



INTERNATIONAL CORPORATE TAX

Doing Business in India

TAX

AUDIT ■ TAX ■ ADVISORY

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New York
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Agenda

- ◆ **India Briefing...**
 - *Recent Reform Initiatives*
 - *Indian Regulatory Regime*
- ◆ **Investment into India**
 - *Entity Structuring*
 - *Investment Structuring*
 - *Capital Structuring*
 - *Repatriation Options*
- ◆ **Specific Tax Considerations**

India

Facts at a glance

- **Location: South Asia**
- **World's 7th largest country by area**
- **World's 2nd largest population (over 1 billion)**
- **Area: 3.8 million sq. kms.**
- **Number of Federal States and Union Territories: 35**
- **Number of dominant languages: 18**
- **Largest Democracy in the world**
- **Federal structure with each state having its own legislative assembly**
- **National elections held every five years; next elections due in 2009**
- **Number of Leading Political Parties: 7**
- **Currently a coalition led by Congress is in power**
- **Leading stock exchanges – Bombay Stock Exchange and National Stock Exchange**
- **GDP Growth Rate approximately 9 p.a. or the last 2 years (9% - 2005-06, 9.2% - 2006-07)**
- **Strengthening of the Rupee against the USD**
- **Buoyant Foreign Investment inflows**
- **Most attractive global foreign investment destination after China**

India today is changing – attracting Foreign Investors...

Yesterday...

- 'Hindu' rate of growth
- Bureaucratic
- Protected and slow
- Small consumer markets
- Underdeveloped infrastructure

...and Today!

- One of the fastest growing economies
- Reasonably proactive
- Opening up and dynamic economy
- Booming and promising consumer markets
- Some of the world's largest infrastructure creation

Recent reform initiatives

- ◆ **Real Estate – Doors now open**
- ◆ **Special Economic Zones – Generation and promotion of additional export activities**
- ◆ **Power – now under automatic route**
- ◆ **Retail – FDI up to 51% for trade in ‘single brand’ products**
- ◆ **Move towards Value Added Tax (VAT)**
- ◆ **Further liberalization of FDI in Insurance Sector – on the cards**

FDI Policy – Regulatory Framework

FDI Policy

Automatic Route – Reserve Bank of India (RBI)

- ◆ Almost all activities - small negative list
- ◆ Within Sectoral Caps and stipulated guidelines
- ◆ Investment through inward remittances at fair value
- ◆ Expansion of capital base of investee company
- ◆ Acquisition of existing shares in Indian Company barring certain exceptions
- ◆ No prior approval-only post facto filings with RBI
- ◆ Technical Collaboration/Brand Name Royalty within ceilings stipulated

Prior Approval Route - Secretariat of Industrial Assistance – Foreign Investment Promotion Board (FIPB) [SIA – FIPB]

- ◆ Investment/transactions falling outside the Automatic Route
- ◆ Proposals attracting industrial license
- ◆ In case of existing subsisting ventures of Foreign Investor with Indian Joint Venture Partner in the same field
- ◆ Technical collaboration falling outside Automatic Route guidelines
- ◆ Case-to-case Parameters
- ◆ Post approval, filings with RBI as under Automatic Route

Today India has an “open door” Foreign Direct Investment (FDI) policy

FDI Sector Limits ...

Automatic Route specified activities subject to sectoral cap and conditions (if any)		Prior approval from FIPB where investment is above sectoral cap for activities listed below	
Airports		Asset construction companies	49%
Greenfield	100%	Atomic minerals	74%
Existing	74%	Broadcasting	
Air transport services		FM Radio	20%
Non resident Indians	100%	Cable network	49%
FDI	49%	Direct-To-home (DTH)	49%
Alcohol distribution and brewing	100%	Hardware facilities	
Banking (private sector)	74%	Uplinking a news and current affairs TV channel	26%
Coal and lignite mining	100%	Uplinking non-news and current affairs TV channel	100%
Coffee, rubber processing and warehousing	100%	Cigar and cigarette manufacturing	100%
Construction & develop. (specified projects)	100%	Courier services (other than those covered under The Indian Post Office Act)	100%
Floriculture, horticulture, animal husbandry	100%	Defense production	26%
Specified Hazardous Chemicals	100%	Investment companies in infrastructure/service Sector (except telecom)	49%
Industrial explosives manufacturing	100%	Refining (PSU)	26%
Insurance	26%	Print Media	
Mining (diamonds, precious metals, stones)	100%	Publishing of Newspapers and periodicals dealing with news and current affairs	26%
Non banking finance companies (for approved activities)	100%	Publishing of scientific magazines/specialty journals/periodicals	100%

