The Inward Investment and International Taxation Review

Fifth Edition

Editor
Tim Sanders

Law Business Research

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Tim Sanders

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EDITOR'S PREFACE

Cross-border corporate structures and transactions are under ever closer scrutiny. While a global economy requires the free movement of capital, goods and services and legitimate cross-border financing and business acquisitions, governments are increasingly concerned by the potential this activity creates for artificial erosion of their tax base and are taking action to protect it. In response to this trend, the current edition has a chapter dedicated to 'BEPS': the OECD Action Plan on Base Erosion and Profit Sharing.

Recent, tangible examples of governments acting to protect their tax base include Notice 2014-52 issued by the US Treasury on 22 September, in response to US corporates relocating their headquarters to non-US jurisdictions. The Notice describes regulations that the US government intends to issue to curtail tax benefits of US corporate inversions where the transaction closes on or after the issue date of the Notice, with no grandfathering for signed but yet to be completed transactions. The Notice also indicated that the US Treasury is reviewing its tax treaty policy and the extent to which it is appropriate for inverted groups to obtain treaty benefits. A further example is the UK government's plan to publish a consultation document on new measures to prevent multinational companies exploiting differences between countries' tax rules through the use of 'hybrid mismatch' arrangements, the focus of action 2 of the OECD's BEPS action plan on international corporate tax avoidance. In the UK Autumn Statement draft legislation was put forward to introduce a new UK tax called diverted profit tax at 25 per cent on profits deemed to have been diverted from the UK (1) through entities, including UK corporate taxpayers, or by means of transactions that deliver effective tax mismatch outcomes without sufficient underlying economic substance or (2) as a result of planning designed to avoid trading in the UK through a UK permanent establishment. These are not isolated examples.

The concern is that legitimate cross-border commercial activity will become caught up in attempts to curtail what governments regard to be artificial and unacceptable activity. At the extremes the distinction between what is genuine commercial activity and artificial manipulation is clear but there is a middle ground where legitimate commercial transactions and activity also generate tax benefits and how this area will be caught up in the drive to tackle perceived cross-border abuse is an area to watch. Whatever the obstacles, companies will continue to trade in the global economy, across borders and as governments increasingly target such activity there will be a pressing need for the adviser to consider the potential impact these initiatives could have on their clients' tax affairs.

The aim of this book is to provide a starting point for readers, and to assist businesses and advisers, each chapter providing topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions with a chapter on the overarching potential impact of BEPS. While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
Skadden, Arps, Slate, Meagher & Flom LLP
London
January 2015

Chapter 14

INDIA

Nandini Pathak and TP Janani[1]

I INTRODUCTION

India has been one of the fastest growing economies of the past decade. Over the past few years, India has been gradually relaxing capital controls and other restrictions under the exchange control regulations, and has also revamped various key financial sector regulations to encourage inward investment. More often than not, corresponding changes have been made to tax legislation; however, gaps remain, giving rise to uncertainty in the investment regime.

Following the recent general elections, a new government led by Prime Minister Narendra Modi has taken office. This government is seen as a promoter of a pro-business environment, and is expected to carry out major structural reforms. For example, the Prime Minister has laid special emphasis on meeting business leaders during his visits to Japan and the US. In a very short time, the new government has liberalised foreign investment in sectors such as the railway, defence and construction sectors, and has liberalised the coal mining industry.

Regulatory clearance mechanisms and administrative enforcement processes have become more efficient and transparent over time, although much more needs to be done. The tax authorities have increasingly taken an aggressive stance on tax aspects relating to cross-border transactions, especially where treaty benefits have been claimed. However, the new government has recently taken some steps to create a taxpayer-friendly regime. Tax and other litigation is a long process (and preferably avoided), but sound judicial decisions provide comfort that genuine transactions will be respected and that the rule of law will be upheld. These bottlenecks aside, India's huge market, with a good network of tax treaties and bilateral investment protection treaties, makes it an attractive

1 Nandini Pathak and TP Janani are associates at Nishith Desai Associates.

investment destination. Some of the key legal frameworks governing foreign investments are outlined below.

Exchange control regulations in India are governed primarily by the Foreign Exchange Management Act 1999 (FEMA). Currently, FEMA permits the following main inward investment routes or regimes: foreign direct investment (FDI); foreign venture capital investors (FVCIs); foreign institutional investors (FIIs) registered under the erstwhile FII regime[2] and foreign portfolio investors (FPIs); and non-resident Indian investors (including persons of Indian origin).

