In December 2015, the government issued draft guidelines in relation to determination of POEM. However, the final guidelines have not yet been issued. The Finance Bill, 2016 (part of the annual budget) proposes to defer the commencement of POEM by one year – i.e., from financial year starting April 1, 2016 onwards.

B. Residency of Partnerships and Trusts.

The India-US DTAA is an example of how a special provision is provided for in a DTAA to deal with availability of treaty benefits to partnerships and trusts. Under Article 3(e) of the India-US DTAA, partnerships, trusts and estates are specifically included in the definition of the term ‘person’. Further, under Article 4 of that India-US DTAA, it is provided that for such entities, the term ‘resident of a contracting State’ applies only to the extent that the income derived by such entity is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries. In this regard, the technical explanation of the India-US DTAA on Article 4 provides that under US law, a partnership is never taxed and a trust and estate are often not taxed. Under the provision, income received by such an entity will be treated only to the extent such income is subject to tax in the US as income of a US resident. Thus, treaty benefits would only be given to such US entities only as far as income received by them is taxable either at the entity or the partner/beneficiary level in the US.

In General Electric Pension Trust, In re: 210, the Authority for Advance Rulings while analyzing this held that a pension trust established under US laws was not entitled to benefits of the India-US DTAA since it was exempt from tax liability in the US.

C. Capital Gains

Article 13 of the India-US DTAA provides that each country may tax capital gains in accordance with the provisions of its own domestic law. While general international tax jurisprudence suggests that a DTAA must allocate taxability to one of the states involved in cases where there is a risk of double taxation, the India-US DTAA specifically opts for domestic law taxability presumably on the basis that differing rules for taxation of capital gains would not create a conflict.

The capital gains tax regime in India works in such a way that all Indian tax residents are taxable on their worldwide income, including income in the nature of capital gains arising from disposal of a foreign asset. However, all non-residents are taxed in India only on India-sourced income i.e. capital gains arising from the disposal of an Indian asset. Similarly, in the US, all US citizens and resident aliens for tax purposes are taxed on their worldwide income in form of capital gains (irrespective of situs of disposed

asset). However, non-residents are not taxed in the US for disposal of all US-sourced assets. There is no US capital gains tax on a non-resident selling US securities.

Thus, in a case where a US citizen disposes of his/her Indian assets, he/she is liable to be taxed both in India (as the asset is India sourced) and in the US (since he/she is a US citizen) as there are no allocation rules provided for the same in the India-US DTAA. In Trinity Corporation v. CIT, the Authority for Advance Rulings held that the capital gains from the sale of shares in an Indian company by a US resident shareholder to a US resident company were taxable in India as the shares of the Indian company had to be regarded as a capital asset situated in India. Although Article 25 of the India-US DTAA provides for tax credit from the state of residence in case of double taxation, the availability of such credit in this case is not assured.

D. Credit Rules: Double Taxation of the Same Income?

Article 25 of the India-US DTAA provides that the US shall allow its residents or citizens to claim a tax credit in the US on income tax paid in India by or on behalf of such residents or citizens. However, the provision also provides that the determination of the source of income for purposes of credit is subject to domestic laws of the US as applicable for the purpose of limiting foreign tax credit. According to the US Internal Revenue Code (“IRC”), in order to claim a tax credit for taxes paid in another country, the income must be ‘foreign sourced’. However, the IRC also provides that all income earned by a US citizen or resident from disposal of assets (irrespective of situs) would be US sourced.

This means that the sale of assets, even in a foreign country by a US person would be treated as US sourced and therefore, foreign tax credit may not be available in such cases. Therefore, since the India-US DTAA does not provide specific allocations in the case of capital gains, there is a risk that a US citizen is subject to tax in both nations in respect of disposal of Indian assets. This uncertainty is the major reason why a large chunk of the investment into India by US entities comes through holding companies set-up in Mauritius. Though the Mauritius route has been under the scanner for quite a few years, courts and tribunals have consistently upheld relief under the India-Mauritius tax treaty, with the most recent ruling being that of the Authority for Advance Rulings in the case of Dow AgroSciences Agricultural Products Limited.