...FDI Sector Limits

Automatic Route specified activities subject to sectoral cap and conditions (if any)		Prior approval from FIPB where investment is above sectoral cap for activities listed below	
Petroleum and Natural gas		Tea Sector – including Tea Plantation	100%
Refining (private comp)	100%	Trading	
Other areas	100%	Trading items sourced from Small scale sector	100%
Power generation, transmission, distribution	100%	Test marketing for equipment for which company has approval for manufacture	100%
Trading		Single brand product retailing	51%
Wholesale / cash and carry trading	100%	Satellite Establishment and Operation	74%
Trading for exports	100%	Telecommunication	
Special Economic Zone and Free Trade	100%	Basic and unified access service	49% to 74%
Warehousing		ISP with gateways, radio-paging, end-to-end bandwidth	49% to 74%
Telecommunication		ISP without gateway	49% to 100%
Basic and cellular	49%	New investment by a foreign investor in a field in which that investor already has an existing joint venture or collaboration with another Indian partner, if there is no conflict of interest clause entered between the foreign investor and existing Indian partner	
ISP with gateways, radio-paging, end-to-end bandwidth	49%	New investment sought to be made in manufacture of items reserved for Small Scale Industries	
ISP without gateway	49%		
Manufacture of telecom equipments	100%		

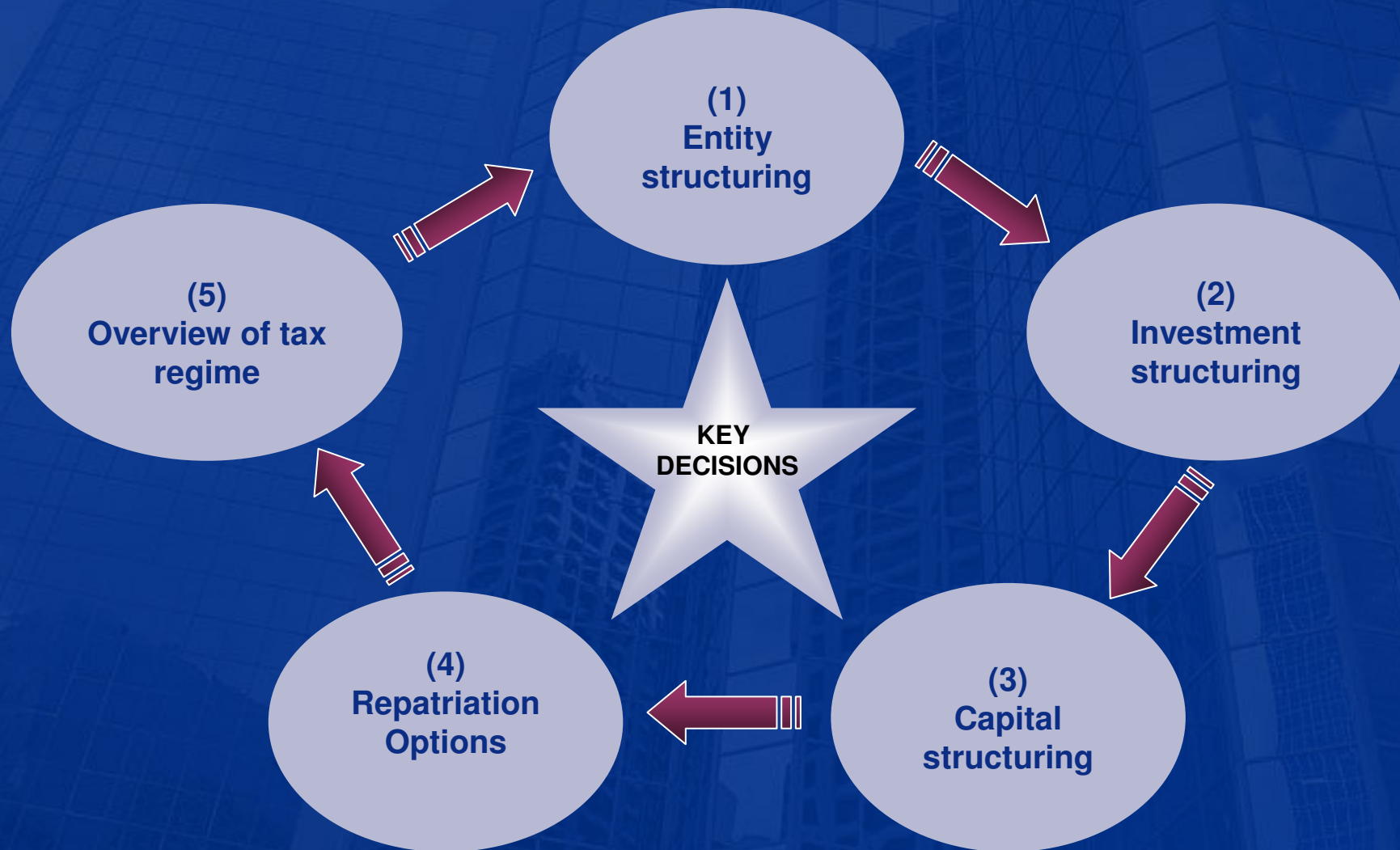
Negative List

Retail Trading (except Single Brand Product retailing), Atomic energy, Lottery Business, Gambling and Betting

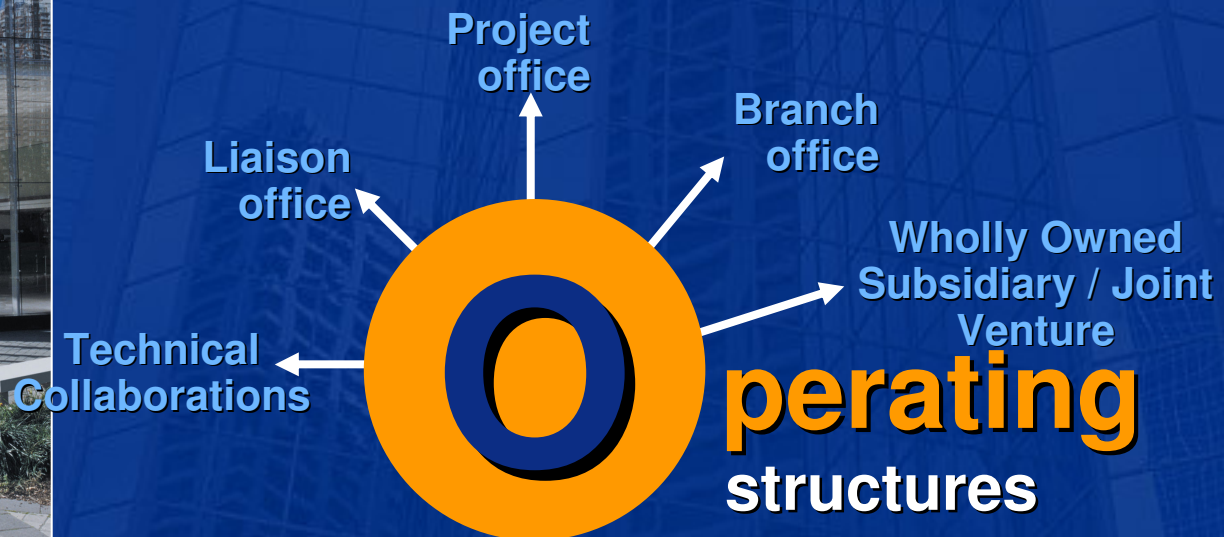
Investor enthusiasm for India is at an all-time high, with roughly 45% of global investors more upbeat about India compared to last year



Investment into India



Gateway to India



Technical collaboration payments

◆ Technical collaboration

- no longer require registration with the RBI
- Lump sum payments not to exceed USD 2 million
- Royalty payments up to 5 percent on domestic sales and 8 percent on export sales permitted

◆ Brand name fees

- Royalty payments up to 1 percent on domestic sales and 2 percent on export sales permitted
- technical royalties subsume payments for brands

◆ Computation as per standard formulae prescribed

◆ Payments for use of trademark and franchise in India no longer requires RBI approval

◆ Consultancy fee

- Remittance upto USD 1 million per project permitted
- No limit on remittances out of EEFC account

(All the above payments are tax deductible subject to compliance with Withholding Tax and Transfer Pricing regulations)