Foreign investment primarily is by way of investment in shares and compulsorily convertible debentures. Investments in other debt instruments are generally considered external commercial borrowings, which are subject to specific restrictions. However, under the FVCIs and FPIs routes, investment by way of non-convertible debentures (NCDs) is permitted subject to conditions specified. Investment in NCDs is becoming popular owing to reasons such as high returns with relatively low risks, choice of maturity term and convenient exit options. Steps have been taken to rationalise and consolidate these investment routes; see Section X, *infra*.

The Companies Act 1956 (CA 1956) was, until recently, the primary companies legislation. The Companies Act 2013 (CA 2013), a shorter and modernised version of CA 1956, was enacted in August 2013; for some time, however, both Acts will continue to apply, as some sections of CA 2013 have not yet been notified to take immediate effect as law (until which time the relevant provisions of CA 1956 will continue to apply). Most operative details of CA 2013 have been made effective through rules issued under CA 2013.

Key taxes comprise income tax (imposed at the central level) and various indirect taxes imposed at the central, state and municipality levels on the sale of goods and services. The new government is vigorously pursuing steps to introduce a comprehensive goods and services tax to subsume most indirect taxes in relation to the sale of goods and services.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

Businesses are generally set up in the form of a company with limited liability, which may either be a private limited[3] or public limited company. Some of the key differences between the two are as follows:

Criterion	*Private company*	*Public company*
Minimum paid-up share capital	100,000 rupees	500,000 rupees
Minimum subscribers to the memorandum of association	2	7

2 The FII regime was recently replaced by the FPI regime.

3 CA 2013 has introduced the concept of a one person company, which falls under the category of a private limited company. As of August 2014, 479 companies have been registered as one person companies.

Criterion	*Private company*	*Public company*
Minimum number of directors	2*	3
Maximum number of members	200†	Unlimited
Quorum for general meeting	Minimum 2	Minimum 5
Right to transfer shares	Restricted	Unrestricted
Invitation to the public for subscription	Prohibited	Permitted

* A one person company must have one director
† CA 2013 has raised this limit from 50 members, which was prescribed under CA 1956. This does not apply to one person companies

Companies with limited liability may further be categorised as listed or unlisted companies. Under CA 2013, it is important to note that a 'listed company' (which is required to comply with a whole gamut of obligations) is defined as a company that has any of its securities listed on any recognised stock exchange. Therefore, even private companies with listed non-convertible debentures will be considered as listed companies and must comply with obligations applicable to listed companies.

Companies may be set up with unlimited liability or with liability limited by guarantee. In the latter case, members' liability is limited by memorandum of association to such amount as members respectively undertake to pay, if necessary, on liquidation of the company.

Tax treatment

The tax liability of all entity types is calculated in relation to the financial year, which runs from 1 April to 31 March. Taxation of different forms of business entities varies (both as to scope of taxable income and tax rates) depending on tax residence. In a particular financial year, a company is treated as resident in India if it is either incorporated in India or wholly controlled and managed in India during that financial year.

Resident entities are taxed on their worldwide income. Non-residents are taxed on their Indian-sourced income (i.e., income accruing or arising, or deemed to accrue or arise, in India, or income received or deemed received in India).

Resident companies are taxed on their income (net of permissible deductions) at 30 per cent.[4] Dividends distributed by an Indian company are subject to a 15 per cent

4 All rates mentioned in this chapter are exclusive of surcharge and cess. In the case of resident companies, a surcharge at a rate of 5 or 10 per cent is applicable on their income tax liability if their total taxable income in a financial year is in excess of 10 million rupees and up to 100 million rupees or in excess of 100 million rupees, respectively. In the case of non-resident companies, a surcharge of 2 or 5 per cent is applicable in similar circumstances. In the case of resident partnerships (including LLPs), a surcharge at 10 per cent is applicable on their income tax liability if their total taxable income in a financial year is in excess of 10 million rupees. Cess (education cess and higher education cess) at 3 per cent (cumulatively) is payable by all entities on the total of their income tax liability and surcharge.

dividend distribution tax (DDT) in addition to the income tax on profits.[5] DDT is a tax liability on the company; therefore, foreign shareholders may not be able to claim foreign tax credit for such DDT in their country of residence.

