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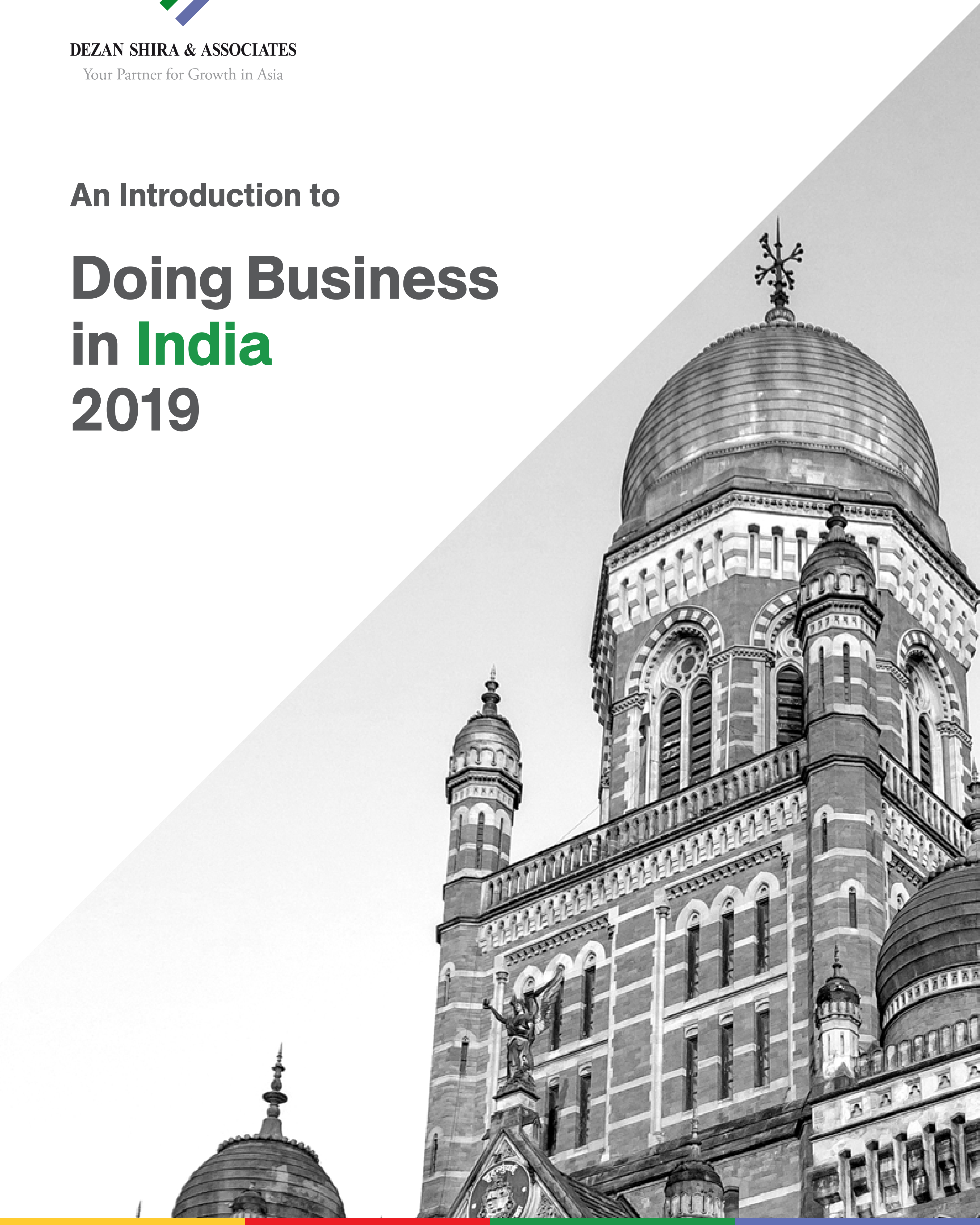
Your Partner for Growth in Asia

An Introduction to

Doing Business in India 2019



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This edition of Doing Business in India was produced by a team of professionals at Dezan Shira & Associates, with Melissa Cyrill and Adam Pitman as Editors.
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About Dezan Shira & Associates

At Dezan Shira & Associates, our mission is to guide foreign companies through Asia's complex regulatory environment and assist them with all aspects of establishing, maintaining and growing their business operations in the region. Since its establishment in 1992, Dezan Shira & Associates has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam, as well as liaison offices in Italy, Germany and the United States, and partner firms across the ASEAN region. With over 25 years of on-the-ground experience and a large team of professional advisers, we are your reliable partner in Asia.

Preface

Foreign direct investment (FDI) in India increased to US$61.96 billion in 2017-18 as per the Department of Industrial Promotion & Policy (DIPP), up slightly from US$60 billion in the previous year. As the government pushes toward the ease of doing business and implementing tax and regulatory reforms, India is perfectly positioned to compete with the world's premier investment locations.

Among emerging markets, India offer investors a unique combination of advantages. Its skilled and low-cost labor force is one of the largest in the world and it has a high level of English fluency relative to other countries in Asia. Economic reforms implemented in the past four years include the roll-out of the goods and services tax (GST), establishing bankruptcy regulations, sector-specific reforms, infrastructural improvements, increasing FDI caps, and the simplification of company registration procedures.

This publication, designed to introduce the fundamentals of investing in India, has been created using the most up-to-date information at the time. It was compiled by Dezan Shira & Associates, a specialist foreign direct investment practice that provides corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence and financial review services to multinationals investing in emerging Asia.

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Dezan Shira & Associates expanded into India in 2007, opening offices in Mumbai and later New Delhi in 2008. The launch of Dezan Shira's India offices was coupled with the launch of India Briefing, which is now a premier source of business and regulatory intelligence related to the Indian market.

Our services in India include corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence, and financial review. Dezan Shira & Associates' experienced business professionals in India are committed to improving your understanding of investing and operating in emerging Asian markets.

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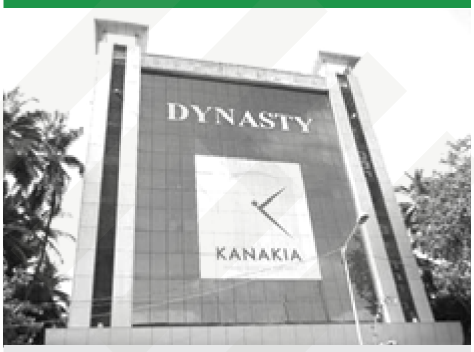

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GST Roll-Out and Regulatory Reforms: The Indian Economy in 2018

If 2016 ended on an epochal note for India's economy with the overnight demonetization of high-denomination currency notes, 2017 ended with the roll-out of the goods and services tax. Over 17 years in the making, the GST replaced multiple indirect state and federal levies that previously created multiple tax jurisdictions in India.

Nevertheless, such an ambitious tax reform was bound to be initially disruptive, especially across a country as vast as India with very differentiated levels of development. In the past one year, changes have been introduced to the types of tax returns available, the GST rates for respective goods and services, the input credit refund mechanisms, the composition scheme for small and medium enterprises (SMEs), the GST's technology platform, and the e-way bill to ease tax compliance in the logistics sector.

With the teething period now almost over, and a general election coming up in 2019, companies across all sectors are expecting a more efficient and transparent tax and regulatory environment. Alongside the GST, the government has doubled down on its efforts to reform bankruptcy rules and adjudication, liberalized the foreign investment policy, and introduced key tax, location-based, and regulatory incentives for manufacturing in India.

Further, under the national program, Digital India, the government continues to digitize all governance and administrative procedures – from applying for a business visa and incorporating a company to making salary payments and meeting social insurance obligations. Overall, the government remains committed to economic, legislative, and regulatory reforms that will ease the entry, investment, and expansion of business operations in India.

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Establishing and Running a Business

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Investment options in India

A foreign investor may set up in India either as an 'unincorporated entity' or an 'incorporated entity'.

Unincorporated entities permit a foreign company to do business in India by establishing a liaison office, branch office, project office, or a trust. An incorporated entity in India has a more structured set up and is governed by the provisions of the Companies Act, 2013 or the Limited Liability Partnership (LLP) Act, 2008.

We discuss the unincorporated entity structures available to foreign companies in India.

- Liaison office;
- Branch office; and,
- Project office.

Liaison office

Foreign companies can open a liaison office in India to facilitate and promote the parent company's business activities and act as a communications channel between the foreign parent company and Indian companies. Unable to engage in commercial, trading, or industrial activities, liaison offices must be sustained by private, inward remittances received from their foreign parent company.

A liaison office is permitted to engage in the following activities:

- Facilitate communication between the overseas head company and parties in India;
- Promote imports/exports between countries;
- Establish financial and technical cooperation between overseas and Indian companies; and,
- Represent the overseas head company in India.

The liaison office must submit a Certificate of Incorporation or Memorandum and Articles of Association, and a copy of the parent company's latest audited balance sheet. The liaison office must also obtain a Permanent Account Number (PAN) from the income tax authorities.

Within 30 days of establishment, the liaison office must register with the Registrar of Companies (RoC) by filing Form FC-1 through the Ministry of Corporate Affair's online portal. The following documents must also be provided:

- A copy of the liaison office charter or Memorandum and Articles of Association in English;
- Full address for the enterprise's principal place of operation outside of India;
- Name and address of the liaison office in India;
- List of directors; and,
- Name and address of the liaison office official representative based in India (for example, the person authorized to accept delivery of notices and documents served to the company).

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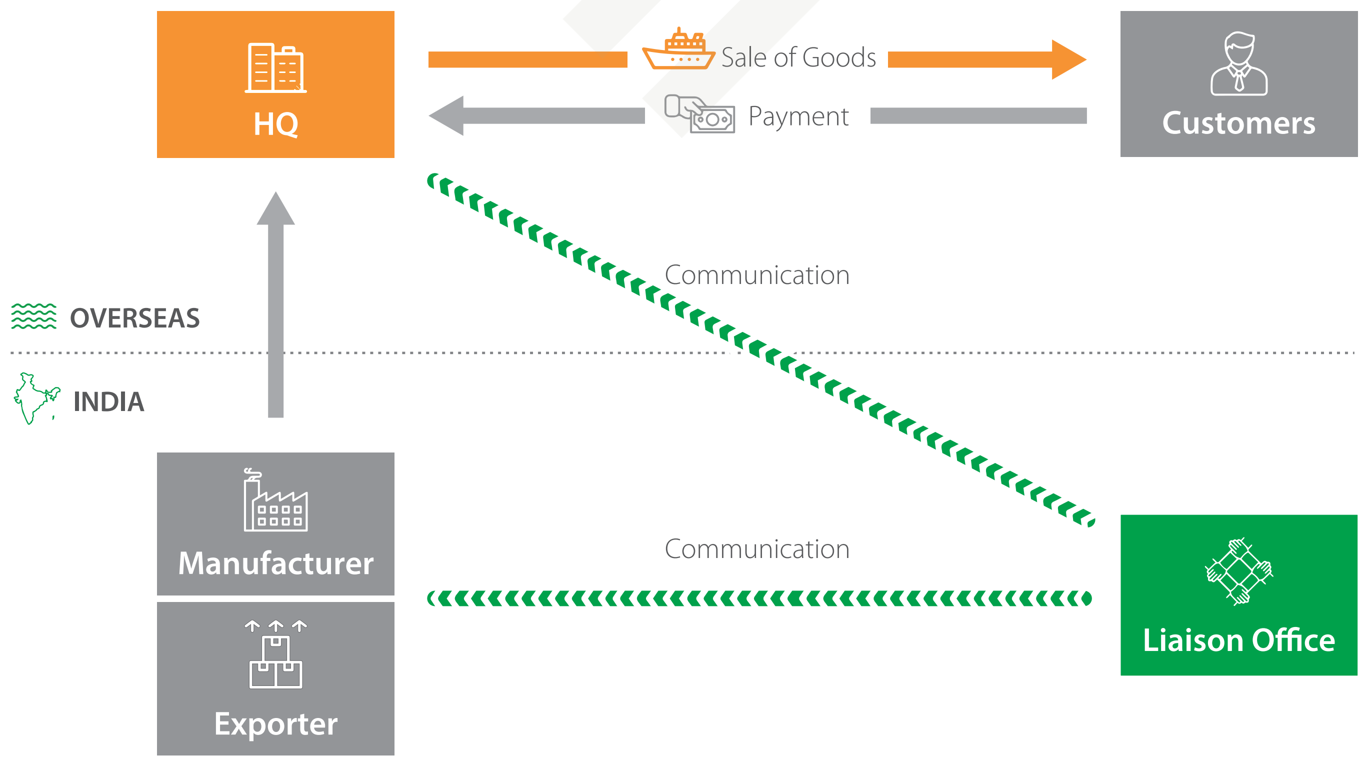
Each year, the liaison office must file an Annual Activity Certificate (AAC), verified and attested by a Chartered Accountant, to the RBI stating that the office's activities are within its charter. An AAC along with Form 49C should also be filed with the Directorate General of Income Tax within 60 days of the close of the financial year.

Only applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong, Kong, Macau, and Pakistan must register with the state police. Copy of an approval letter for citizens from these countries shall be marked by the AD Category I bank to the Ministry of Home Affairs, Internal Security Division – I, Government of India, New Delhi for necessary action and record. All other countries are exempt from registering with the state police.

The Foreign Exchange Management Act (FEMA), administered through the Reserve Bank of India (RBI), governs the application and approval process for the establishment of a liaison or branch office. Under the Act, foreign enterprises must receive specific approval from the RBI or through an 'authorized dealer' bank to operate a liaison office in the country. Applications are to be submitted through Form FNC (Application for Establishment of Branch/Liaison Office in India).

Liaison Office in India: Activities Allowed by RBI



The approval process generally takes 20 to 24 weeks and permission to operate a liaison office is granted for a three-year period, which can be extended before the expiry of the validity of the approval. However, in the case of Non-Banking Finance Companies (NBFCs) and those entities engaged in construction and development sectors, the validity is two years only. Liaison offices opened by such entities (excluding infrastructure development companies) shall not be allowed any extension of time. Upon expiry of the validity period, the liaison office has to either close down or be converted into a joint venture / wholly owned subsidiary in conformity with the foreign direct investment policy.

Additionally, an enterprise must also meet the following conditions before qualifying for the establishment of a liaison office:

- Must have profitable operations during the immediately preceding three years in the home country; and,
- Must have a minimum net worth of US$50,000 verified by the most recent audited balance sheet or account statement.