Entity Structuring – Modes of Business Presence

	Liaison office	Project office	Branch office	WOS / JV
Activities	Representation/ communication only	Execution of specific projects	Specified permissible activities	Automatic/ prior approval route
Restrictions	No Commercial/ business activities permitted	No other permissible activities	Number of restrictions	As imposed by foreign direct investment guidelines
Taxation	Generally a non- taxable presence	Taxable presence. Tax rate – 42.23%	Taxable presence. Tax rate –42.23%	Taxed Tax rate –33.99%
Set-up time	4 – 6 weeks	Automatic route/ post facto filings	4 – 6 weeks	4 – 12 weeks
Regulatory Authorities	Prior approval of RBI	Prior approval of RBI. Prior approval not required for setting-up Project Office if certain conditions are fulfilled	Prior approval of RBI.	If investment falls under Automatic Route, only an intimation to be filed with RBI. Otherwise obtain Government/FIPB approval



Note: Basic rate plus applicable surcharges for financial year (April to March) 2007-2008

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Investment Structuring (Contd.)...

Options / Possible Alternate Jurisdictions

Income Streams	India-Mauritius treaty*	India-Cyprus treaty*	India-Singapore treaty*	India-Netherlands treaty*
WHT on Dividends**	◆ NIL under domestic tax law			
Withholding tax (WHT) on Capital Gains	◆ Nil	◆ Nil	<ul style="list-style-type: none"> ◆ Nil, subject to anti-abuse provisions like Singapore Co. should not be a shell / conduit company - Factors like listing on Singapore stock exchange and total annual expenditure on operations in Singapore of at least Singapore \$200,000 relevant ◆ Exemption continues till beneficial provisions in India-Mauritius treaty continues 	◆ Nil - If capital stake in JV is less than 10% or if shares in JV are not sold to resident in India
WHT on Interest#	<ul style="list-style-type: none"> ◆ Nil for any bank being tax resident of Mauritius and carrying on <i>bona fide</i> banking business ◆ Nil for Mauritian tax resident provided transaction is approved by Indian Government ◆ 21% on gross basis otherwise 	<ul style="list-style-type: none"> ◆ Nil for Cypriot tax resident provided transaction is approved by Indian Government ◆ 10% on gross basis otherwise 	<ul style="list-style-type: none"> ◆ 10% - If loan granted by bank being tax resident of Singapore and carrying on <i>bona fide</i> banking business or by a similar financial institution ◆ 15% on gross basis otherwise 	<ul style="list-style-type: none"> ◆ NIL - If loan granted / guaranteed / insured by Government of Netherlands (Tax treaty provides extended definition of Government of Netherlands) ◆ 10% on gross basis otherwise
WHT on Royalties#	<ul style="list-style-type: none"> ◆ 15% on gross basis ◆ Domestic tax law providing WHT rate of 10.56% may prove more favourable 	<ul style="list-style-type: none"> ◆ 15% on gross basis ◆ Domestic tax law providing WHT rate of 10.56% may prove more favourable 	◆ 10% on gross basis	<ul style="list-style-type: none"> ◆ 10% on gross basis ◆ Payments for use of any industrial, commercial or scientific equipment – not royalty – not taxable
WHT on Service Fees#	◆ Nil	<ul style="list-style-type: none"> ◆ 15% (Fees for Included Services) / 10% (Technical Fees) on gross basis ◆ Domestic tax law may prove more favourable 	<ul style="list-style-type: none"> ◆ 10% on gross basis ◆ Benefit of restricted definition of Fees for Technical Services could be explored 	<ul style="list-style-type: none"> ◆ 10% on gross basis ◆ Benefit of restricted definition of Fees for Technical Services could be explored

* Demonstration of substance & submission of tax residency certificate relevant

** Subject to levy of DDT @17% on amount of dividends distributed by JV. There exist underlying tax credit provisions in Indian Tax Treaties with Mauritius and Singapore. Therefore, credit for corporate tax paid by JV on profits out of which dividends are paid could be available in these countries subject to tax laws of these countries. However, the applicability of underlying tax credit provisions to DDT in these countries require separate examination.