Moreover, complications arise in case of credit claimed in relation to dividends as well since Article 25 is subject to limitations contained in the IRC. In India, dividend distribution tax is payable at the company’s level on distribution and is exempt in the hands of the shareholder. However, the IRC taxes resident shareholders for dividends received by them. The IRC provides that foreign tax credit is generally available only in a case where tax is paid on the same income by the same taxpayer in a foreign country. Although the Indian company is to pay tax on the same distribution, since the tax is paid at the company level and since dividends received is exempt in the hands of the shareholder in India, claiming a tax credit for the shareholder becomes difficult. Thus, US credit rules consider only ‘juridical double taxation’ where the same entity is doubly taxed on account of the same income as opposed to ‘economic double taxation’ where the same income is doubly taxed in the hands of different entities. Such situations have created tax leakage.

However, Article 25 of the India-US DTAA also provides that if a US company owns at least 10% of the voting stock of its subsidiary in India, the US would grant underlying tax credit for tax paid in India for distributions made by the Indian company in the form of dividends. Thus, tax credit would be available in the US in cases where the shareholder is a US company and the holding in the Indian company is at least 10%. Nonetheless, the specific inclusion of underlying credit only for US company shareholders of Indian companies, owning at least 10% of the

211. [2007]165TAXMAN272(AAR)

Indian company’s shares might suggest that tax credit may not be available to any US shareholder which is not a company.

E. PE Issues

The concept of a PE is commonplace in almost all DTAs. In general, business profits of an enterprise earning income are taxable only in its state of residence unless if it earns such income through a PE in the source state. Thus, a US entity earning business profits from India would be taxed in India for the same only if such profits are earned through a PE in India. As per Article 5 of the India-US DTAA, a PE can be anything from a fixed place of business, a dependent agent in India entering into contracts or securing orders on behalf of the US entity or a service PE.

Although all US DTAs contain the PE clause, the service PE clause is found in very few DTAs. The service PE clause is borrowed from the UN Model Convention and creates a PE when a US entity deputes its employees to India to perform services on its behalf. In general, a service PE is only created when the deputed employees spend a particular time period in the other State performing services on behalf of the foreign entity. The India-US DTAA has provided for a time period of 90 days to be spent in India for a US entity to create a service PE through deputation of employees performing services in India.

However, the service PE provision in the India-US DTAA has carved out a different rule when a US entity deputes employees to an associated enterprise or related party. In such a case, irrespective of time spent, a service PE would be created if employees are deputed to the Indian entity to perform services on behalf of the foreign entity. The Hon’ble Supreme Court of India in DIT v. Morgan Stanley & Co214 has elaborated on the scope of this provision. The Court held that in case of stewardship activities performed by employees of the US entity in India, since the activities could not be considered as provision of services by or on behalf of the US entity, there would be no service PE implications. With respect to employees of the US entity who were deputed to the Indian related party, a service PE was held to exist since the employees continued to be on the rolls of the US entity and the employees had a lien on their employment.

Once a PE is created in India, taxation of business profits is determined as per rules contained in Article 7 of the India-US DTAA. Although the authorized OECD approach suggests that the source state must have the right to tax only those profits as are directly attributable to a PE in India, the India-US DTAA borrows the limited force of attraction rule as contained in the UN Model Convention. Thus, apart from profits directly attributable to the Indian PE, the US entity would also be taxed for profits from sales in India of similar goods as sold through the PE or profits from business activities in India similar to those undertaken through the PE.

F. Fee for Included Services

As per Article 12 of the India-US DTAA, ‘fees for included services’ means payments made to any person in consideration for the rendering of any technical or consultancy services if such services are incidental to the application or enjoyment of the right, property or information in relation to royalty payments or ‘make available’ technical knowledge, experience, skill, know-how, or processes etc. Further, the India-US DTAA lays down a 15% withholding tax on such payments falling under this provision. This provision is generally not contained in most other US DTAs and this provision is found mostly only in Indian DTAs.

The Memorandum of Understanding annexed to the India-US DTAA explains the concept of the expression ‘make available’ used in Article 12 and clarifies that other than in cases where royalty payments are involved, Article 12 only covers services where there is transfer of some technology, knowledge or skill whereby the recipient is able to independently apply the same.

213. A similar provision can be found in India’s DTAs with Canada and Australia as well.
Thus, in cases where technical services are provided by US entities in India, payments for the same will not be subject to withholding tax under the India-US DTAA unless if such criteria are satisfied. The Karnataka High Court in the case of CIT v. De Beers India Minerals (P.) Ltd.\textsuperscript{215} and the Delhi High Court in CIT v. Guy Carpenter & Co Ltd.\textsuperscript{216} have upheld this principle.