Branch office

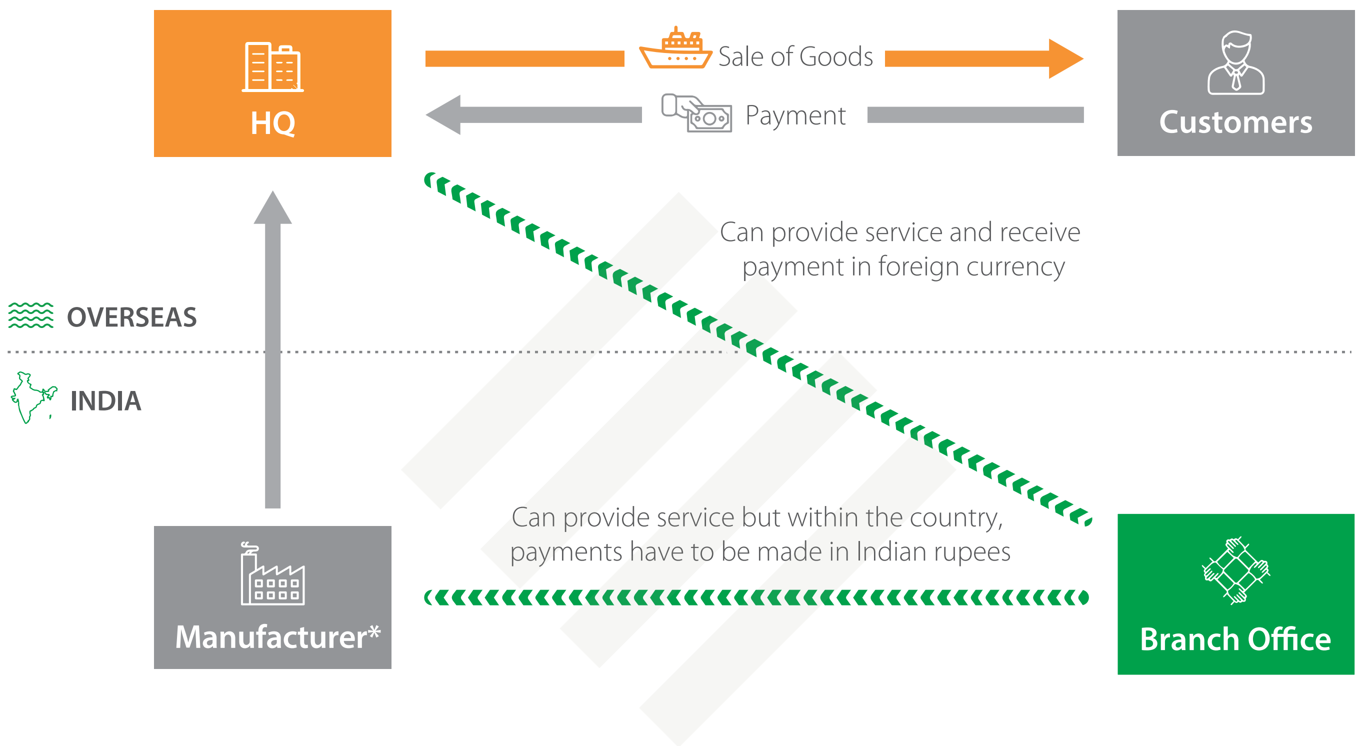
Foreign companies, including those engaged in manufacturing and trading activities, are able to establish branch offices to carry out business activities substantially the same as those carried out by their parent company. Branches are permitted to carry out trading activities but may not engage in manufacturing activities on their own—these may be subcontracted to Indian manufacturers. Branch offices operating in SEZs, however, are permitted to undertake manufacturing and service activities in sectors with 100 percent FDI approval.

Branch offices are permitted to engage in the following activities:

- Export/import of good;
- Rendering professional or consultancy services, IT services, or technical product support;
- Carrying out research work in which the parent company is engaged;
- Representing the parent company as a buying/selling agent or in order to establish technical or financial collaborations with Indian companies;
- Operating as a foreign airline or shipping company;
- Promoting technical or financial collaboration between Indian companies and parent or overseas group company; and,
- Rendering technical support to the products supplied by parent/group companies.

FEMA also governs the application and approval process for the establishment of a branch office, requiring that companies receive approval from the RBI. Permission to operate a branch office is granted for a three-year period, which can be extended at a later date.

Branch Office in India



**A branch office can manufacture if in an SEZ with 100% FDI.*
A branch office can also provide services to independent manufacturers.

An enterprise must also meet the following conditions before qualifying for the establishment of a branch office:

- Must have profitable operations during the immediately preceding five years in the home country; and,
- Must have a minimum net worth of US$100,000 verified by the most recent audited balance sheet or account statement.

If a company does not meet these requirements, but is a subsidiary of a company that does, the parent company may also submit a Letter of Comfort on the subsidiary's behalf during the application process. The process for establishing a branch office is identical to that required for a liaison office, and the same documents including Form FNC, the Certificate of Incorporation or Memorandum and Articles of Association, and an audited balance sheet must be submitted. A PAN must also be acquired, and the office must register with the Registrar of Companies through the Ministry of Corporate Affair's online portal.

Each year, the branch office must file an AAC, verified and attested by a Chartered Accountant, to the RBI stating that the office's activities were within its charter. An AAC should also be filed with the Directorate General of Income Tax within 60 days from the end of the financial year. All profits earned by the branch office may be remitted from India and will be subject to payment of all applicable taxes.

Only applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong, Macau, and Pakistan shall have to register with the state police. Copy of an approval letter for persons from these countries shall be marked by the AD Category I bank to the Ministry of Home Affairs, Internal Security Division – I, Government of India, New Delhi for necessary action and record. All other countries are exempted from registering with the state police.

Project office

If a foreign company has secured a contract from an Indian company to execute a project in India and has attained the appropriate funding source or governmental clearance, a project office may be established.

One of the following criteria must be met in order to obtain permission to establish a project office:

- The project is funded directly by inward remittance from the overseas head company;
- The project is funded by a bilateral or multilateral international financial agency such as the World Bank or IMF;
- The project has received clearance by the relevant authorities within India; or,
- The Indian company awarding the contract has been granted a term loan for the project.

If none of the above criteria are met, an overseas company looking to establish a project office in India must make a specific request with the Central Office of the RBI for approval.

Each year, the project office will be required to submit a Project Status report compiled by a Chartered Accountant to the company's AD branch. This report ensures the activities undertaken by the project office conform with the activities permitted by the RBI.

Only applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong, Kong, Macau, and Pakistan shall have to register with the state police. Copy of an approval letter for persons from these countries shall be marked by the AD Category I bank to the Ministry of Home Affairs, Internal Security Division – I, Government of India, New Delhi for necessary action and record. All other countries are exempted from registering with the state police.

Project offices may open a non-interest bearing foreign currency banking account with an authorized dealer branch in India for project expenses and credits. The office may maintain both a foreign currency account and a rupee account while operating in India. Project offices are allowed occasional remittances to their parent companies and must provide a chartered accountant certificate verifying the offices can still meet their liabilities. Following project completion, the project office may repatriate any capital surplus once all tax liabilities have been paid, a final audit of the project accounts has been completed, and a document verifying the remittable surplus provided. Thereafter the project office is wound up.

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Establishing a Business in India – Offices, Partnerships, and Companies
India Briefing News
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Setting up a wholly foreign-owned business in India

Wholly owned subsidiaries (WOS) are the most suitable and widely used form of business enterprise for foreign investors in India because they allow total control over business operations, provide limited liability, and have fewer restrictions on business activities than liaison offices and project offices.

They have independent legal status as Indian companies distinct from the foreign parent company. This means that a wholly owned subsidiary is subject to Indian laws and regulations as applicable to other domestic Indian companies and treated as an Indian company for taxation.

Establishing a wholly owned subsidiary

Under Indian law, foreign investors can establish wholly owned subsidiary companies in the form of private limited companies if they operate in sectors that permit 100 percent foreign direct investment (FDI). With India's recent loosening of FDI caps, companies are now also able to establish WOS in the telecom services and asset reconstruction sectors.

First, a minimum of two directors (at least one must be a resident in India) must be appointed and registered through India's e-filing system for Director Identification Numbers (DIN). Minimum requirements for the establishment of a private limited company include the existence of two directors, two shareholders (who may be the same person as the directors), and a minimum authorized share capital of US$1,500 (INR 100,000).

Second, a suitable name must be selected that preferably indicates the main objectives of the company and submitted with the RoC along with a brief description of the business' proposed functions to verify both the name's appropriateness and availability. Upon successful name registration, the applicant company has 20 days to file its Memorandum of Association (MOA) and Articles of Association (AOA), and proceed with formal incorporation filings.

The following forms are required to be filed with the Ministry of Corporate Affairs for establishing a WOS:

- RUN facility for reservation of name; and
- SPICe form for incorporation of the company.

Upon successful submission of the above documents, the RoC will issue a Certificate of Incorporation and a Corporate Identification Number (Corporate Identity). The process generally takes four to five weeks weeks to complete, and private limited companies are permitted to commence business immediately following their successful incorporation.

Tax liability for companies

What follows is a brief description of the various taxes which should be taken into consideration when incorporating a private limited / WOS company in India.

Corporate Income Tax (CIT)

This tax is imposed on the 'net income' of companies registered under the Indian Companies Act, 1956 (amended 2013) or foreign corporations earning income in India. A company, whether Indian or foreign, is liable to pay tax under the Indian Income Tax (IT) Act, 1961. While a resident company is taxed on its worldwide income, a non-resident (foreign) company is taxed only on income that is received in India, or that arises, or is deemed to accrue or arise, in India.

A flat 30 percent CIT plus a surcharge and a health and education cess is applied to resident enterprises, including wholly foreign-owned subsidiaries. For such companies, the surcharge is seven percent or 12 percent of the amount of CIT, if the total income exceeds INR 10 million (US$154,882) or INR 100 million (US$1.55 million), respectively. For the Assessment Year 2019-20 (FY 2018-19), the CIT for domestic companies with an annual turnover of up to INR 500 million (US$7.74 million) has been brought down to 25 percent from 30 percent.

Meanwhile, a 40 percent CIT rate plus a surcharge and a health and education cess is applied to non-resident enterprises conducting income generating activities in India. The surcharge for foreign companies is two percent or five percent if the income is over INR 10 million (US$154,882) or INR 100 million (US$1.55 million), respectively. A foreign company means an enterprise that has operations and origin in any other country except India. India has Double Taxation Avoidance Agreements with most countries thus providing tax relief to foreign investors in India.

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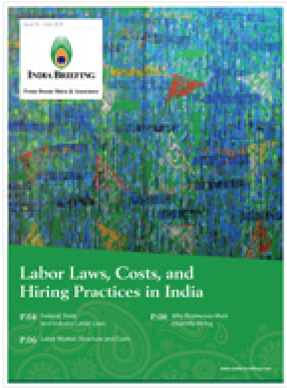

Labor Laws, Costs, and Hiring Practices in India
June, 2018

In this issue of India Briefing magazine, we discuss the structure of India's labor laws, with special reference to the country's manufacturing and IT sectors. We also briefly examine the composition of India's labor market and compute average hiring costs in IT and manufacturing. Finally, we put a spotlight on India's female labor force participation rate, which is among the lowest in Asia, and explain how firms benefit by pursuing diversity hiring strategies.

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India’s DTAAs and WHT Rates

Recipient	WHT (%)				Recipient	WHT (%)			
	Dividend	Interest	Royalty	For technical services		Dividend	Interest	Royalty	For technical services
Albania	10	10	10	10	France	15	0/10/15	20	10
Armenia	10	10	10	10	Georgia	10	10	10	10
Australia	15	15	10/15	10/15	Germany	10	10	10	10
Austria	10	10	10	10	Greece	N/A	N/A	N/A	N/A
Bangladesh	10/15	10	10	N/A	Hungary	10	10	10	10
Belarus	10 /15	10	15	15	Iceland	10	10	10	10
Belgium	15	10 /15	20	10	Indonesia	10	10	10	N/A
Bhutan	10	10	10	10	Ireland	10	10	10	10
Botswana	7.5 /10	10	10	10	Israel	10	10	10	10
Brazil	15	15	25/15	15	Italy	15/25	15	20	20
Bulgaria	15	15	15/20	20	Japan	10	10	10	10
Canada	15/25	15	10/15	10/15	Jordan	10	10	20	20
China (People’s Republic of China)	10	10	10	10	Kazakhstan	10	10	10	10
Chinese Taipei (Taiwan)	12.5	10	10	10	Kenya	15	15	20	17.5
Colombia	5	10	10	10	Korea, Republic	15	10	10	15
Croatia	5/15	10	10	10	Kuwait	10	10	10	10
Cyprus	10	10	10	10/15	Kyrgyz Republic	10	10	15	15
Czech Republic	10	10	10	10	Latvia	10	10	10	10
Denmark	15/25	10/15	20	20	Libya	N/A	N/A	N/A	N/A
Egypt	N/A	N/A	N/A	N/A	Lithuania	5/15	10	10	10
Estonia	10	10	10	10	Luxembourg	10	10	10	10
Ethiopia	7.5	10	10	10	Macedonia	10	10	10	10
Fiji	5	10	10	10	Malaysia	5	10	10	10
Finland	10	10	10/15	10	Malta	10	10	10	10

India's DTAAs and WHT Rates									
Recipient	**WHT (%)**				**Recipient**	**WHT (%)**			
	Dividend	**Interest**	**Royalty**	**For technical services**		**Dividend**	**Interest**	**Royalty**	**For technical services**
Mauritius	5/15	7.5	15	N/A	South Africa	10	10	10	10
Mexico	10	10	10	10	Spain	15	15	10/20	20
Mongolia	15	15	15	15	Sri Lanka	7.5	10	10	10
Montenegro	5/15	10	10	10	Sudan	10	10	10	10
Morocco	10	10	10	10	Sweden	10	10	10	10
Mozambique	7.5	10	10	N/A	Switzerland	10	10	10	10
Myanmar	5	10	10	N/A	Syria	5/10	10	10	N/A
Namibia	10	10	10	10	Tajikistan	5/10	10	10	N/A
Nepal	5/10	10	15	N/A	Tanzania	5/10	10	10	N/A
Netherlands	15	10/15	20	10	Thailand	10	10	10	N/A
New Zealand	15	10	10	10	Trinidad & Tobago	10	10	10	10
Norway	10	10	10	10	Turkey	15	10/15	15	15
Oman	10/12.5	10	15	15	Turkmenistan	10	10	10	10
Philippines	15/20	10/15	15	N/A	Uganda	10	10	10	10
Poland	10	10	15	15	Ukraine	10/15	10	10	10
Portugal	10/15	10	10	10	United Arab Emirates	10	5/12.5	10	N/A
Qatar	5/10	10	10	10	United Kingdom	10/15	0/10/15	10/15	10/15
Romania	10	10	10	10	United States	15/25	10/15	10/15	10/15
Russian Federation	10	10	10	10	Uruguay	5	10	10	10
Saudi Arabia	5	10	10	N/A	Uzbekistan	10	10	10	10
Serbia	5/15	10	10	10	Vietnam	10	10	10	10
Singapore	10/15	10/15	10	10	Zambia	5/15	10	10	10
Slovenia	5/15	10	10	10					

Applicable Tax Rates for Wholly Foreign-Owned Subsidiary (WOS)		
WOS	**Assessment year 2018-19**	**Assessment year 2019-20**
Total turnover or the gross receipt in the previous year 2015-16 does not exceed INR 500 million (US$7.6 million)	25% of the taxable income	NA
Total turnover or the gross receipt in the previous year 2016-17 does not exceed INR 2.5 billion (US$38.35 million)	25% of the taxable income	25% of the total income
Any domestic company	30% of the total income	30% of the total income

Surcharge Applicable on Private Limited Companies			
	Net income not exceeding INR 10 million (US$153,000)	**Net income between INR 10 to 100 million (US$153,00 -1.53 million)**	**Net income exceeding INR 100 million (more than US$1.53 million)**
Domestic company	Nil	7%	12%

Tax on the distribution of dividends

Corporate entities are subject to a tax on the distribution of dividends. However, in the case of shareholder, the associated income is exempt from tax. The current effective rate of the Dividend Distribution Tax is 20.36 percent (15 percent plus surcharge and cess). No exemption from payment of the DDT is granted for the profits relating to SEZ developers. In addition, individuals, firms and HUF residents in India receiving dividend income more than US$150,000 (INR 1 million) shall be charged tax at a flat rate of 10 percent.