A non-resident company is taxed at 40 per cent on its Indian-sourced income (net of permissible deductions). A non-resident may opt to be taxed under the Income Tax Act 1961 (ITA) or the applicable tax treaty, whichever is more beneficial. Under most comprehensive tax treaties entered into by India, the business income of a non-resident is not subject to tax in India unless the non-resident has a permanent establishment (PE) in India, or unless its income falls within specific categories such as dividends, interest or royalties listed in the respective tax treaty.

ii Non-corporate

General partnerships (including unincorporated joint ventures) are permitted, but there is a restriction on the maximum number of partners. Foreign investors are not allowed to invest in partnerships set up in India; however, non-resident Indians and persons of Indian origin are allowed to make capital contributions into partnerships in India (on a non-repatriation basis) subject to certain remittance and sector-specific conditions. For the purposes of the ITA, a partnership is considered resident in India if even part of its control and management is situated in India. Partnerships are taxed at 30 per cent only at the level of the partnership, with the distributed profits being tax exempt in the hands of partners.

Limited liability partnerships (LLPs) are hybrid entities with the advantage of being separate legal entities (such as companies) with the operational flexibilities of partnerships. However, foreign investment directly into an LLP or through downstream investment by an Indian company is allowed only under restricted circumstances and with prior government approval. LLPs with FDI are not permitted to avail themselves of offshore debt under FEMA's external commercial borrowings regime. FIIs and FVCIs are not permitted to invest in LLPs. Further, capital contributions to LLPs by foreign investors are allowed only by way of cash considerations. The taxation of LLPs is similar to that of partnerships. Further, conversion of a general partnership or a company into an LLP is a tax-neutral event subject to the satisfaction of specific conditions prescribed for this purpose.

Apart from partnerships, the other non-corporate entity into which foreign investors commonly invest are funds registered with the Securities and Exchange Board of India (SEBI), which are generally established as trusts (although they may also be established as LLPs or companies). Recently, the SEBI (Alternative Investment Funds) Regulations 2012 (AIF Regulations) were notified, and succeeded and repealed the erstwhile SEBI (Venture Capital Funds) Regulations, 1996 (VCF Regulations). VCFs registered with SEBI prior to the AIF Regulations can continue to operate as VCFs (unless transitioned to the new regime under the AIF Regulations), and FVCIs are permitted to invest in such VCFs. The exchange control regulations do not specifically contemplate or

5 The Finance Act, 2014 has recently changed the manner of computation of DDT under the ITA. With effect from 1 October 2014, DDT is computed on a grossed up basis.

provide for investment in funds registered under the new AIF Regulations. In practice, however, we have seen that foreign investors have been generally permitted to invest in Category I and Category II AIFs, subject to certain conditions and restrictions.

Legally, a trust is an obligation attached to property. The properties of the trust legally vest in the trustee that manages the trust, but the trustee holds such property in a fiduciary capacity for the benefit of beneficiaries, so designated for the purposes of the trust. A trust is not regarded as a separate taxable unit. A trustee is liable to be taxed on the income of an irrevocable trust in a representative capacity on behalf of the beneficiaries. In the case of irrevocable determinate trusts,[6] the income of the trust is taxable in the hands of the trustee in the same manner as it is subject to tax in the hands of the beneficiaries. In the case of irrevocable discretionary trusts, the income in the hands of the trustee is taxable at the maximum marginal rate of 30 per cent (excluding surcharge and cess). In the case of revocable trusts, the income of the trust is taxable in the hands of the settlor of the trust. The same principles are applicable to AIFs structured as trusts (except AIFs that qualify as VCFs, for which specific tax benefits have been prescribed under the ITA). It has also recently been held that where investors have made revocable contributions to a trust, the income arising from such trust will be taxable in the hands of the investors.[7] This ruling has given a major boost to AIFs, which can now seek to achieve pass-through status by ensuring that the capital contributions made by contributors is on a revocable basis.