**G. Limitation on Benefits**

As is the general norm for US DTAAAs, the India-US DTAA also contains a limitation on benefits clause. In this regard, Article 24 of the India-US DTAA provides for a limitation on benefits clause. As with its other treaties, the US has ensured that under the India-US DTAA, only 'qualified residents' of either treaty state are entitled to benefits of the treaty.

With respect to corporate entities, the provision is intended to ensure that only companies that are resident in either state that fulfill substantial substance requirements and strong business activities in such state may be entitled to treaty benefits.

In this regard, Article 24 lays down a two-fold ownership/base-erosion test for claiming treaty benefits by which more than 50% of each class of an entity’s shares must be owned, directly or indirectly, by individual residents who are subject to tax in either state, or by the government or government bodies of either state and the entity’s gross income must not be used in substantial part, directly or indirectly, to meet liabilities in form of deductible payments to persons, other than persons who are residents of either State, government or government bodies of either state or US citizens. However, benefits under the India-US DTAA may be claimed if the entity is engaged in active trade or business in respect of which the concerned income has been earned or if a principal class of its shares are actively traded in a recognized stock exchange in either state.

**H. FATCA**

India and the US entered into an agreement in July 2015 for implementation of the US the FATCA. FATCA is a broad set of rules to increase tax compliance by ‘US persons’ (essentially US citizens, US green card holders and US residents) with financial assets held outside the US. FATCA subjects virtually any entity, even if: (i) remotely / indirectly invested in the US market; or (ii) financial institution dealing with US citizens / green-card holders; or (iii) subsidiary of a US person, to strict due diligence and reporting compliances with the US Internal Revenue Services. FATCA legislation defines financial institutions in such a way, that it includes banks, custodians, brokers, certain types of insurance & companies, mutual funds, hedge funds, private equity funds, trust companies, etc. If a financial institution outside the US does not comply with due diligence and reporting obligations prescribed, investment income/ sale consideration receivable in relation to sale of US investments would be liable to withholding tax at 30% in the hands of the payee. The financial institution would have to claim refund to avail benefits of the India-US tax treaty, if applicable.

Under the India-US agreement for implementation of FATCA, both governments have agreed to exchange information annually on an automatic basis with respect to reportable accounts held by financial institutions in their respective jurisdictions. Consequently, the Indian government has introduced rules regarding reporting obligations of Indian financial institutions.

**I. Mutual Agreement Procedure and Transfer Pricing**

The India-US tax treaty has clauses similar to the OECD model convention for Mutual Agreement Procedure for resolution of situations where taxpayers considers that actions of India and US tax authorities result or would result in taxation which is not in accordance with the provisions of tax treaty. For effective resolution of such disputes and to boost investment sentiments among MNCs, in January 2015, the Central Board of Direct Taxes signed a

\textsuperscript{215} (2012) 346 ITR 467 (Kar.).\textsuperscript{216} (2012) 346 ITR 504 (Del.).
Framework Agreement with the Revenue Authorities of USA. The framework agreement seeks to resolve about 200 past transfer pricing disputes between the two countries in the Information Technology (Software Development) Services and Information Technology enabled Services segments. More than 100 cases have been resolved as of January 2016.

Prior to resolution of disputes under the Framework Agreement the US bilateral Advance Pricing Agreement (“APA”) programme was closed to India. The success of the Framework Agreement in short period of one year has led to the US Revenue Authorities opening up their bilateral APA programme to India. The USA is expected to begin accepting bilateral APA applications shortly. Unilateral APA programmes allow taxpayers to enter into an agreement with tax authorities in advance regarding the appropriate arms’ length price/ method for computation thereof. This helps reduce potential transfer pricing disputes. It may be noted that transfer pricing applies subjective tests for computation of arms’ length price for cross-border transactions between associated enterprises. Consequently, disputes arising from transfer pricing adjustments forms a significant component of income tax disputes in India. Bilateral APAs are those where both countries involved agree on a common arms’ length price in relation to identified transactions between associated enterprises. This becomes important for multi national companies as differences in arms’ length price arrived at by two/ more jurisdictions involved could lead to double taxation.
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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm’s culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our “Hotlines”. These Hotlines provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our NDA Insights dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction.

We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our ThinkTank discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports.

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