To avoid a situation of double taxation being created by the DDT, it is permitted that, to compute the tax, any dividend received by a domestic company during any financial year from its subsidiary shall be allowed to be deducted from the dividend to be distributed. This is provided the dividend received by the domestic company has been subject to DDT and the domestic company is not the subsidiary of any other company.

Minimum alternate tax

All companies declaring taxable income that is less than book profits are subject to the Minimum Alternate Tax (MAT). Presently, MAT is levied at 18.5 percent of book profits plus the applicable surcharges and education cess. The MAT is levied on companies whose tax payable under normal income tax provisions is less than 18.5 percent of book profits. Additionally, MAT is applicable to SEZ developers/units for income arising on or after April 1, 2012.

The Finance Act of 2016 rolled back MAT for foreign companies with retrospective effect from April 1, 2001. It is applicable if the foreign company is a resident of a country which:

- Has a tax treaty with India and such foreign company does not have a permanent establishment (PE) as defined in the relevant treaty; or
- Does not have a treaty with India, and such foreign company is not required to seek registration under any law relating to companies.

The Finance Act of 2018 waived MAT for select industries in the infrastructure sector, namely shipping, exploration of mineral oils, operation of aircrafts, and civil construction business in turnkey power projects.

Taxation of royalties and technical fees

Under domestic tax law, the royalties/technical fees that are payable to non-residents with a permanent establishment in India are taxed on a different basis compared to non-residents without permanent establishment in India. Concessional tax rates apply if the agreement relates to a matter that has been approved by the government of India. The payments made are subject to tax avoidance agreements entered into by the non-resident's country.

Wealth tax

As of April 1, 2016, the wealth tax has been abolished. For information on the indirect taxes that a company will encounter in India, see our Tax and Accounting in India section.

Navigating FDI caps and restrictions

Amendments in India's FDI policy have opened up a number of key business sectors to increased foreign investment and, in several instances, eliminated the need for foreign investors to obtain approval from the government before investing.

These amendments are further periodically augmented, with several sectors significantly increasing the amount of foreign investment permitted.

FDI routes and forms

Foreign investment into India falls under one of two FDI routes:

- Government route: For investment in business sectors requiring prior approval from the government. With the abolition of the Foreign Investment Promotion board (FIPB), the Department of Industrial Policy and Promotion (DIPP) will now direct FDI proposals that require government approval to the concerned federal ministry or department.
- Automatic route: For investment in business sectors that do not require prior approval from the government, but the filing of a notification after the incorporation of the company and issue of initial shares.

Foreign investment takes one of two principal forms:

- Foreign direct investment (FDI): The acquisition of shares or other securities in an Indian company.
- Foreign institutional investment (FII): Investment by foreign institutional investors (such as hedge funds, insurance companies, or mutual funds) registered with the Securities and Exchange Board of India (SEBI).

These distinctions are important when interpreting recent changes in foreign investment policy, as FDI caps and approval routes often vary by both industry and type of investor.

Changes to FDI caps and approval routes

The latest amendments to the FDI policy were made in January 2018 to ease doing business and remove unintended obstacles for investments in certain industries. Major beneficiaries include single brand retailers, the medical devices industry, real estate brokerages, power exchanges, and local audit firms.

The government also provided more clarity on compliance requirements, easing the overall investment process. For instance, investments via the automatic route involving "countries of concern" will now be referred to the DIPP. Previously these investments needed security clearance from the Ministry of Home Affairs (MHA). In the case of investments from "countries of concern" requiring government approval – these will continue to be processed by respect administrative ministries and government departments.

The issuance of equity shares will be permitted against non-cash considerations, such as pre-incorporation expenses and the import of machinery, for sectors eligible to receive investments under the automatic route. Previously, this was allowed only for investments under the government approval route.

Prior to 2018, foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian companies or LLP's, and in the Core Investing Companies, was allowed up to 100 percent after government approval. The FDI policy is now amended so that if such investments are regulated by any financial sector regulator, then foreign investment up to 100 percent under the automatic route will be allowed.

If the investment activity is not regulated by any financial sector regulator, or is only partly regulated, or where there is doubt regarding regulatory oversight, foreign investment up to 100 percent will be allowed under the government approval route – subject to conditions, such as a minimum capitalization requirement.

Single and multi-brand retail trading

While previous FDI policy only permitted one non-resident entity with ownership of a brand (or rights to a brand) to invest in Indian companies engaged in the retail trading of that brand, policy changes now allow multiple non-resident entities to invest in Indian entities engaged in single-brand retail trading of that brand (as long as each own or have rights to the brand via a legally binding agreement).

Foreign firms can also fully own local single-brand retail chains. Previously, foreign firms needed approval from the Department of Industrial Policy and Promotion (DIPP) to invest above 49 percent. Until recently, foreign retailers operating in India had to source a minimum of 30 percent of the value of purchased goods – domestically. To make doing business in India easier, foreign retailers can now meet this requirement – incrementally – within the first five years of their operations in India.

Specifically, this means that a retailer can source material from India for their international product lines but also have it count towards their domestic sourcing requirements. After five years of operations in India, however, the company must begin sourcing 30 percent of their material in India for products sold in the domestic market. The changes in FDI Policy were approved by the federal government on January 10, 2018.

In respect to multi-brand retail trading, changes made in 2012 permitted up to 51 percent FDI with prior government approval. Conditions for investment, however, required companies to invest at least 50 percent of the total FDI proceeds into 'back-end infrastructure,' such as manufacturing, processing, packaging, and distribution. Changes made in 2013 now clarify that at least 50 percent of the first US$100 million invested must be in 'back end infrastructure' within three years.

Furthermore, the previous requirement for multi-brand retail trading companies (MBRTCs) regarding manufacturing and processing 30 percent of products in 'small industries' has been discontinued, and companies are now permitted to source their products from any manufacturing or processing entity so long as investment in plant and machinery is below US$2 million at the first engagement. MBRTCs are now also allowed to establish outlets in a wider range of locations, as the previous restriction to cities with populations of at least one million has been scaled back. State governments now possess the authority to permit MBRTCs to operate in their region.

India's Current FDI Caps

	Previous (2017) Policy		2018 Policy	
Sector/Industry	**Investment Cap**	**Approval Route**	**Investment Cap**	**Approval Route**
Single Brand Retail	Up to 49%	Automatic	100%	Automatic
	Above 49%	Government		
Non-Banking Financial Companies/ Core Investing Companies	Up to 100%	Government	100% (if registered with RBI)	Automatic
			100% (If unregistered with RBI)	Government
Air Transport Services	Up to 49% (100% for NRIs and OCBs)	Automatic route	up to 49% (100% for NRIs and OCBs)	Automatic
			Above 49% and up to 100%	Government
Air India Limited	Nil	Nil	FDI not to exceed 49%, either directly or indirectly. Substantial ownership and effective control to be vested in Indian Nationals.	Government
Real Estate Brokerage	Nil	Nil	100%	Automatic
Medical Devices			Amended definition of 'Medical devices': 100%	Automatic
Power exchanges	Up to 49%; only in secondary market	Automatic	Up to 49%; including in primary market	Automatic

**The data for FY 2016-17 is provisional due to delays in the annual filing of taxes.*

Investing in Indian companies

The issuance of shares by Indian companies falls under the compliance guidelines outlined in the Foreign Exchange Management Act (FEMA). Companies seeking capital through the public route should base the issuance price on SEBI guidelines. Unlisted companies seeking capital may not issue private shares at a price less than fair value determined according to internationally accepted pricing methods or arm's length basis. The price will be determined by a SEBI registered banker or a chartered accountant. The acquisition of unlisted shares by a non-resident from an Indian resident must be exchanged at fair value based on the SEBI guidelines.

Units operating in SEZs may issue shares at a price based on the valuation against the import of capital goods. This valuation must receive approval from a Development Commissioner Committee and the appropriate customs officials. Shares must be officially issued within 180 days of receipt of invested capital, or the funds must be refunded to investors.

Upon the issuance of shares to foreign investors, the issuing company has 30 days to file Form FC GPR, which needs to be filled in manually and is available at the RBI website: *http://ebiz.gov.in/app/login*.

Foreign investors should be familiar with Indian investment regulations and compliance requirements before moving to invest in regulated sectors.

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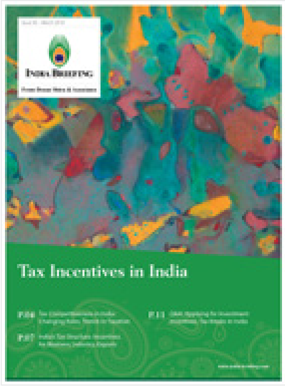

Tax Incentives in India
March, 2018

In this issue of India Briefing magazine, we examine India's corporate tax structure, analyze the latest trends in India's tax system, and strategies that companies can use to offset their tax burden. We also answer frequently asked questions on applying for investment incentives and tax breaks in India. Foreign investors should note that tax benefits available to businesses in India are determined by economic activity, industry, location, and size of firm.

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Tax and Accounting in India

- Indirect tax in India
- India's audit process

Indirect tax in India

Taxation permeates business transactions in India, and a strong understanding of tax liabilities can enable foreign investors to maximize the tax efficiency of their investments while ensuring full compliance with all tax laws and regulations. This section provides an overview of indirect taxes for businesses and individuals in India and discusses accounting and audit practices in the country.

Making a strategic and informed decision about investing in India requires a thorough understanding of the diverse options for investment in the country, in addition to the regulatory structures that govern operations and compliance.

Goods and Services Tax (GST)

The Goods and Services Tax (GST), launched on July 1, 2017 is a single, value added tax levied on the manufacture, sale, and consumption of both goods and services at the national level. The new tax subsumes most indirect taxes previously levied at the federal and state level.

GST is a consolidated tax based on a uniform tax rate fixed for both goods and services across India, and is payable at the final point of consumption. At each stage of sale or purchase in the supply chain, the tax is collected on value-added goods and services, through a tax credit mechanism (or input credit mechanism). We discuss key features of the GST below.

Indirect Tax Structure under GST

Indirect taxes subsumed under GST		Indirect taxes not subsumed under GST
Federal level	**State level**	
• Central Excise Duty • Additional Excise Duty • Service Tax • Additional Customs Duty / Countervailing Duty • Special Additional Duty of Customs	• State Value Added Tax/Sales Tax • Entertainment Tax (other than levied by the local bodies) • Central Sales Tax (levied by the Centre and collected by the States) • Octroi and Entry tax • Purchase tax • Luxury tax • Taxes on lottery, betting, and gambling	• Excise Duty/VAT on Petroleum Products for initial years (in addition to GST at Nil rate) • Excise Duty on Tobacco Products (in addition to GST) • Electricity Duty by state (in addition to GST) • Entertainment Tax levied by local bodies • State excise on Alcoholic Beverages (no GST)

Dual tax

The GST is a dual levy, which means that both the federal and State government levy tax on supply of goods and services based on the nature of transaction (Inter-State or Intra-State). Accordingly, GST has two concurrent components: one, a State/Union territory GST (SGST/UTGST), levied and collected by the state or union territory (UT) and two, a Central GST (CGST), levied and collected by the federal government (commonly referred to as "the centre" in India). The dual levy property of GST has been kept in line with the constitutional requirements of fiscal federalism in India.

Integrated Goods and Services Tax (IGST)

Under GST, inter–State supplies between any two States and imports to the country are subject to the IGST, which is levied and collected by the federal government. The IGST is the aggregate of the CGST and SGST; it is appropriated from the State where the supplies are consumed.

Tax on supply

The GST is applicable on the "supply" of all goods and service. Previously, tax was applicable across all levels of supply chain- manufacture, sale, or provision of goods and services. But, under GST, the liability to pay CGST or SGST arises at the time of supply. Depending on whether the transaction is 'inter-state' or 'intra-state' (between states or within a state, respectively), separate GST provisions is applicable to help a business determine the place of supply for goods and services.

Destination-based tax

GST is levied only at the final destination of consumption. The principle of destination-based tax is one of the factors that helps determining the place of supply. This, as a result, helps in deciding the tax which is to be levied on the transaction of good and services. If the transaction is intra-State, it is subject to CGST + SGST and if it is inter-State, it is subject to IGST.

RELATED SERVICES

Dezan Shira & Associates provides tax consulting for foreign companies in India. For more information, please contact us at tax@dezshira.com

Input tax credit (ITC) mechanism

The ITC forms the backbone of the GST regime in India. The ITC mechanism helps in the seamless flow of tax-credits throughout the value-chain, and across the boundaries of India's states. The GST is essentially a tax on value addition at each stage of the supply chain; every supplier, who is the person supplying the goods and/ or services or an agent acting as such on behalf of such a supplier, can claim credits (over input taxes paid at each stage of supply chain) in the subsequent stage of value addition.

Thus, a continuous chain of set off is established from the original producer's or service provider's level up to the retailer's level, thus, eliminating the burden of double taxation. Suppliers at each stage are permitted to set off the GST paid on the purchase of input goods and services against GST to be paid on the supply of goods and services

It is important for dealers to note that no cross utilization of the ITC is permitted between the state and federal levy. This means that the credit of CGST paid on inputs may be used only for paying CGST on the output, while the credit of SGST on inputs may be used only for paying SGST, except in the case of inter-state supply of goods.

- To avail input tax credit, following conditions must be met:
- The dealer holds tax Invoice, debit or credit note, supplementary invoice issued by a supplier registered under the GST Act;
- The said goods or services have been received;
- Returns have been filed; and,
- The supplier has paid the due tax to the government.

Reverse charge mechanism

The government has deferred the reverse charge mechanism under goods and services tax to September 30, 2019. Previously, it was to be implemented from October 1, 2018.

Under this mechanism, the GST is levied on goods or services procured from unregistered dealers by the buyer and deposited with the government.

Unregistered dealer supplying to a registered dealer

Normally, the supplier of goods or services pays the GST on supply. In the case of the reverse charge mechanism, the receiver becomes liable to pay the tax – basically, the chargeability gets reversed. If a vendor is unregistered but supplies goods to a person who is registered under GST, then this mechanism will apply – the GST will be paid directly by the receiver to the government, instead of the supplier. The registered dealer who pays the GST under the reverse charge mechanism has to self-invoice the purchases made.

Services through an e-commerce operator

If an e-commerce operator supplies services, then reverse charge will apply on the e-commerce operator. They will be liable to pay GST. If the e-commerce firm does not have a physical presence in India, then a person legally representing such e-commerce entity will be liable to pay tax. If there is no representative, the entity must appoint a representative who will be held liable to pay GST.

Supply of certain goods and services specified by CBIC

The Central Board of Indirect Taxes and Customs (CBIC) has issued a list of goods and services on which the reverse charge mechanism is applicable.

GST Council

It is a federal forum that includes federal, state, and union territory governments on its board. The GST Council comprising of the federal finance minister as the chairman, the federal Minister of State (Revenue), and the state and union territory finance ministers will make recommendations to the federal, state, and union territory governments on issues like tax rates, exemption lists, threshold limits, and all other matters relating to the GST.

Since the roll-out of the GST in 2017, the GST Council has been issuing periodic changes to the tax rate structure, filing mechanism, input credit system, refund mechanism for exporters, and other regulatory aspects. It is important to keep track of these changes to ensure your business stays compliant.

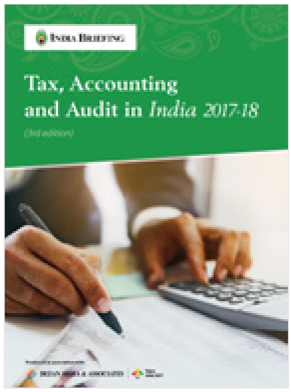
GST registration

Every business and professional entity based in India, with an annual turnover exceeding US$31,054 (INR 2 million), and US$15,527 (INR 100,000) in the northeastern states of India, is required to obtain GST registration.