Recipient should be beneficial owner of Income and should not have a PE in India – Transfer pricing regulations need compliance in case of related party transactions



Capital Structuring Options

Particulars	Equity Shares	Preference Shares	Convertible Debentures	External Commercial Borrowings (ECBs) i.e. Overseas Loans	Domestic Debt
Prior regulatory approval from Government of India / Foreign Investment Promotion Board	Required if activities of the Indian Investee Company do not fall under the Automatic Route of FDI Guidelines.			Not required up to USD 500 million during a financial year subject to prescribed end use and other restrictions	Not required
Withdrawal of funds	Generally not possible during company's life span except under certain court approved restructuring schemes	Redemption possible out of profits / fresh issue of shares only	Not Applicable	Minimum lock-in period of 3 years for loan upto USD 20 mn and 5 years for loans in excess thereof	Flexibility in repayment of funds
Buy Back of equity / Redemption of Preference shares	Buy Back Possible subject to restrictions	Redemption needs to be as per terms of issue (at par under foreign exchange laws) / statutory provisions	Not Applicable	Not Applicable	Not Applicable
Rate of interest / dividends	No restriction subject to profitability and transfer to statutory reserves	Upto 300 basis points above State Bank of India prime lending rate - subject to profitability and transfer to statutory reserves	No restrictions	All in cost ceilings upto 200 basis points above Six months LIBOR for loan maturity between 3 to 5 yrs and upto 350 basis points above Six months LIBOR for Loan maturity over 5 yrs	No restriction
Withholding tax in India	Nil *	Nil *	21% **	21% **	21% @
Tax deductibility	Not deductible	Not deductible	Deductible #	Deductible #	Deductible #

* Indian Company declaring dividend to deduct Dividend Distribution Tax (DDT) @ 17% on the dividends distributed

** Subject to relief under certain tax treaties

Interest paid deductible subject to applicable taxes being withheld

@ Nil for Banks / specified Financial Institutions / Entities



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Repatriation Options

Dividend

- ◆ Post tax profits can be repatriated by way of dividend
- ◆ Dividend exempt in the hands of shareholders - JV to pay DDT at 17%
- ◆ In a holding company structure, there would be a dual layer of DDT
- ◆ There is a compulsory requirement to transfer certain percentage of profits (ranging from 0% to 10% based on percentage of dividend proposed to be declared) to reserves at the time of dividend declaration - This would result in 'cash trap', which can inter-alia be utilized to redeem preference shares

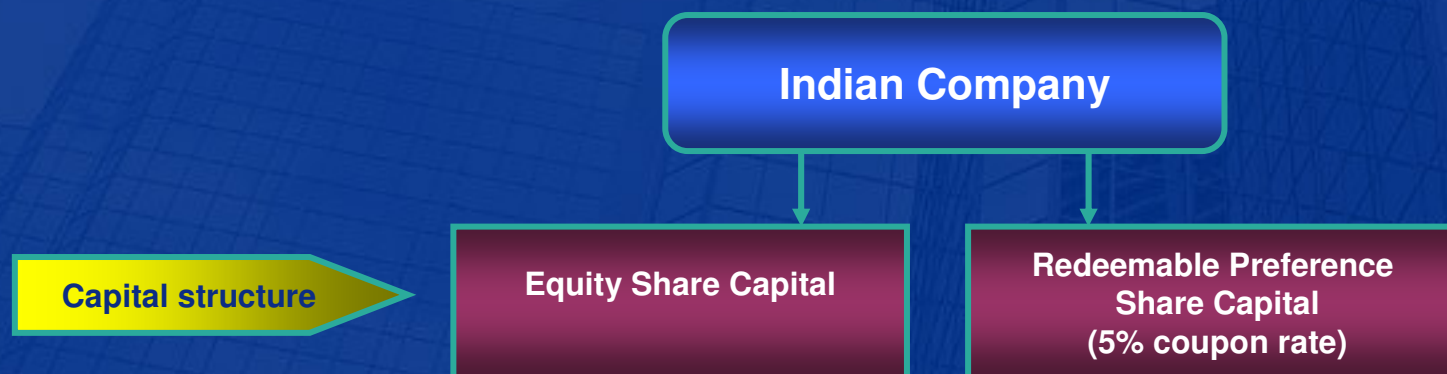
Buyback

- ◆ An Indian company can buy its own shares from the existing shareholders for cash
- ◆ Buyback to satisfy the condition prescribed under the Indian corporate laws
 - Maximum 25% of the paid up equity capital each year
 - Consideration for buyback should not exceed 25% of paid up capital plus free reserves of the company
 - Fresh issue prohibited for 6 months following buy-back
 - Debt-equity ratio not to exceed 2:1 post buy back of shares
- ◆ Repatriation of proceeds from buy back of shares should not require prior regulatory approval
- ◆ Gains on buyback of shares would be liable to capital gains tax in the hands of the shareholder (Treaty benefits available)