The following categories of suppliers are mandatorily required to be registered irrespective of turnover:

- Taxable person carrying on interstate supply;
- Foreign companies supplying goods and services in India;
- Businesses liable to pay tax under reverse charge;
- Agents supplying on behalf of taxable person;
- Input service distributor;
- Sellers on e-commerce platforms;
- Aggregator supplying services under their brand name (e-commerce companies); and,
- Authorities responsible to withhold tax or deduct Tax Deducted at Source (TDS).

RELATED READING



Tax, Accounting and Audit in India 2017-18 (3rd Edition)
July, 2017

The third edition of Tax, Accounting and Audit in India is updated for 2017, and provides an overview of the fundamentals of India's tax, accounting, and audit regime, including the major tax, legal, and regulatory obligations foreign investors are likely to encounter when establishing or operating a business in the country. This edition of the guide also includes a detailed introduction of the Goods and Services Tax (GST) that was launched on July 1, 2017, representing the complete transformation of India's indirect taxation structure.

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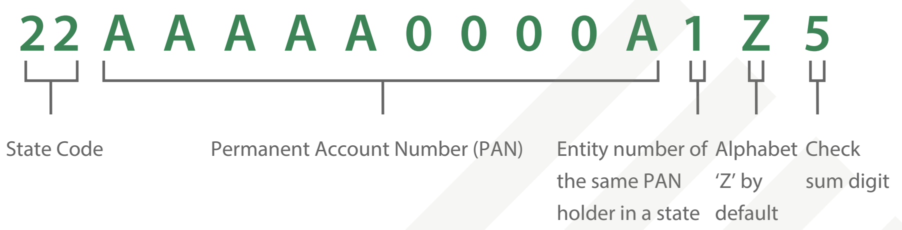
Entities supplying taxable products and services to different states in India need to be registered in all the states from which the supplies are made. An entity already registered in a state under any existing law must migrate to the GST regime within the stipulated period.

Once registered, businesses will receive a 15-digit GST identification number (GSTIN) based on a state-wise code and their PAN. The format is shown below:

Goods and Services Tax Identification Number (GSTIN) Format



GST composition scheme for SMEs

The composition scheme is a system under the GST Act that allows suppliers of goods, other than exempt goods, and restaurant related service providers to file their GST returns at a fixed rate.

The scheme can be accessed by any taxpayer whose turnover on the 'taxable supplies of goods' does not exceed INR 15 million (US$230,100). For Indian states in the northeast and the north Indian state of Himachal Pradesh, the threshold limit is INR 7.5 million (US$115,050). The turnover of all business verticals under the registered PAN has to be taken cumulatively to decide eligibility. The supply of goods also needs to be intrastate and all business verticals must be included when applying for the scheme. However, there are no restrictions on procuring goods from other states.

If the turnover of the business exceeds the threshold amount during the financial year, the benefits of the composition scheme cannot be used, and the firm needs to file simple GST returns from this point onwards.

To opt into the scheme, the business needs to file form GST CMP – 02 with the government through the online GSTN portal. The indication to remain in the scheme needs to be made before every financial year. Taxpayers need to file the form GST CMP – 04 if they want to opt out of the composition scheme or if they fail to meet the criteria for the scheme at any time during the financial year.

Registered persons who need to file GSTR 5, 6, 7, or 8 are not eligible for this scheme.

Filing GST returns

All GST returns have to be filed electronically, through a common e-portal provided by the Goods and Services Tax Network (GSTN). GSTN is a not-for-profit, private limited company, which provides the Indian government with information technology support for implementing the GST.

The GST Identification Number obtained when a company registers is required for all returns filing. Nil returns must also be filed on a monthly or quarterly basis.

GSTR 1 – Form for outward supply

Every GST registered dealer needs to file the GSTR 1 form. It requires all the details of the sales made in that month. All invoices raised have to be uploaded onto the system. These can be edited until the GSTR 1 is submitted but any mistakes after submission can only be corrected in the next month.

Submit this form monthly – if the aggregate annual turnover of the business is above INR 15 million (US$ 230,550). Otherwise, it may be filed quarterly. Submission date is by the 10th of the next month. The GSTR 1 is then sent to the buyer, who will file the GSTR 2. There is no tax payment made at this point.

GSTR-1A – Making changes in GSTR 1

Any changes made by the purchaser to the GSTR 1 form are reflected in the GSTR 1A, and will be verified by the supplier. Once these changes are accepted, the GSTR 1 form is filed.

GSTR 2 – Form for purchase transactions

GSTR 2 is a validation form for the GSTR 1 raised by the supplier. It is received as a GSTR-2A form, which when confirmed and filed is the purchaser's GSTR 2. In case of any discrepancies, the changes made will be reflected in the GSTR 1A and returned to the supplier for verification. It is an invoice matching process. The form needs to be submitted by the 15th of the next month.

GSTR 3 – Monthly return based on GSTR 1 and 2

GSTR 3 is a consolidation of GSTR 1 and 2. It is automatically generated to show the entire tax liability. This tax needs to be paid and returns filed on the GST portal. As per the Act, it needs to be submitted by the 20th of the next month.

GSTR-3B – Simple return form until August 2018

GSTR-3B is an alternate form to the GSTR 3. The only difference is that no reconciliation between supplier and purchaser is necessary to file GST returns. The government recently released a simplified version of the form. This form has to be filed by the 20th of the next month for which GST is being calculated.

Forms GSTR 4, 5, 6, 7 and 8 are special returns to be filed by different categories of people.

GSTR 4 and GSTR 9A – Composition scheme

Returns must be filed by March 31, 2018 for the financial year (FY) 2018-19.

Thereafter, GSTR 4 needs to be filed by the 18th of the month succeeding the quarter for which GST is being paid. GSTR 9A is the form for annual returns for taxpayers under this scheme. Submission of this form is required by December 31 of the next financial year.

GSTR 5 – Non-Resident Taxable Persons in India

Non-resident taxable persons in India are foreign suppliers who have temporary business in India but no permanent establishment. Such businesspersons are required to register themselves through the GSTN by submitting Form GST REG 09, at least five days before the commencement of business in India.

Taxpayers falling in this category are also required to make an advance deposit of tax for the estimated amount of liability at the time of submission of the registration form. The form needs to be co-signed by a resident of India with a valid PAN.

The certificate of registration, which permits foreign businesspersons to become temporary taxpayers, is valid for 90 days from the date of registration or the number of days mentioned in the registration form, whichever is lesser.

There is no threshold for registration; all non-resident and foreign taxpayers falling in this category must register. The input credit mechanism or the composition scheme under GST are not available to them. If such a person intends to extend their period of business in India, Form GST REG 11 needs to be furnished before the end of the original registration period.

All the details of sales are to be filed in the GSTR 5 form that will then be included in the GSTR 2 form of the purchaser. The submission date of this form is the 20th of the next month or within seven days of the registration period ending, whichever comes first. Any refund on the original deposit for tax will be given after the verification of details furnished in this form.

The form GSTR 5A needs to be filed by non-residents even if they provide online services to a non-taxable recipient. This includes database access or data retrieval services and online information. The registration procedure remains the same.

GSTR 6 – Input Service Distributor

An Input Service Distributor is the office that receives the invoice for input services rendered to any or all of their branches registered under the same PAN. The credit for CGST/SGST/IGST paid for these services should be distributed on a proportional basis by amount of input received to the respective branches.

Input credit is a provision under the GST Act that allows a business to claim back the taxes paid for purchase of certain goods and services. For example, if a supplier is taxed INR 500 (US$7.76) on the goods purchased, and is taxed INR 750 (US$11.51) on the sale of the same goods, they will receive input tax credit of only INR 500 (US$7.76), and must pay the balance amount of INR 250 (US$3.75) as tax.

This provision allows a business that incurs a large share of common expenditure to simplify the input credit procedure and is only applicable if both parties, the purchaser and the supplier, have paid taxes. Therefore, it avoids double tax on a single service or product.

Incorrectly claiming input credit is a criminal offence and attracts fines of up to 24 percent interest on the excess amount of credit claimed annually.

The GSTR 6 is the monthly return to be filed by an Input Service Distributer by the 13th of the next month. This form details the documents issued and the manner for distribution of input tax credit. The GST Council recently notified an extension for the submission deadline to March 31, 2018 for all returns for the period of July 2017 to February 2018.

GSTR 7 – Tax Deduction at Source

Tax collected by a purchaser of goods or services at the time of payment to a supplier is known as Tax Deduction at Source or ‘withholding tax’.

Any department or establishments under the federal or state government, local authorities, government agencies, and persons notified by a government body, as well as public sector undertakings that collect TDS are required to file GSTR 7.

The rate of TDS under GST is one percent CGST and one percent SGST, therefore total rate is two percent, and is applicable for contracts valued above INR 250,000 (US$3,835). If the contract involves inter-state purchasing, i.e. the supplier is registered in a different state from the recipient, no TDS is charged. Non-deduction, short deduction, non-payment, or short payment of TDS is an offence and a minimum penalty of INR 10,000 (US$154.10) is prescribed under the GST act.

As the registration started late in 2017, the GST council deferred the filing provisions and processes for TDS to June 30, 2018 to ensure an uncomplicated rollout of the GST system.
The Indian government, on average, grants up to 10,000 civil contracts per year. For contractors to be eligible for input credit, they will have to register under GST and file this form once the council announces its commencement. This will be an important step to ensure tax compliance from the contractors as input credit from government contracts will be reflected in their own GSTR 1, 2, 3, 3B filing.

GSTR 8 – Tax Collection at Source

Businesses that own or manage a digital or an electronic facility or platform for e-commerce have to obtain GST registration as well as register for TCS through form GST REG 07. An e-commerce operator, such as Flipkart, deducts TCS from payments made to them from a purchaser before remitting the same to the supplier.

Form GSTR 8 has to be filed by all eligible operators by the 10th of the following month. This form details the supplies effected through an e-commerce platform and one percent TCS is collected on them.

The TCS through submission of GSTR 8 will reflect on form GSTR 2A of the supplier. Annual returns through GSTR 9B has to be submitted by these taxpayers by December 31 of the next financial year. As for TDS, the registration for TCS also started late last year, but the filing has been deferred to June 30, 2018.

In a clarification of guidelines, the GST council notified that e-commerce operators with sales less than INR 2 million (US$30,680) need not register and that e-commerce operators cannot opt for the composition scheme.

GSTR 9 – Annual return

This form consolidates the returns made throughout the year. Details of sales and purchases under different tax types (SGST, CGST, and IGST) are furnished in this form. Any sales or purchases that have not been shown in the monthly filings can be corrected here. It is effectively a summary of the monthly/quarterly GST returns. A statutory audit report has to be additionally submitted in case of companies and individual/HUF – if turnover exceeds INR 10 million (US$153,700).

If the annual turnover exceeds INR 20 million (US$307,400), GSTR-9C must be filed instead of GSTR 9. Such taxpayers also need to file an audit for the company's annual accounts, and a reconciliation account of tax paid versus tax payable.

Submission for all annual returns is required by December 31 of the following tax year.

GSTR 10 – Final return

Any business whose GST registration has been cancelled or surrendered needs to file this form. It has to be filed within three months of cancellation or surrender. It is a one-time form for final GST settlement.

Offences and penalties under the GST

The GST Act has prescribed strict provisions to ensure compliance and enforcement across various areas of GST such as GST registration, filing GST returns, and correct entry of invoices. Any registered taxable person who is involved in offences specified under the Act will face punishment in the form of penalty, prosecution and in certain cases, even arrest.

The provisions related to offences and penalties are covered under section 122 to 138 of the GST Act. Section 122 enlists 21 offences punishable under the Act.

Penalty fees for delayed monthly returns is charged at INR 50 (US$0.77) per day for GSTR 1, 3B, 4, 5, 6 and INR 20 (US$0.31) per day for nil returns; the maximum being INR 5,000 (US$76.70). For GSTR 5A, the government recently reduced late fees to INR 200 (US$3.07) per day of delay and INR 100 (US$1.53) per day for nil returns; with a maximum penalty of INR 5,000 (US$76.70). This is the same penalty structure for GSTR 6, 7, and 8. For annual returns – GSTR 9, 9A, 9B, and 9C – the penalty is INR 200 (US$3.07) per day of delay, or INR 100 (US$1.53) per day for nil returns, up to 0.25 percent of the firm's turnover.

In addition, interest is calculated at 18 percent annually – starting from the day after the deadline – on the amount of outstanding tax.

Tax avoidance under the GST composition scheme – by registering when the business does not fit the prerequisites – is heavily penalized. Up to 100 percent of the taxes levied on the company can be charged as penalty.

Taxpayers should note that the GST forms must be filed in order. For example, the forms for January must be filed before the forms for February. In case of outstanding non-compliance, late fees and interest charged can result in a cascading effect and a large accumulation of fines and taxes.

If a dealer or a taxpayer is not satisfied with the decision or an order passed against him/her by an adjudicating authority, regarding the offences prescribed under the GST act, s/he may appeal to the First Appellate Authority. If still dissatisfied, s/he may appeal to the National Appellate tribunal, thereafter to the High Court, and finally to the Supreme Court of India.

GST rates

Different categories of goods and services are taxed differently under GST. The GST council has provided a four-tier tax structure tied at 5 percent, 12 percent, 18 percent, and 28 percent, with lower rates for essential items and the highest for luxury and de-merits goods. An additional consumption cess is imposed on demerit goods ranging anywhere from 3 percent (on personal jets) to 12 percent (on sodas) to 290 percent (on pipe tobacco).

In the goods schedule, tax is exempted for primary food like fresh fruits and vegetables, oilseeds, eggs and dairy produce and other essential items like vaccines, kerosene, books, journals, and periodicals, and aids and implements used by handicapped persons.

For services, categories that are exempt include education and healthcare, as well as travelling on the metro, local train, and religious travel.

Impact of GST on imports and exports

In the previous tax system, the import of goods and services were subject to import duties such as custom duty, countervailing duty or CVD (equivalent to excise duty) and special additional duty (equivalent to value added tax), and the import of services was subject to service tax.

Under the reformed tax structure, IGST replaces previous indirect taxes imposed on the import of goods and services. However, customs duty and other protective taxes such as anti-dumping duty, safe-guard duty continue to be levied on imports, in line with the previous tax regime.

The imports under GST are treated as inter-state supply; which means that IGST that is imposed on the inter-state supply of good and services is also imposed on the imports of goods and services. Since GST is a destination-based tax, IGST is levied in the State where the imported goods are consumed and import services are received.

IGST can be paid using input tax credit of central goods and services tax (CGST), state goods and services tax (SGST), and IGST. Input tax credit is the credit that a dealer can claim on taxes paid on his/her purchase.

GST on Imports

Imports	Taxes levied
Import of Goods	IGST + Basic Customs Duty + other protective duties (if applicable)
Import of Services	IGST

In case of CGST and SGST, no cross utilization of input tax credit is allowed. That means, input tax credit of CGST can only be utilized for CGST and IGST, and input tax credit of SGST can only be utilized to pay for SGST and IGST.
Under GST, import of service is taxable if:

- The supplier of service is located outside India;
- The recipient of service is located in India;
- The place of supply of service is in India; and,
- The supplier of service and the recipient of service are not merely establishments of a distinct person.

An importer is required to file monthly tax return under GST. Under the previous law, importer was required to file returns under state tax law for purchase of goods (import of goods) and under central tax laws for claiming countervailing duties. While filing monthly returns, importers must declare the goods imported in table-5 of GSTR-2 form, and services imported in table-6 of GSTR-2 form.

Previously, transportation of goods by aircraft and inbound shipment was not liable to service tax. Under GST, there is no such exemption.

Under GST, exports of goods and services are exempted from taxation. However, input tax credits relating to such supply of goods and services can be availed. Moreover, taxes paid on raw materials and services used in export of goods and services will be refunded to the exporters.

Strategies to reduce tax burden in India

India looks favorably upon regional trading arrangements, which include Free Trade Agreements (FTAs), Preferential Trade Agreements (PTAs), and Comprehensive Economic Cooperation Agreements (CECAs).

These are arrangements between two or more countries, or between a country and a trading bloc to abolish or reduce tariffs, quotas, and preferences on goods and services traded.

Double taxation avoidance agreements (DTAs or DTAAs) aim to prevent the same income from being taxed by two or more states, while also eliminating tax evasion and encouraging cross-border trade efficiency.

DTAAs within a bilateral agreement enshrine the treatment of many forms of tax, including corporate income tax, individual income tax, withholding tax, and dividends tax.

RELATED NEWS

Singapore and India to Include Limitation of Benefits in DTAA Amendment: Implications for Foreign Investors
India Briefing News
January, 2017

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India’s Regional Trade Agreements in Effect	
Trade agreement	**Type of agreement**
Asia-Pacific Trade Agreement (APTA)	Preferential Trade Agreement (PTA)
India-ASEAN Trade in Goods Agreement (India-ASEAN TIG)	Free Trade Agreement (FTA)
Global System of Trade Preferences (GSTP)	PTA
South Asia Free Trade Agreement (SAFTA)	FTA
India, Sri Lanka Free Trade Agreement (SLFTA)	FTA
India Malaysia Comprehensive Economic Cooperation Agreement (IMCECA)	Comprehensive Economic Cooperation Agreement (CECA)
Japan India Comprehensive Economic Partnership Agreement (JICEPA)	Comprehensive Economic Partnership Agreement (CEPA)
India Korea CEPA (IKCEPA)	CEPA

Select DTAAs and Withholding Tax Rates				
Recipient	**WHT**			
	Dividend (%)	**Interest (%)**	**Royalty (%)**	**For technical services (%)**
Australia	10	10	10	10
Canada	15/25	15	10/15	10/15
China	10	10	10	10
France	15	0/10/15	20	10
Germany	10	10	10	10
Israel	10	10	10	10
Italy	15/25	15	20	20
Japan	10	10	10	10
South Korea	15	10	10	15
Singapore	10/15	10/15	10	10
U.A.E.	10	5/12.5	10	N/A
U.K.	10/15	0/10/15	10/15	10/15
U.S.	10/25	10/15	10/15	10/15

India's Audit Process

Audit season in India can be a hectic and confusing time for foreign invested enterprises operating in the country. While most foreign executives in India leave auditing to chartered accountants and professional services firms, it is important to maintain at least a basic understanding of the audit process, how to prepare an enterprise for audit, and key considerations that should be taken into account.

There are two primary objectives associated with annual audit in India. The first objective is for auditors to report to shareholders and the government whether or not the company's balance sheet provides a true and fair reflection of its state of affairs and any profit or loss derived during the financial year. The second, an incidental objective, concerns the detection and prevention of fraud and error. Hiring an experienced firm to complete annual audit in a timely and accurate manner is critical to achieving both objectives.

An overview of India's audit process

Audits of company accounts have been compulsory in India since the passing of the first Companies Act in 1913. Since then, the Institute of Chartered Accountants of India (ICAI), a statutory body established under the Chartered Accountants Act, 1949, has regulated the profession of chartered accountants in India and ensured the maintenance of India's accounting standards. All chartered accountants are members of the ICAI, and must comply with the standards stipulated by the ICAI and the Audit and Assurance Standards Board (AASB).

Essentially, an audit is the inspection of an individual, business or organization's accounts, and is traditionally completed by an independent individual or firm with specialized skills and knowledge of auditing procedures in the country in question. In other words, accountants verify that a company's business transactions were recorded accurately, and provide a true and fair reflection of that company's financial situation.

The importance of the audit process cannot be understated, as the results can be used for the following purposes:

- Helping investors know the financial health of the company;
- Assuring the government that the company is properly discharging its legal duties;
- Helping lenders evaluate the credibility of the company;
- Drawing management's attention to any shortcomings in the company's business operations; and,
- Helping management improve business efficiency.

Auditing objectives

As mentioned earlier, there are two key objectives associated with annual audit in India: expressing to shareholders and the Indian government a true and fair view of the company's financial statements, and detecting and preventing instances of fraud and error.

Ensuring a company's balance sheet provides a true and fair reflection of its current state of affairs requires an auditor who, after completing the audit process, will express their opinion of the company's financial statements via an auditor's report.

These financial statements should include Balance Sheet, Profit & Loss Account, Cash Flow Statement and Notes to Accounts. A "true and fair view" can only be satisfied if the financial statements are accurate and not misleading.

A company can expect the auditor to feel they have provided a true and fair assessment if the following criteria are satisfied:

- The accounts are prepared with reference to the entries in the account books;
- Entries are supported by proper vouchers, documents, or other evidence;
- No entry in the account book is omitted while preparing the financial statements, and nothing is included in the financial statements that were not in the account books; and,
- The financial statements are prepared in accordance with the relevant accounting standards.

An incidental objective associated with annual audit in India is the detection of errors or fraud in a company's financial statements. If an irregularity is detected, the auditor has a duty to report the details to management, who is then expected to remedy such an error.

Types of audits

Basic audits in India are generally classified into two main types:

Statutory audits

Statutory audits are conducted to report the current state of a company's finances and accounts to the Indian government and shareholders. Such audits are performed by qualified auditors working as external and independent parties. The audit report of a statutory audit is made in the form prescribed by the government agency.

Internal audits

Internal audits are conducted at the behest of internal management in order to check the health of a company's finances, and analyze the organization's operational efficiency. Internal audits may be performed by an independent party or by the company's own internal staff.

In India, every company whose shares are registered on the stock exchange must have an internal auditing system in place. This includes:

- Every unlisted public company having:
    - Paid up share capital of US$7 million (INR 500 million) or more during the preceding financial year; or
    - Turnover (income) of US$29 million (INR 2 billion) or more during the preceding financial year; or
    - Outstanding loans or borrowings from banks or public financial institutions exceeding US$14 million (INR 1 billion) or more at any point of time during the preceding financial year; or,
    - Outstanding deposits of US$3 million (INR 250 million) or more at any point of time during the preceding financial year.
- Every private company having:
    - Turnover of US$29 million (INR 2 billion) or more during the preceding financial year; or,
    - Outstanding loans or borrowings from banks or public financial institutions exceeding US$14 million (INR 1 billion) or more at any point of time during the preceding financial year.

Statutory audits

In India, statutory audits are conducted for each fiscal year (April 1 to March 31) and not the calendar year. The two most common types of statutory audits in India are:

Tax audits

Tax audits are required under Section 44AB of India's Income Tax Act 1961. This section mandates that those whose business turnover exceeds US$149,200 (INR 10 million), and those working in a profession with gross receipts exceeding US$75,000 (INR 5 million), must have their accounts audited by an independent chartered accountant.

The audit report is made using Form 3CD along with either Form 3CA (for companies) or Form 3CB (for entities not included under Form 3CA). The provision of tax audits are applicable to everyone, be it an individual, a partnership firm, a company, or any other entity. The tax audit report is to be completed by November 30 after the end of the previous fiscal year.

Non-compliance with the tax audit provisions may attract a penalty of 0.5 percent of turnover or US$1,500 (INR 100,000) whichever is lower. There are no specific rules regarding the appointment or removal of a tax auditor.

Company audits

The provisions for company audits are contained in the Companies Act, 2013 as applicable. Every company, irrespective of its nature of business or turnover, must have its annual accounts audited each financial year. For this purpose, the company and its directors must first appoint an auditor at the outset.

Thereafter, at each annual general meeting (AGM), an auditor is appointed by the shareholders of the company who will hold the position from one AGM to the conclusion of the next AGM. The Companies (Amendment) Act, 2017 now allows the appointment of auditors for five years so that their appointment will not need to be ratified in every annual general meeting (AGM). Also, public listed companies must constitute an audit committee.

Listed companies and companies belonging to prescribed class of companies will not appoint or re-appoint the auditor for:

- More than two terms of five consecutive years, if the auditor is an audit firm; and,
- More than one term of five consecutive years if the auditor is an individual.

Only an independent chartered accountant or a partnership firm of chartered accountants can be appointed as the auditor of a company.

The following persons are specifically disqualified from becoming an auditor per the Companies Act, 2013:

- A body corporate;
- An officer or employee of the company;
- A person who is partnered with an employee of the company, or employee of an employee of the company;
- Any person who is indebted to a company for a sum exceeding US$15 (INR 1,000) or who has guaranteed to the company on behalf of another person a sum exceeding US$15 (INR 1,000);
- A person who has held any securities in the company after one year from the date of commencement of the Companies (Amendment) Act, 2000; and,
- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

The auditor is required to prepare the audit report in accordance with the Company Auditor's Report Order (CARO) 2016. CARO requires an auditor to report on various aspects of the company, such as fixed assets, inventories, internal audit systems, internal controls, and statutory duties, among others. The audit report must be obtained before holding the AGM, which itself should be held within six months from the end of the financial year.

Audit reporting

As discussed earlier, audits are conducted to ensure a company's financial statements present a true and fair view of its financial affairs. Therefore, the auditor's opinion expressed in the ultimate report is based on the information gathered during the audit and the verification of financial statements.

Upon completing the report, the auditor may express one of the following four opinions:

Unqualified opinion

An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.

It confirms that:

- Generally accepted accounting principles are consistently applied in the preparation of financial statements;
- Financial statements comply with the relevant statutory requirements and regulations; and,
- There is adequate disclosure of all material matters relevant to the proper presentation of financial information (subject to statutory requirements).

Qualified opinion

A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed, but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or the limitation of scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being "subject to'" or "except for" the effects of the matter to which the qualification relates.

Disclaimer of opinion

A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient and appropriate audit evidence and is, therefore, unable to express an opinion on the financial statements.

Adverse opinion

An adverse opinion is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to indicate the misleading or incomplete nature of the financial statements.

Convergence with international reporting standards

India's new accounting standard, Ind AS 115, is in effect from April 1, 2018, which is the start of the country's new financial year. As explained by the Ministry of Corporate Affairs, the Ind AS 115 lays down the principles to be applied by an entity to report useful information to users of financial statements. These principles include the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.

Companies based in India will need to adopt a more detailed process for revenue recognition as the Ind AS 115 removes scope for interpretation in several areas. It prescribes only one underlying principle for revenue recognition, which is the transfer of control over goods or services. The new standard also replaces the 'fair value' concept with 'transactions price', which according to the Institute of Chartered Accountants of India (ICAI) – is better suited for the measurement of revenue.

The ICAI also stated that the Ind AS 115 offers clarity in areas involving multiple element contracts or bundled products, licensing, royalties for intellectual properties, financing components, and variable consideration.

Experts believe the new accounting standard will bring in much needed transparency in the accounting and audit process by improving disclosures. This will impact a broad range of sectors in India, including technology, real estate, mining and metals, engineering-procurement-construction, and telecom as the standard incorporates new concepts of revenue recognition. Further, the existing standards Ind AS 18 and 11, which are used to examine revenue and construction contracts, respectively – will be withdrawn as the Ind AS 115 comes into effect.

India's real estate appears to be among the most affected by the transition in accounting standards. From this financial year on, listed real estate firms will need to switch to the Project Completion Method from the existing Percentage Completion Method (POC). This means that home buyer payments toward the purchase of under construction projects will no longer be treated as turnover or profit from sales; rather they will be examined as advances or loans.

The Ind AS 115 is in keeping with international best practices, and aligns the Indian accounting standard with the International Financial Reporting Standards (IFRS) set globally by the International Accounting Standards Board and the IFRS Foundation.

However, the application of the Ind AS 115 for the banking sector in India has been deferred by the Reserve Bank of India to April 1, 2019.

Key considerations to ensure a smooth audit

Many investors are concerned about India's reputation for having notoriously unclear rules and procedures, and approach the audit season with no small degree of trepidation. With proper advice and some relevant knowledge of the local operating environment, however, investors will find that India's legal and financial operational procedures are not as complex as they may have initially thought.

An audit does not need to be a costly and disruptive exercise for businesses, and an audit report can be invaluable in helping companies manage their business better and address problems or loopholes going forward by identifying irregularities and errors. This section explains the processes a foreign-invested enterprise in India can expect to undergo during statutory audit, and what companies need to know and prepare to make the audit process go smoothly.

Initial brief

Auditors should be provided with an overview of a company's business activities and structure so as to enable them to provide the most thorough and accurate feedback possible. While most auditors have some general industry knowledge, briefing auditors on the specific activities a business conducts, its supply chain and procurement procedures, and existing internal controls can allow the audit process to proceed smoothly. While auditors are expected to perform checks on internal controls independently, it can be beneficial to first explain how these internal controls function.

Purchasing and procurement procedures

Auditors will closely examine purchasing and procurement procedures, and will likely request a flow chart during audit proceedings that outlines the specifics of this process. Preparing this flow chart beforehand can save valuable time during the audit process, and providing this to auditors even if they do not request it can enable the provision of thorough feedback that will allow businesses to better understand the efficiencies and deficiencies of their operations.

Businesses can also expect auditors to examine major purchases to ensure the company is not being overcharged for the purchase of raw materials and other supplies. It is not atypical for dishonest employees to elect to purchase from more expensive, lower quality suppliers with whom they may have some personal connection or relationship (that is, family connections or businesses and suppliers paying them a commission on purchases). By closely surveying purchasing and procurement procedures, these deficiencies can be identified and halted in the aftermath of an audit.

Auditors will additionally compare purchase vouchers with the relevant tax invoices received from the sellers of goods received notes (GRNs) to confirm whether or not the quantities and amounts match. This will allow auditors to check whether the rates of materials on invoices correspond to purchase orders raised by the company, and whether the dates on GRNs relate to the current accounting period. These checks can be time consuming, and it is recommended to have a properly trained accounting team in place to assist with these checks and make it easier for auditors to evaluate a complete paper trail.

The production process

An effective auditor will additionally make note of an enterprise's production and manufacturing process, and the various steps a company follows to convert raw materials into marketable goods. It is helpful to prepare a list of the main raw material inputs a business is using in production to facilitate this process. Companies can also expect auditors to check internal controls at this stage, especially those relating to the input of raw materials. In some respects, this aspect of the audit process relates back to the examination of purchasing and procurement procedures.

Journal vouchers, tax expense, and cash

A company's auditor will also seek to verify whether the bills supporting journal vouchers and expenditures relate to the current period. While examining journal vouchers, an auditor will ensure that the tax deduction at source (TDS) was in fact deducted, wherever applicable. It is relatively common for companies to neglect to deduct TDS by mistake, and it is essential to ensure internal processes have not made such an oversight.

When claiming travel and other related expenses for tax deductions, companies should always ensure that supporting documentation is retained and provided to an auditor when necessary. It would be prudent to include in executives' job descriptions and employment contracts that they must provide evidence of expenditure on business trips and other related expenses to avoid any doubt or oversight in this respect. Auditors will often seek to confirm that these expenses are within the prescribed limits outlined in the relevant job description.