Capital Reduction

- ◆ In case company doesn't satisfy buyback conditions, company can undertake a capital reduction through a Court process
- ◆ Repatriation of proceeds from reduction of capital should not require prior regulatory approval
- ◆ Distribution to shareholders to the extent of reserves to be treated as dividend, which would attract DDT at 17%. The balance sum (i.e. gross sum received by shareholders on reduction of share capital less amount considered as deemed dividend) would be liable to tax as capital gains in the hands of shareholders

Preferred Stock Model repatriation



- Indian Company to have a mix of Equity as well as Preference share capital
- Foreign Company to hold redeemable preference shares
- Indian Company to pay preference dividend at a coupon rate of 5% of the preferred share capital
- Payment of preference dividend subject to DDT at the rate of 17%
- Preference shares to be redeemed within 20 years
- Redemption to be made at par value - of fully paid up preference shares only
- Preference shares can be redeemed out of distributable profits or proceeds of fresh issue
- Redemption not subject to withholding tax / DDT

India Trend – Direct Taxes

- ◆ Indian Cos are taxable at 30%. Surcharge @10% applies if income is in excess of INR 10 million. Education cess is applicable at 3% on income-tax (inclusive of surcharge, if any).
- ◆ Foreign Cos are taxed at 40%. Surcharge @2.5% applies if income is in excess of INR 10 million. Education cess is applicable at 3% on income-tax (inclusive of surcharge, if any).
- ◆ Companies subject to Minimum Alternate Tax (MAT) @ 10% of books profits (plus applicable surcharge and education cess)
- ◆ Individuals taxed as per the residential status. Residency in India is determined by physical number of days stay in India
- ◆ Maximum Marginal tax rate for individuals – 33.99%

Withholding tax – It is a pre-payment of tax liability and can be adjusted against the final liability, which crystallizes subsequent to the filing of the tax return and its assessment by tax authorities.

Payer to deduct tax at source ('TDS') on the payment of specified income at the rates prescribed at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier.

Corporate Tax Return – Yearly filing on or before 31 October for each Financial Year ended 31 March

Withholding Tax Statements in case of payments to residents and non-residents – Quarterly filings on or before 15 July, 15 October, 15 January and 30 April

Advance Tax Payments – Quarterly payments on or before 15 June, 15 September, 15 December and 15 March

India Trend – Direct Taxes

Income-tax

- Expenses incurred for business purposes - allowed as deduction
- Uniform financial year for tax: 01 Apr - 31 Mar
- Dividends are tax free for shareholders, but companies have to pay a Dividend Distribution Tax @ 17%
- Capital Gains Tax on unlisted securities
 - For foreign companies:
 - Short term : 40% (plus applicable surcharge and education cess) / treaty rate
 - Long Term : 20% (plus applicable surcharge and education cess) / treaty rate
 - For domestic companies:
 - Short term : 30% (plus applicable surcharge and education cess)
 - Long Term : 20% (plus applicable surcharge and education cess)
- Tonnage Tax regime prevalent
- Securities Transaction Tax on stock market transactions
- Fringe Benefit Tax on value of fringe benefits provided to employees – presumptive tax payable by companies

Transfer Pricing

- Enacted and regulated under the Indian Income-tax Act
- In line with International Practices
- International transactions with Associated Enterprises should be at arms length
- Five methods prescribed for computing the Arm's Length price
- Documentation required
- Audit
- Stiff Penalties for Non-Compliance
- No thin capitalization rules

Business income – Computation mechanism

Business income

Less

Allowable expenses

=

Taxable income

- Profits & gains from business & profession
- Profit on sale of import license
- Cash assistance received/receivable against export
- Duty drawback
- Non compete fees

The above mentioned list is illustrative. Further, income may be taxed under other heads as well viz capital gains, salaries etc

- Normal business expenditure is usually deductible in computing taxable income
- Certain expenditures require specific conditions to be fulfilled in order to be deductible, such as (illustrative list) :
 - Provision for bad and doubtful debts;
 - Depreciation
 - Expenditure on scientific research (capital or revenue)
 - Certain expenses allowed only on payment basis e.g.. Statutory dues, employee incentives, interest on loan etc
 - Certain expenses deductible only when tax withheld appropriately