Auditors are also required to check that any payment in cash or aggregate payments in cash totaling over INR 20,000 in one day are not claimed as a deduction (in accordance with Section 40A(3) of the Income Tax Act 1961), and also check other credit balances in cash. A company's Bank Reconciliation Statement should also be spot-checked by an auditor to verify expenditures.

Inventory

Manufacturing businesses need to demonstrate that they have maintained their RG 23 books and stock registers for manufacturing or processing materials. An auditor will verify that this has been done correctly, and will need to ascertain whether the RG 23A Part II / RG 23C Part II are aligned with purchase registers, and whether input credits have been recorded correctly. Auditors will also check a company's Personal Ledger Account (PLA) register to ensure that payments were accurately made through their PLA after considering input credit. Auditors are also expected to perform a physical inspection of stock to confirm that inventory counts match the company's inventory register.

Other reconciliations

A company's auditor will also need to reconcile the following items:

- Excise/GST returns with purchases and sales;
- Provident fund contributions;
- Professional tax contributions; and,
- Employee state insurance contributions.

These contributions are mandatory under statute and apply to all companies in India.

Miscellaneous

Management accounts opening balances

Businesses should also have management accounts ready in the event that an auditor wants to check that the opening balances in those accounts have been carried forward correctly from the previous year's audited financial statements. It is not uncommon for some minor adjustments to be necessary.

Rental agreements

It is a good idea to ensure that the rent for a factory or office has been paid on time in accordance with the rental agreement, and that the rental agreements are up-to-date in advance of an audit.

PANs for contractors

Companies must also ensure that they are properly maintaining photocopies of Permanent Account Number (PAN) cards for any contractors that come under TDS applicability. If a company has not been provided with a contractor's PAN but is required to deduct TDS, it is necessary to deduct TDS at the default rate of 20 percent.

Why audits are important to your business

Audits are often seen by companies as annoying and unwelcome disturbances to their normal operations, and an audit in an unfamiliar country can be a particularly dreaded proposition. However, audits perform two vital functions.

First, they ensure that a business is complying with all relevant laws and regulations in India. They are needed to confirm that the business is correctly assessing its taxable income, backing up claimed deductions with the necessary receipts, and making the appropriate TDS deductions when required. Failure by a foreign invested enterprise to fulfill these legal obligations and improper record-keeping can result not only in fines from the Indian government, but also potential penalties imposed by other jurisdictions, such as under the U.S. Foreign Corrupt Practices Act or other similar legislation in Europe.

The second vital function of an audit is to identify any weaknesses or areas of improvement for a business. It is for this reason that many companies opt to conduct internal audits in addition to their legally required annual audit, as auditors often have the independence and experience to give valuable recommendations on how problems might be resolved. Audits can help to improve management practices and a company's internal controls should be prepared to accommodate and assist with audits. If a company's annual audit reveals any deficiencies in its business processes or internal controls, it may be wise to closely examine those processes and controls. This may include assessing the staff charged with carrying out the company's operations to ensure they are competent in their roles. It is only by having adequate internal controls that a business can perform to its full potential, and an annual audit is an independent and valuable measure of the adequacy of those controls and procedures.

Detecting and avoiding fraud

As an incidental objective associated with annual audit, detecting fraud and error can be as important as assessing whether a company's balance sheet accurately represents its current state of affairs. For companies with operations in India, it is important to maintain an awareness of what constitutes fraud, and the fine line between fraud and error in the eyes of an auditor.

According to Deloitte's 2016 India fraud survey, 65 percent of respondents believe that fraud will continue to rise in the coming years. This is despite efforts by management to establish a robust control environment. While management is inherently the first line of defense against fraud and error, internal and external auditors are often considered the second line of defense. Fraud refers to the willful and deliberate misrepresentation of financial information with the intention of deceiving others (that is, shareholders, the government, etc.). This can entail both defalcation involving the misappropriation of cash or goods, and the fraudulent manipulation of accounts by management or employees.

Defalcation involving the misappropriation of cash or goods can encompass a number of specific activities including, but not limited to:

- Recording fictitious or bogus payments;
- Undercasting the receipt side total of a cashbook;
- Showing the same payment twice;
- Recording more payments than actual amounts paid by altering the figures on vouchers;
- Misappropriating undisbursed wages; and,
- Recording personal expenses as business expenses.

Fraud through the manipulation of accounts typically implies presenting accounts more favorably than they are in reality, and distorting the profit or loss of a business and its financial state of affairs (also known as “window dressing”).

This type of fraud is committed at the management level, and auditors will oftentimes suspect fraud if they encounter:

- Missing vouchers, invoices, checks, or contracts;
- Balances that do not add up;
- Significant fluctuations in the gross profit and net profit margin ratio;
- A difference between the stock as per records and physically counted stock;
- When the control account does not agree with subsidiary books; and,
- When parties provide contradictory explanations for Inconsistencies.

The key difference between “fraud” and “error” often relates back to the intent to deceive, and distinguishing between the two can be challenging. Auditors are charged with exercising judgment when preparing their opinion for the final audit report, but do not make legal determinations of whether fraud has actually occurred. Rather, the auditor’s opinion is persuasive rather than conclusive in nature and based solely upon the information they reviewed and analyzed during the verification of financial statements.

If fraud is suspected by an auditor, this suspicion will be reflected in their opinion and an interested party may subsequently decide to carry out an investigation into the matter in question.

Fraud risk management

India is among the world's fastest growing emerging markets, aided by liberal foreign investment policies and an expanding consumer base. This has catapulted the number of market players – foreign and domestic – and led to high levels of competition in each industry, often exposing firms to the threat of fraud and other risks.

A recent industry survey showed that in 2017, 89 percent of the companies based in India were victims of at least one instance of fraud; 33 percent of them suffered revenue losses of more than seven percent due to this. Foreign investors expanding to the Indian market therefore need to prioritize conducting due diligence when entering into partnerships and contracts with firms and vendors in India.

Aside from the due diligence review, firms should pay key attention to daily compliance associated with financial reporting, security of company assets, floor operations, and inventory assessment, among other business activity records. Mitigating the risk of fraud begins with a robust governance structure that includes the audit of budgeting processes, ethics policies, quality control, monitoring procedures by senior management, and rotation procedures. Any weakness in an organization's governance structure creates vulnerability for fraud.

Aside from ensuring an organization possesses a robust governance structure, providing an anonymous hotline or other channel for whistleblowers to alert management of fraudulent behavior can be an effective mode of fraud detection. The Companies Act, 2013 additionally mandates listed companies to establish a mechanism for whistleblowers to alert management of fraud at the director or employee level.

3

Human Resources and Payroll Considerations

- Key considerations when hiring staff
- Payroll and social insurance

Key considerations when hiring staff

Visa application

When applying for a long-term visa in India, there are a number of procedures and legal frameworks that must be understood. India provides two kinds of work-related visas: a business visa and an employment visa. For these visas, Indian authorities require documentation from the applicant as well as the applicant's employer. Applicants and employers should plan to allow at least one week to prepare the required documentation.

Meanwhile, applicants applying for a visa by post should allow two to three weeks for visa application processing, despite declared visa processing times. The documents required by Indian authorities are dependent on the applicant's nationality; applicants and their employer should verify all required documentation with the Indian consulate in the applicant's home country. Nevertheless, the majority of the required visa application documents are similar for most developed economies in Europe and North America.

Foreign nationals that intend to visit India for meetings with Indian companies should apply for a business visa. Depending on the applicant's nationality, a multiple entry business visa can be granted for a period of up to five years at a time. However, the maximum allowable stay period per visit is determined by the issuing Indian consulate. US applicants, for example, can obtain a multiple entry business visa that is valid for ten years, but each period of stay is limited to six months. To acquire a business visa for India, the application must ordinarily contain the following documents.

For both business and employment visa applications, each document provided by the employer needs to be drafted on company letterhead, signed by a senior manager, and marked with the company's official stamp. In addition, each of these documents need to be original copies. The only exceptions to these stipulations are the Incorporation Certificate and the PAN card, which can be scanned or photocopied. Still, these stipulations mean that employers must be prepared to send original copies to the applicant by post.

Companies that have successfully sponsored business and employment visas in the past are often well prepared to organize support documentation. However, companies that have not previously sponsored these visas should consider contracting an India-based visa consultant. Indian consular staff scrutinize and sometimes investigate the language of key documents, such as invitation letters for business visas or permission and justification letters for employment visas. Visa consultants are well acquainted with the application process and can provide form letters and useful advice to mitigate the potential for problems.

Visa requirements for foreign nationals working in India

Employee eligibility

1. At least 18 years old
2. In good health
3. Filling a position unsuitable for a qualified Indian employee
4. Will not be working in a routine, secretarial or clerical job
5. Must have an annual salary in excess of US$ 25,000 (with the exception of language teachers, ethnic cooks, embassy staff and voluntary workers)

Documents required from employee

6. A completed visa application form
7. A valid passport
8. A passport sized photo
9. Proof of address, such as a driver's license or utility bill
10. A detailed curriculum vitae

Documents required from employer

11. Permission letter that requests approval for the applicant's visa
12. Sponsorship letter
13. Tax liability letter pledging responsibility for the applicant's income tax in India
14. Justification letter confirming that a qualified Indian candidate was unavailable/unsuitable
15. Details of the applicant's unique specialization and professional capabilities
16. Appointment letter detailing the job role and salary
17. Comprehensive employment contract
18. Copy of the company's Permanent Account Number (PAN) card
19. The company's Incorporation Certificate
20. Application form

Approximate time to complete

2-4 WEEKS

Visa registration

Expatriates first encounter with Indian bureaucracy often occurs at the Foreign Regional Registration Office (FRRO). This process is now online and is no longer as cumbersome as it used to be. Long-term visa holders should register their visa as soon as possible; failing to register a visa within the specified time period can result in a fine, and in some cases, an investigation. An investigation can take several weeks – the visa holder is not permitted to leave the country during this time period. In addition, investigations may complicate any future visa applications or renewals.

General instructions

All foreigners (including foreigners of Indian origin) visiting India on long term (more than 180 days) Student Visa, Medical Visa, Research Visa and Employment Visa are required to get themselves registered with the FRRO or the Foreigners Registration Officer (FRO) concerned having jurisdiction over the place where the foreigner intends to stay, within 14 days of arrival. Pakistan nationals, however, are required to register within 24 hours of their arrival. All Afghan nationals are required to register with the FRRO/FRO concerned within 14 days of arrival except those Afghan nationals who enter India on a visa valid for 30 days or less provided the Afghan national concerned gives his/her local address in India to the Indian Mission/FRRO/FRO. Afghan nationals who are issued visas with 'Exemption from police reporting' are exempt from police reporting as well as exit permission provided they leave within the Visa validity period.

Foreigners – other than those mentioned above – will not be required to get themselves registered, even if they have entered India on a long-term visa, provided their continuous stay in India does not exceed 180 days. If the intention of the foreigner is to stay in India for more than 180 days, the person should get registered well before the expiry of 180 days from the date of arrival with the FRRO / FRO concerned.

Registration is also required in the case of visas issued for less than 180 days and if there is a special endorsement required for registration. However, foreigners entering on Entry (X) and business visas valid for more than 180 days are still required to register with the FRRO / FRO – if they continuously intend to stay for more than 180 days on each visit.

Visa registration documents

To register an employment visa, a visa holder needs to prepare the registration documents required by Indian authorities. Like the visa application, both the visa holder and their employer must provide support documents to register the visa. This process requires coordination between the visa holder and their employer; visa holders and their employer should plan to allow 2-3 days to gather and complete these documents.

The visa holder must ordinarily provide:

- A completed visa registration application form;
- Six passport size photos of the applicant;
- A copy of the photo page within the passport;
- A copy of the visa page within the passport;
- Proof of address, such as a driver's license or utility bill, from the visa holder's home country;
- A notarized copy of a lease deed/agreement or a C-Form from a hotel of residence; and,
- Visa registration fees.

The employer must ordinarily provide:

- Two copies of a permission letter that requests approval for the applicant's visa registration;
- Two copies of a sponsorship letter that pledges responsibility for the applicant's activity in India and promises to repatriate the applicant at company cost if any adverse conduct comes to notice;
- Two copies of a letter confirming the visa holder's residential address in India;
- Two copies of an employment contract that specifically states the monthly salary, designation, tenure of employment, etc; and,
- The company's Incorporation Certificate.
- All documents, with an exception for the Incorporation Certificate, must be original copies, drafted on company letterhead, signed by a senior manager, and marked with the company's official stamp.

Hiring staff in India: Common legal issues

While India has a large labor pool, skilled workers and senior management can be difficult to recruit. Many employers use websites such as Monster.com, Naukri.com, or LinkedIn to source employees, but the most successful employers generally establish direct relationships with universities for graduate talent and local recruiters for experienced talent. Local consultancies that produce market research can assist foreign employers to gauge local labor markets and establish the relationships needed to source premium talent.

Separately, employers in India may find an incongruence between a candidate's soft skills and their actual experience. An HR best practice would be to adopt a rigorous application review process for technical and senior personnel, verifying employment, education, criminal records, as well as reference checks. Many local service providers can provide employment screening services for employees at any level, as well as more in depth background investigations for C-Suite candidates.

Beyond these general considerations, employers need to be aware of various federal and state mandated compliances. The vast majority of labor laws that govern employment are found at the national federal level, though employers will also find some sub-national variation at the state level, particularly through the various Shop and Establishment Acts. Employers that are unfamiliar with labor laws in India should engage a law firm or professional services firm to review laws and compliances that impact their business. Although not comprehensive, here we outline some of the key pieces of legislation that impact most employers in India.

Employment contracts

Indian labor laws provide a minimum of guarantees and benefits to all employees, and employers should note that these laws supersede the provisions of labor contracts.

However, it should be noted that most of these laws apply to those employees drawing salaries below a certain threshold. Most blue collared workers in the organized sector in India receive wages higher than those stipulated in these laws and so have no recourse to the protections under these laws.

There is no separate law for employment contracts in India. These contracts come under the general purview of the Contracts Act so are open to judicial interpretations, which can be subjective.

In general, however, there are three types of employment contracts in India:

- Permanent (direct) contract;
- Fixed contract; and,
- Temporary contract.

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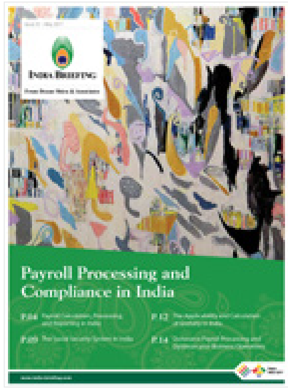

Payroll Processing and Compliance in India
May, 2017

In this issue of India Briefing Magazine, we discuss payroll processing and reporting in India, and the various regulations and tax norms that impact salary and wage computation. Further, we explain India's complex social security system and gratuity law, and how it applies to companies. Finally, we describe the importance of IT infrastructure, compliance, and confidentiality when processing payroll in India.

AVAILABLE HERE

When drafting contracts, employers should pay special attention to the Industrial Disputes Act, which provides a large number of protections to employees; the Shops and Establishments Act, which governs the hours of work, payment of wages, leave, holidays, terms of service and other conditions; as well as the several wage and remuneration acts, which regulate the payment of wages, bonuses, and equalize pay for men and women. Any termination policy outlined within the contract should be checked against the current law prior to it being carried out. For example, companies that employ more than 100 workers need government permission to conduct layoffs.

Besides company rules and regulations, employers are advised to incorporate the following clauses into contracts:

- Non-disclosure;
- Employee poaching;
- Unfair competition; and,
- Trademarks, patents and trade secrets.

Due process in terminating an employee in India

Employers are exposed to a number of legal and reputational risks resulting from wrongful termination, or not following due process. Employers should, therefore, plan to construct contracts and human resource (HR) materials to ensure that senior management, HR personnel and employees are fully apprised of their rights and responsibilities.

There is no standard process to terminate an employee in India. An employee may be terminated according to the individual labor contract signed between the employee and the employer, if the contract defines a process for termination. Employers should be aware, however, that labor laws supersede the provisions of labor contracts – any termination policy or clause outlined within a contract should be checked against the law by a professional.

In cases where there is no labor contract, or the labor contract does not define a method of termination, then the employer must follow the state law. In this scenario, an employer needs to abide by India's state and industry-specific labor legislations to terminate the employee.

Important HR Laws in India	
Laws related to wages	
The Payment of Wages Act, 1936; The Payment of Wages Rules, 1937; the Payment of Wages (Amendment) Act, 2005.	Designed to regulate the payment of wages to employees. Stipulates the wage periods, time and mode of payment of wages.
The Minimum Wages Act, 1948; The Minimum Wages (Central) Rules, 1950	Sets minimum wage levels that must be paid to skilled and unskilled workers.
The Payment of Bonus Act, 1965; The Payment of Bonus Rules, 1970	Governs bonus payments. Seeks to provide employees a share in the profits of a company. Applies to a workplace with 20 or more employees
Laws related to working hours, conditions of service and employment	
The Industrial Employment (Standing Orders) Act, 1946	Provides a standard model of service conditions for employees. Applies to all establishments where 50 or more workmen are employed.
The Factories Act, 1948	Designed to regulate working conditions in factories.
The Contract Labour (Regulations and Abolition) Act, 1970	Designed to regulate the employment of contract laborers. Applies to organizations with 20 or more people.
Shops and Establishment Act	Designed to regulate employee wages, hours of work, leave holidays and terms of service. Each state has its own version of the Act.
Laws related to gender	
The Maternity Benefits Act, 1961	Regulates employment of women before and after child birth. Applies to every establishment that has 10 or more employees.
The Equal Remuneration Act, 1976	Provides for the payment of equal wages to men and women employees.
Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013	Maintains that during an inquiry following a written request, an internal committee may recommend to transfer the aggrieved woman to any other workplace/grant leave of up to three months.
Laws related to social security	
The Employees' State Insurance Act, 1948; the Workmen's Compensation Act, 1923	Regulates employee compensation for injury by accident during employment.
The Employees' Provident Fund & Miscellaneous Provisions Act, 1952; The Employees' Provident Fund & Miscellaneous Provisions (Amendment) Act, 1996	Mandate the provision of the provident fund, pension fund and deposit-linked insurance fund. Applies to establishments with 20 or more people.
The Payment of Gratuity Act, 1972	Mandates a gratuity payment to employees in a company with ten or more people and applies to all employees regardless of salary.

Payroll and social insurance

Withholding tax returns

Similar to China, businesses in India are required to withhold Individual Income Tax (IIT) from an employee's salary on a monthly basis. During the first seven days of each month, employers must deposit the deducted tax from the previous month with the central government. The only exception to this rule involves the month of March, during which tax deducted may be deposited on or before April 30th.

Employers are required to withhold tax on various payments including rent, interest, dividend, royalty, and service income. In this sense, the compliance requirements for employers are more complex in India than in many other countries. Businesses should actively coordinate with employees to understand the details of supplementary income they are receiving and make the relevant calculations and submission of tax before deducting them from the salary.

Quarterly withholding tax return statements must also be submitted by the last day of the month following the end of a quarter to the central government reporting the tax deducted at source during the quarter. Failure to meet either this deadline or the monthly TDS deposit deadline can result in both interest and penalties being imposed on a company.

Individual Income Tax (IIT) liability determination

For expatriates, the extent to which services rendered in India are taxable is irrespective of whether the salary is received from inside India or outside India. The taxation of individuals is determined by residence status. Under the Income-tax Act, 1961, an individual can have the status of Resident and Ordinarily Resident (ROR), Non-resident, or Resident but Not Ordinarily Resident (RNOR).

It is also important to note that under the following conditions, 60 days is substituted by 182 days for:

- An Indian citizen or a person of Indian origin who visits India during any tax period; and,
- An Indian citizen who leaves India during any tax period for the purpose of employment outside India.

Residency Rules in India

Conditions	Residential status	
	Resident	Non-resident
Basic Conditions	Stayed in India for a period of 182 days or more during the tax period "or"	Satisfies none of these conditions
	Stayed in India for a period of 60 days or more during the tax period and 365 days or more in the 4 years preceding the tax year	
Conditions	**ROR**	**RNOR**
Additional Conditions	Been resident in India in at least 2 of the 10 years immediately preceding the tax year	Satisfies either one condition or neither of them
	Stayed in India for a period of 730 days or more in 7 years immediately preceding the tax year	

Income in the form of salaries includes remuneration in any form for personal services provided under an expressed or implied contract of employment or service. Such income is subject to tax on a 'due' or 'receipt' basis, whichever is earlier, and includes wages, annuity or pension, gratuity, fees, commission, prerequisites, or profits in lieu of salary, advance salary, leave encashment, etc. Except for under provisions dealing with short stay exemptions, no specific expatriate concessions are available under India's tax laws.

An expatriate can be a resident of two countries at the same time. In such a scenario, there could be double taxation of the same income, but relief from double taxation may be available under the relevant Double Taxation Avoidance Agreements (DTAAs). Taxation relief can be available in the form of a tax credit in the country of permanent residency. Further, submission of a Tax Residency Certificate containing prescribed particulars is a necessary condition for availing of benefits under DTAAs. An application under Form 10FA must be made to obtain a tax residency certificate in India.

Income tax returns

The process for filing income tax returns is a fairly straight forward one. You must:

1. **Acquire a PAN number**

   A permanent account number (PAN) is absolutely necessary for income tax returns. It is a ten-digit number that is issued on a laminated card, and will be used as your ID when registering on CBDT's website.

2. **Acquire Aadhaar number**

   Aadhaar is a 12-digit unique identification number (UID) issued by the Unique Identification Authority of India (UIDAI) to every individual resident of India. The government has made it mandatory to link the Aadhaar number to the PAN number and necessary for filing tax returns.

3. **Select the appropriate tax return form**

   There are several income tax return forms according to your specific situation. These include forms for individuals with a single house, for companies, and for persons who are applicable for special taxation schemes, and can be found on Indian Income tax's website. Ensure that you select the relevant one.

4. **Work out which rate of tax you are on**

   The rates of income tax are listed in the country's Finance Bill, which is reviewed and amended every year.

5. **Corporate Income Tax (CIT)**

   Domestic companies are taxed at a flat rate of 30 percent plus a surcharge, education cess, and secondary and higher education cess. From fiscal year 2017-18 onward, the CIT for domestic companies with an annual turnover of up to INR 500 million (US$7.74 million) has been brought down to 25 percent.

   Meanwhile, a 40 percent CIT rate and surcharge, education cess, secondary and higher education cess is applied to non-resident enterprises conducting income generating activities in India. The surcharge for foreign companies is two percent if the income is over INR 10 million (US$154,882) or five percent if it is over INR 100 million (US$1.55 million).

Tax applicability on income earned in India

As mentioned previously, companies and individuals not working in India but earning an income there are still applicable for tax. It used to be that long-term capital gains were waved for taxation, but this is no longer the case.

The rates of tax for non-resident Indians are:

- On any investment income, the income tax rate is between 10 to 30 percent;
- For long-term capital gains, the rate will either be 10 percent or 20 percent, depending on the nature of your operation; and,
- On short-term capital gains, 15 percent.

Calculate your income tax rate

You should then calculate your tax amount against the above rates of tax. You can use the tax calculator on CBDT's website to do this. Make sure that the information you enter is absolutely accurate, otherwise your tax return application will be rejected.

After using the tax calculator, you can then follow the prompts on CBDT's website to complete your tax return. Alternatively, you can use a non-government website to perform the tax return for you, but these will invariably charge a fee for doing so.

Retain your tax documents

Having completed your tax return, ensure that you retain printouts and statements of your taxable income in the event that you are contacted by the tax authorities.

Provident Fund scheme

While much of the Indian population does not participate in the country's social insurance program known as the Provident Fund scheme, Indian citizens in the organized sector are entitled to coverage. International workers including expatriates working for an employer in India are also eligible to participate in the Provident Fund scheme. Employers are required to contribute 12 percent of their employees' specified salary to the scheme, and contributions must be deposited on a monthly basis by the 15th of the subsequent month.

The schemes under the Employees' Provident Fund Organization apply to businesses with at least 20 employees. Contributions to the Employees' Provident Fund Scheme are obligatory for both the employer and the employee when the employee is earning up to INR 15,000 (US$220) per month, and voluntary, when the employee earns more than this amount. If the pay of any employee exceeds this amount, the contribution payable by the employer will be limited to the amount payable on the first INR 15,000 (US$220) only.

The Employee Provident Fund scheme (EPF) is one of the main platforms of savings for all employees working in government, public, or private sector organizations. It came into existence with the promulgation of the Employees' Provident Funds Ordinance on the 15th November, 1951. It was replaced by the Employees' Provident Funds Act, 1952 and is now referred as the Employees' Provident Funds & Miscellaneous Provisions Act, 1952 which extends to the whole country, except Jammu and Kashmir state.

A provident fund is created to provide financial security and stability to employees. The contributions are made regularly. The primary purpose of the PF fund is to help employees save a fraction of their salary every month so that they can use the same in an event that the employee is temporarily unable to work or at retirement. The tax-free interest and the maturity award ensure a good growth to an employee's money.

The PF can be used for multiple purposes at different moments as it guarantees benefits such as:

- Accumulation plus interest upon retirement, resignation, and death; and,
- Partial withdrawals allowed for specific expenses such as house construction, higher education, marriage, illness etc.

Employer and Employee Contributions

Particulars	Contribution account			Administration account		Total
	EPF	EPS	EDLI	EPF	EDLI	Total
Employee	12	0	0	0	0	12
Employer	3.67	8.33	0.5	0.85	0.01	13.36
Total	15.67	8.33	0.5	0.85	0.01	25.36

Note: Providing EPF benefits to workers is mandatory for units employing 20 or more persons and earning up to INR 15,000 a month.

4

Operational Issues

- Import and export licensing procedures in India
- Sourcing from India

Import and export licensing procedures in India

India's import and export system is governed by the Foreign Trade (Development & Regulation) Act of 1992 and India's Export Import (EXIM) Policy.

Import and export of all goods are free, except for the items regulated by the EXIM policy or any other law currently in force. Registration with regional licensing authority is a prerequisite for the import and export of goods. The customs will not allow for clearance of goods unless the importer has obtained an Import Export Code (IEC) from the regional authority.

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Import policy

The Indian Trade Classification (ITC)-Harmonized System (HS) classifies goods into three categories: restricted, canalized, and prohibited. Goods not specified in these categories can be freely imported without any restriction if the importer has obtained a valid IEC. There is no need to obtain any import license or permission to import such goods. Most of the goods can be freely imported in India.

Licensed (restricted) items

Restricted items can be imported only after obtaining an import license from the relevant regional licensing authority. The goods covered by the license shall be disposed of in the manner specified by the license authority, which should be clearly indicated in the license itself. The list of restricted goods is provided in ITC (HS). An import license is valid for 24 months for capital goods, and 18 months for all other goods.

Canalized items

Canalized goods are items which may only be imported using specific procedures or methods of transport. The list of canalized goods can be found in the ITC (HS). Goods in this category can be imported only through canalizing agencies. The main canalized items are currently petroleum products, bulk agricultural products, such as grains and vegetable oils, and some pharmaceutical products.

Prohibited items

These are the goods listed in ITC (HS) which are strictly prohibited on all import channels in India. These include wild animals, tallow fat and oils of animal origin, animal rennet, and unprocessed ivory.

Import procedures

All importers must follow detailed customs clearance formalities when importing goods into India. A comprehensive overview of EXIM procedures can be found on the Indian Directorate of General Valuation's website.

Bill of Entry

Every importer is required to begin by submitting a Bill of Entry under Section 46. This document certifies the description and value of goods entering the country.

The Bill of Entry should be submitted as follows:

- The original and duplicate for customs;
- A copy for the importer;
- A copy for the bank; and,
- A copy for making remittances.

Under the Electronic Data Interchange (EDI), no formal Bill of Entry is required (as it is recorded electronically) but the importer is required to file a cargo declaration after prescribing particulars required for processing of the entry for customs clearance.

Bills of Entry can be one of three types:

- Bill of Entry for Home Consumption – This form is used when the imported goods are to be cleared on payment of full duty. Home consumption means use within India. It is white colored and hence often called the 'white bill of entry'.

- Bill of Entry for Housing – If the imported goods are not required immediately, importers may store the goods in a warehouse without the payment of duty under a bond and then clear them from the warehouse when required on payment of duty. This will enable the deferment of payment of the customs duty until goods are actually required. This Bill of Entry is printed on yellow paper and is thus often called the 'yellow bill of entry'. It is also called the 'into bond bill of entry' as the bond is executed for the transfer of goods in a warehouse without paying duty.

- Bill of Entry for Ex-Bond Clearance – The third type is for ex-bond clearance. This is used for clearance from the warehouse on payment of duty and is printed on green paper.

It is important to note that the rate of duty applicable is as it exists on the date a good is removed from a warehouse. Therefore, if the rate changes after goods have been cleared from a customs port, the customs duty as assessed on a yellow bill of entry (Bill of Entry for Housing) and paid on the value listed on the green bill of entry (Bill of Entry for Ex-Bond Clearance) will not be the same.

Other non-EDI documents

If a Bill of Entry is filed without using the Electronic Data Interchange system, the following documents are also generally required:

- Signed invoice;
- Packing list;
- Bill of lading or delivery order/air waybill;
- GATT declaration form;
- Importer/CHA declaration;
- Import license wherever necessary;
- Letter of credit/bank draft;
- Insurance document;
- Industrial license, if required;
- Test report in case of chemicals;
- Adhoc exemption order;
- DEEC Book/DEPB in original, where applicable;
- Catalogue, technical write up, literature in case of machineries, spares or chemicals as may be applicable;
- Separately split up value of spares, components, and machinery; and,
- Certificate of Origin, if preferential rate of duty is claimed.

Export policy

Just like imports, goods can be exported freely if they are not mentioned in the classification of ITC (HS). Below follows the classification of goods for export: restricted, prohibited, and State Trading Enterprise.

Restricted goods

Before exporting any restricted goods, the exporter must first obtain a license explicitly permitting the exporter to do so. The restricted goods must be exported through a set of procedures/ conditions, which are detailed in the license.

Prohibited goods

These are the items which cannot be exported at all. The vast majority of these include wild animals, and animal articles that may carry a risk of infection.

State Trading Enterprise (STE)

Certain items can be exported only through designated STEs. The export of such items is subject to the conditions specified in the EXIM policy. In addition, certain restrictions apply to the import and export of goods from and to certain countries. While most goods can be imported or exported to countries, India has a Most Favored Nation (MFN) agreement, making trade with certain countries prohibited as per UN sanctions or international conventions.