- Taxed @ 33.99% for FY 2007-08
- Above tax liability to be compared with 11.33% of book profits
- Higher of the above two to be paid as tax

- Any subsequent benefit obtained in respect of liability/deductible expenditure taxed in year of receipt
- Income from specified businesses taxed on presumptive basis and normal mechanism not applicable at the option of the tax payer

Taxability of capital gains

Sale of listed equity shares / units of equity oriented mutual funds

Domestic Law

- NIL^(a) on Long Term Capital Gains, and
- 10 percent + applicable SC on Short Term Capital Gains

Treaty

- Depending on applicable treaty. Generally taxable as per domestic law
- Some favourable treaties exist e.g. India – Mauritius tax treaty

For Long term Capital Gains:

Inflation indexation for resident available except for debentures / bonds

Exchange fluctuation protection for non-resident in respect of shares / debentures stipulated

Note: (a) Applicable only to listed equity shares / units of equity oriented mutual funds sold through stock exchange or on redemption of units of equity oriented mutual funds and Securities Transaction Tax is paid. Above tables excludes special regimes applicable for Foreign Institutional Investors, etc.

Taxability of capital gains (continued)

Sale of Capital Assets (other than listed shares / units of equity oriented mutual fund) - Capital Gains

Domestic Law

- 20 percent + applicable SC on Long Term Capital Gains, and
- Normal Applicable Rates on Short Term Capital Gains

Treaty

- Depending on the applicable treaty.
Generally, taxable as per domestic law
- Some favourable treaties exist
e.g. India – Mauritius tax treaty

For Long term Capital Gains:
Exchange fluctuation protection for non-resident - Inflation indexation for resident

Important Tax Laws / Administration

- ◆ All taxpayers / tax deductors to obtain Permanent Account Number (PAN) / Tax Deduction Account Number (TAN)
- ◆ Compulsory tax audit required where the gross turnover /sales / receipts exceed INR 4 million (in case of business) or INR 1 million (in case of profession)
- ◆ Unabsorbed business losses can be carried forward and set-off against future profits up to eight years
- ◆ Indefinite carry forward and set-off for unabsorbed depreciation
- ◆ Change in 51% equity / voting shareholding and delay in filing tax returns affects carry forward of unabsorbed business losses
- ◆ Default in withholding taxes impacts deductibility of sums paid / payable
- ◆ At present no specific provisions for:
 - Consolidation of tax profits / losses of entities within same group
 - Thin capitalization or Controlled Foreign Corporations (CFCs)

Overview of Indian Transfer Pricing Regulations

◆ In line with international Standards

◆ Wide Net

- International Transaction
- Associated Enterprises
- Arm's-length Principle
- Methods
 - Comparable Uncontrolled Price Method (CUP)
 - Resale Price Method (RPM)
 - Cost Plus Method (CPM)
 - Profit Split Method (PSM)
 - Transactional Net Margin Method (TNMM)
 - Any other method as may be prescribed

◆ Information & Documentation

- Mandatory & Exhaustive Requirements

◆ Penalties

- 2% of Transaction Value for non-maintenance/non-furnishing of documentation.
- 100% to 300% of tax evaded for adjustment to taxpayer's income
- Rs. 100,000 for non furnishing of accountant's report.

◆ Accountants' Report to be filed alongwith the return of income

Mutual Agreement Procedure (MAP)