Export procedures

The following is required to export from India:

- A PAN based Business Identification Number (BIN) from the DGFT. This must be acquired before filling out a shipping bill or a bill of export for exported goods.
- If exporting by air or sea, a shipping bill must be filled out, or if exporting by road, a bill of export must be completed. These bills contain information relevant to exporting from India, including the name of the exporter, invoice number, consignee, description and quantity of goods, free on board (FOB) value, etc.
- When submitting a shipping bill/bill of export, other relevant documents must also be provided, such as invoices, export contracts, and packing lists.
- A certificate of origin must also be submitted. This is used to verify where goods have been produced.

Types of duties

There are many types of duties levied in India on imports. These duties are as follows:

Basic duty

Basic duty is the typical tax rate that is applied to goods. The rates of custom duties are specified in the First and Second Schedules of the Customs Tariff Act of 1975. The First Schedule contains rates of import duty, and the second schedule contains rates of export duties. Most of the items in India are exempt from custom duty, which is generally levied on imports.

The first schedule contains two rates: standard rate and preferential rate. The preferential rate is lower than the standard rate. When goods are imported from a place specified by the federal government for lower rates, the preferential rate is applicable. In any other case, the standard rate will be applicable. If the federal government has signed a trade agreement with the country of origin, then the federal government may opt to charge a lower basic duty than indicated in the first schedule.

Imports from related parties will attract a review of the value of goods by the Special Valuation Branch to assess whether the value is at arms length. A conclusion that the valuation is suppressed could lead to imposition of loading charges to the value.

IGST and GST compensation cess

Additional duties of customs, commonly referred to as the Countervailing Duty (CVD) and Special Additional Duty of Customs (SAD), has been be replaced by the levy of the Integrated Goods and Services Tax (IGST), barring a few exceptions, such as pan masala and certain petroleum products. The IGST replaces the previous system of federal and state categories of indirect taxation.

A Customs Duty calculator is made available on the online portal of excise and customs, the ICEGATE website. There are seven rates prescribed for IGST – Nil, 0.25 percent, 3 percent 5 percent, 12 percent, 18 percent, and 28 percent. The actual rate applicable to an item will depend on its classification and will be specified in Schedules notified under Section 5 of the IGST Act, 2017.

Further, a few items such as aerated water products, tobacco products, and motor vehicles, among others, will attract an additional levy of the GST compensation cess, over and above IGST. The cess is calculated on the transaction value or the price at which the goods are sold. The Goods and Services Tax (Compensation to States) Act, 2017 was enacted to levy compensation cess for providing compensation to Indian states for the loss of revenue arising on account of implementation of the GST from July 1, 2017.

The compensation cess on goods imported into India shall be levied and collected in accordance with the provisions of Section 3 of the Customs Tariff Act, 1975, at the point when duties of customs are levied on the said goods under Section 12 of the Customs Act, 1962, on a value determined under the Customs Tariff Act, 1975.

Anti-dumping duty

This is levied on specific goods imported from specified countries – including the US – to protect Indian industries. India can impose duties up to, but not exceeding, the margin of dumping, or the difference between the normal value and the export price.

Safeguard duty

A safeguard duty is a tariff designed to provide protection to domestic goods, favoring them over imported items. If the government determines that increased imports of certain items are having a significantly detrimental effect on domestic competitors, it may opt to levy this duty on those imports to discourage their proliferation.

However, the duty does not apply to articles imported from developing countries. The government may exempt imports of any article from this duty. The notification issued by the government in this regard is valid for four years, subject to further extension. However, the total period cannot exceed 10 years from the date of first imposition.

Social Welfare Surcharge

The Education Cess and Secondary and Higher Education Cess on imported goods is now abolished and replaced by the Social Welfare Surcharge. This surcharge will be levied at the rate of 10 percent of the aggregate duties of customs, on imported goods.

Valuation

Customs duty is payable as a percentage of ‘Value’ which is known as ‘Assessable Value’ or ‘Customs Value.’ The Value may be either:

- ‘Value’ as defined in Section 14 (1) of the Customs Act; or,
- ‘Tariff Value’ described under Section 14 (2) of the Customs Act.

The Tariff Value is fixed by the Central Board of Indirect taxes and Customs (CBIC) for any class of imported goods or export goods. Authorities will consider the trend of value of the goods in question while fixing tariff value. Once fixed, the duty is payable as a percentage of this value.

The value of imported goods for the assessment of duty is determined in accordance with the provisions of Section 14 of 1962 and the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. According to the rules, the assessable value equal the transaction value of goods as adjusted for freight and cost of insurance, loading, unloading and handling charges.

In the assessable value, the following criteria are included:

- Commission and brokerage;
- Cost of container, which are treated as being one with the goods for customs purposes;
- Cost of packing – labour or materials;
- Materials, components, tools, etc. supplied by buyer;
- Royalties and license fees;
- Value of proceeds of subsequent sales;
- Other payment as condition of sale of goods being valued;
- Cost of transport up to place of importation;
- Landing charges; and,
- Cost of insurance.

The following costs are excluded from the assessable value:

- Charges for construction, erection, assembly, maintenance or technical assistance undertaken after importation of plant, machinery or equipment;
- Cost of transport after importation;
- Duties and taxes in India; and,
- Types of duties on exports and imports in India are covered in the Customs Tariff Act 1975. The Act provides all the laws and regulations related to customs in India.

Customs handling fee

The Indian government assesses a one percent customs handling fee on all imports in addition to the applied customs duty.

An introduction to sourcing from India

Choosing where to source from can be a stress-inducing process, for although the practice is now commonplace, it is nevertheless still fraught with various risks and difficulties that can just as easily cripple a business as make it more profitable. Key considerations include understanding how to navigate the regulatory framework of the country in question, knowing if it has a workforce capable of producing the intended goods for export, and identifying the most suitable type of sourcing platform.

For the past twenty years, China has been dominant as a sourcing destination. The country's extensive, cheap and skilled labor force has long since established China as a sourcing favorite in Asia, but its star no longer shines as bright as it once did. With a complex regulatory framework and rising labor costs, businesses may wish to consider other locations in order to ensure their competitive edge is not blunted.

Moreover, China is trying to transition from a low-end manufacturer to a high-end manufacturer, sourcing cheap products from other places for increasingly wealthy Chinese consumers, and transitioning Chinese jobs to higher paid manufacturing and services. India, on the other hand, is at an earlier stage – developing its manufacturing base and trying to create the supply chain infrastructure that China is renowned for.

India's sourcing edge

With increasing labor costs, declining population trends, and reduction of preferential investment policies, China is gradually losing its cost advantage and competitiveness in comparison to other Asian countries. India is one of the most appealing alternatives among China's competitors. In this section, we take a look at India's export industry and analyze some of the key advantages that the county possesses as a sourcing destination.

Market size

India is the world's third largest market after China and the US. Its economy posted a Gross National Income (PPP) of US$8.59 trillion in 2016-17, growing at a rate of 7.1 percent. Foreign businesses entering India now are comparing their experiences to China in previous decades – and despite ASEAN's ambitions, none of the Southeast Asian economies offer a single, unified market this size.

Analysts estimate that India's nominal year-on-year expenditure growth of 12 percent will result in India becoming the third largest consumer market by 2025. Maximum consumer spending is expected in food, housing, consumer durables, transport, and communication sectors.

Labor surplus

India's population was 1.32 billion in 2016, and there are more than 605 million people below the age of 25. What this translates into is a projected 115 million workers in the 20-24 age bracket, according to the International Labor Organization (ILO). This young workforce will make a significant contribution to India's consumer base, and contrast favorably to demographic changes in China.

Low labor costs

China is committed to developing high-end, value-added manufacturing to fuel the next stage of its economic development. Companies that want to manufacture cheap goods in Asia need to understand how lower labor costs in India can help them achieve their goals. India has some of the lowest labor costs in Asia: a monthly minimum wage of US$137 as compared to US$155 in China at the end of 2016, at its lowest.

In 2017, 14 regions in China increased their minimum wage, including Shanghai, which raised it by five percent from RMB 2,190 (US$335) to RMB 2,300 (US$351) and Shenzhen, which raised it from RMB 2,030 (US$310) to RMB 2,130 (US$325). In 2016, nine provinces raised their minimum wages and in 2015, 19 provinces raised their minimum wages.

In India, social insurance benefits are available only to firms in the organized sector. This means they are legally registered under law and pay tax. Furthermore, provision of social security benefits are mandated for only those firms that have a minimum number of employees. In contrast, businesses in China have considerably higher social insurance commitments.

Economic reforms

Prime Minister Narendra Modi's government is keen to transform India's manufacturing ecosystem under its "Make in India" initiative. Other flagship initiatives, such as "Digital India" and "Startup India" have already caught the attention of the biggest Chinese technology companies and VC firms. Meanwhile, ease of doing business is an important target of government reforms in the regulatory and corporate establishment domains, as are tax, real estate, and bankruptcy regulation.

Government support for industry

The Indian government is making foreign investment easier in India, announcing a much more liberalized and streamlined FDI policy in 2017. Government initiatives to create smart cities, trade corridors, industrial clusters, special economic zones (SEZs), and advance port infrastructure offer various preferential policies for foreign firms and investors.

Beyond this, Modi's encouragement of "competitive federalism" has helped localize economic reforms and business incentives, adding a healthy dose of realism to the federal government's expansive vision.

Special economic zones (SEZs)

Up until 2000, India did not have SEZs, and instead had a number of export processing zones (EPZs), which, although similar in structure to the modern SEZ, failed to attract many firms to India. The government introduced the SEZ concept in April 2000, structured closely on the already successful model of China. SEZs are designed to help stimulate both foreign and domestic investment, boost India's exports, and create new employment opportunities.

India's Special Economic Zone Act, 2005 amended the country's foreign investment policy and converted its EPZs to SEZs, with notable zones including Santa Cruz (Maharashtra state), Cochin (Kerala state), Kandla and Surat (Gujarat state), Chennai (Tamil Nadu state), Visakhapatnam (Andhra Pradesh state), Falta (West Bengal state), Noida (Uttar Pradesh state), and Indore (Madhya Pradesh state).

Since the Act's promulgation, the Indian government has also accepted proposals for additional, far smaller SEZs, which must be proposed by developers to the Indian Board of Approval. The SEZ Rules, 2006 lay down the complete procedure to develop a proposed SEZ or establish a unit in an SEZ.

As of September 2017, 221 SEZs are in operation, and by January 2018, a massive 423 have received formal approval for operation. Although India's SEZs are relatively new, they have become important sourcing and manufacturing destinations for foreign investors. Below we examine how these zones function, and highlight key information relevant for companies considering setting up in an Indian SEZ.

Incentives for setting up in an Indian SEZ

Some advantages of setting up a sourcing or manufacturing platform within an Indian SEZ include:

- Duty free import and domestic procurement of goods for the development, operation, and maintenance of your company.
- 100 percent income tax exemption on export income for first five years, 50 percent for five years thereafter, and 50 percent of the export profit reinvested in the business for the next five years. These incentives will be withdrawn from April 1, 2020 (Sunset Clause), pending an extension, which is currently under discussion.
- Exemption from the Goods and Services Tax (GST) and levies imposed by state government. Supplies to SEZs are zero rated under the IGST Act, 2017, meaning they are not taxed.
- External commercial borrowing (ECB) is allowed up to US$500 million a year without restriction. For developers of an SEZ, the ECB channel may be availed after receiving government approval, and only for providing infrastructure facilities in the zone. However, ECB will not be permissible for development of integrated township and commercial real estate within the SEZ.
- Permission to manufacture products directly, as long as the goods you are producing fall within a sector which allows 100 percent FDI.
- The benefits of India's SEZ policy have been substantial and have already served to exponentially increase the amount of foreign firms operating in India. Since 2005, exports from the country have almost continually been increasing, largely due to the rise in sourcing and manufacturing platforms there.

Choosing an SEZ location in India

There are many SEZs for your company to choose from – a list of which can be obtained from the Department of Commerce's website – and so deciding on which is best for you can often be a difficult and stress-inducing process.

For companies directly sourcing from or manufacturing in India, your platform should be well placed to acquire the raw materials needed for production, while at the same time being in an area suited for export (that is, on the coastline).

It used to be that this was a difficult balance to strike, but the new government's emphasis on infrastructural investment means that procuring your materials from other parts of India is becoming a lot easier.

Developing an SEZ in India

As mentioned previously, developers can apply to the Indian Board of Approval to establish an SEZ where one currently doesn't exist.

Companies, co-operative societies, individuals, and partnership firms are all able to file an application, and simply need to submit the Form-A that is available on the Department of Commerce's website.

The information you have to fill out on the form ranges from basic details, such as the name, address, and personal information of the applicant, to more specific details of the proposal, such as the type of land it will be set up on and its means of financing.

The amount of land that your proposal requires will determine what type of SEZ it will be.

The different types are:

- Multi sector SEZ (requiring a minimum of 1000 hectares of land);
- Sector specific SEZ (requiring a minimum of 100 hectares);
- Free Trade and Warehousing Zone (FTWZ) (requiring a minimum of 40 hectares); and,
- IT/ITeS/handicrafts/bio-technology/non-conventional energy/gems and jewelry SEZ (requiring a minimum of 10 hectares).

A proposal will be first considered by the respective state government where the SEZ is to be located, before it receives formal backing from the Board of Approval.

Key considerations for sourcing and procurement

As touched upon previously, there are numerous advantages a company can gain by global sourcing. These advantages can be viewed as the objectives of a sourcing operation in India and its success can subsequently be measured against them.

Broadly speaking, a company should ask whether their operation:

- Reduces operational costs;
- Enhances efficiency;
- Stabilizes the supply chain in the long term;
- Minimizes risk; and,
- Allows access to an appropriately skilled workforce.

Indirect and direct sourcing models

There are two principal options available to foreign companies seeking to enter and establish a sourcing platform in India. The first is to find and agree terms with a local partner, who would act as a company's primary representative for their operation in India. This option is certainly the easiest to execute, as exporting from India without maintaining a personal footprint there will bypass the need to go through the legal processes that are necessary for establishing a foreign presence.

Choosing a sourcing partner

Choosing a sourcing partner can be a difficult process, as the choice will invariably have a direct impact on the quality of a company's products and, consequently, its reputation. It should therefore be approached and conducted in a very careful manner.

Key considerations include:

- The potential partner's level of experience (whether they have exported from India before);
- The location of the partner and where the goods are being produced (whether they will be operating in an SEZ and thus qualify for tax benefits); and,
- Where the partner is based (answering questions such as if their location is near the coast or factoring how much the added costs will amount to, based on their location, to procure necessary materials).

Locating and screening a sourcing partner in India

There are a number of ways a company can go about finding a sourcing partner, with the most common means being hiring a professional sourcing agent, consulting official government databases, and searching on various sourcing websites, such as Alibaba.com and GlobalSources.com.

The obvious downside of taking this route is the lack of direct control a foreign company would have over its operations. Although a deep pool of skilled workers exists in India, leaving a company's platform indirectly supervised can negatively affect the rate and quality of production.

Using a sourcing partner in India can therefore be seen as an 'indirect' way of managing a sourcing operation. Whilst it is comparatively simple and cheap, the lack of direct involvement makes it harder to ensure that all sourcing objectives are being met. This should always be born in mind when choosing to handle sourcing operations in India without a personal footprint in the country.

Establishing an office on the ground

The second option is to actually establish a local presence within India. Although creating an office on the ground inevitably necessitates a greater financial and legal burden for the company in question, it is an effective means of ensuring higher performance levels for a sourcing platform in India. This can be done by establishing a liaison office or branch office as mentioned earlier.