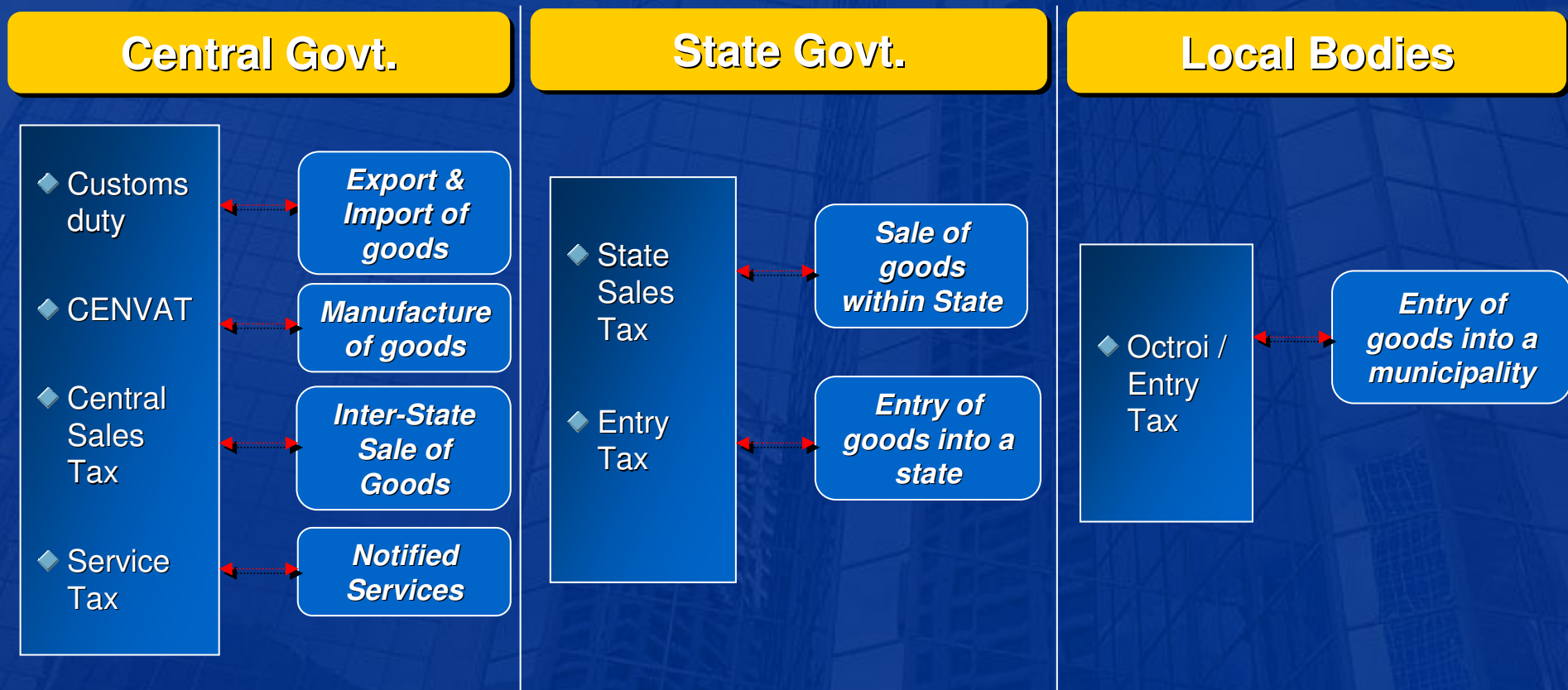
MAP

- ◆ A mechanism to resolve disputes relating to taxation not in accordance with tax treaties – Article 27 of the India-US Tax Treaty
- ◆ MAP available irrespective of remedies available in domestic tax laws
- ◆ Mutual Agreement between two competent authorities
- ◆ Implementation irrespective of domestic law restrictions

MAP procedures as a substitute for Appellate proceedings to address Transfer Pricing issues like:

- ◆ Attribution of income, expenses, deductions, credits, allowances, etc. of an enterprise of one State to its Permanent Establishment in the other State
- ◆ Allocation of income, deductions, credits or allowances, etc. between persons
- ◆ transfer pricing situations under Article 9, Article 11 (Interest) and Articles 12 (Royalties / FTS).

Indirect Taxes - Three Tier levy



Reorganization / Exit options

AMALGAMATIONS

Tax Neutral

**Company Law
Compliance/Indian
High Court approval
necessary**

**Suitable for
consolidating
businesses**

DEMERGERS

Tax Neutral

**Company Law
Compliance/Indian
High Court approval
necessary**

**Suitable for spin-off
of part of business,
undertaking,
division, etc**

SALE OF BUSINESS

**Itemized Sale /
Slump Sale**

**Lower Tax Rates for
Gains on Long Term
Capital Assets (20
percent plus Surcharge)**

**Gain on sale of
Goodwill taxable / its
Cost not amortizable**

Opportunities, threats and challenges

OPPORTUNITIES

Large growing market

Availability of skilled man-power at competitive rates

Increasing disposable incomes

THREATS

Stringent legal, regulatory and tax framework

Political instability

**Sector specific risks
e.g. Telecom, Power,
etc**

CHALLENGES

Choice of Business Model

Selection of Indian business partner

Operational Tax and Regulatory issues

Questions ?

Questions ?

Questions ?

Questions ?

Questions ?





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