III DIRECT TAXATION OF BUSINESSES

Resident entities are taxable on their worldwide income, while non-residents are only taxable on their Indian-sourced income. Taxable income under the ITA is calculated as the sum of income calculated under mutually exclusive heads of income. For taxation of specific types of entities, see Section II.i, *supra*.

i Tax on profits

Taxable profits must be calculated in accordance with prescribed accounting standards, but with adjustments required to comply with restrictions prescribed with respect to deductions by way of depreciation (for both tangible and intangible assets), losses and expenditure. To the extent these may be calculated differently for accounting purposes, adjustments are made when calculating tax profits.

Further, in order to incentivise certain activities such as research and development or sectors like infrastructure, certain capital allowances are permitted. Profits earned by certain enterprises, such as those set up in special economic zones (SEZs), are exempt in varying proportions over a certain number of years.

6 Trusts where the beneficiaries' individual shares in the income of the trust can be determined at any given point in time solely on the basis of the trust deed, particularly without the exercise of discretion on the part of the trustee.

7 *Dy CIT v. India Advantage Fund – VII*, ITA No. 178/Bang/2012.

As a general rule, revenue expenditure wholly and exclusively incurred for the purposes of the business is deductible. Expenses attributable to income qualifying as exempt income cannot be deducted while calculating taxable income where a business earns both taxable income and exempt income; however, determining expenses attributable to taxable income is a highly disputed issue. For example, in the case of acquisition financing, since dividends are considered exempt in the hands of the shareholders (since DDT is a tax imposed on the distributing company), there is risk of non-deductibility with respect to interest paid. An important restriction with respect to expenses is the prohibition on the deductibility of expenses for which tax-withholding obligations have not been complied with.

Further, to discourage excessive rebates and deductions being claimed by companies, where the tax liability determined based on the regular method for calculation of taxable profits is lower than the minimum alternate tax (MAT) prescribed under the ITA, MAT becomes payable. MAT is determined as 18.5 per cent of the 'book profits' as defined under the ITA. Certain expenses, amounts amortised and allowances are added back to the taxable profits to determine such 'book profits'. However, MAT credit (excess of MAT over regular tax liability) can be carried forward up to 10 years for adjustment against taxable profits to the extent they are in excess of MAT. A similar tax treatment (alternate minimum tax) is applicable to entities other than companies such as partnerships and sole proprietorships (excluding individuals, Hindu undivided families, associations of persons and bodies of individuals with less than 2 million rupees of adjusted total income (corresponding to book profits in the case of companies)). As per accounting standards, companies are required to maintain accounts on an accrual basis; however, under the ITA it is permissible for a company to maintain accounts either on the basis of receipt or accrual, at its discretion and subject to consistency over the years.

Capital and income

The general principle is that all income or net receipts of a revenue nature are subject to tax unless specifically exempted, and capital receipts are exempt unless specifically subject to tax. The ITA defines 'income' to include 'capital gains' (i.e., gains arising from the transfer of a capital asset). Taxation of capital gains differs depending on their classification as either long-term or short-term gains: gains from the transfer of capital assets other than listed securities of a company and certain other specified securities, if held for a period of up to 36 months, are classified as short-term capital gains and, if held for a period longer than 36 months, as long-term capital gains. In the case of listed securities and other such specified securities, the threshold would be 12 months instead of 36 months. Until recently, capital gains arising from the transfer of unlisted shares were classified on the basis of the 12-month threshold. However, this has recently been modified to 36 months.

Recent amendments have been introduced to tax capital receipts that do not involve any element of profit or gain. They include taxation of notional gains from the purchase of shares by a company (other than a company held by the government or a listed company) for a value less than the fair market value of the shares, to the extent of the difference; and the issue of shares at a premium by a company (other than a company held by the government or a listed company), to the extent the fair market value of the shares do not justify such premium.

Losses

Losses attributable to a particular source of income in a financial year can be offset against losses attributable to other sources of income within the same head of income[8] in the same financial year, except in the case of long-term capital loss. Long-term capital loss from a particular source in a particular year can be set off only against long-term capital gains (and not against short-term capital gains) earned in that year from other sources. Further, if any loss under a head other than capital gains could not be completely set off against income from a different source under the same head, they must first be offset against gains under the head capital gains and to the extent such loss is in excess of the gains, and thereafter they are to be offset against income under any other head; however, capital gains cannot be set off against income from any other heading. If any loss cannot be so set off in the same year, they can be carried forward for up to eight years. In the event of unabsorbed depreciation, it can be set off against income from any category other than salary, and there is no time limit for carrying forward.

There are no provisions in the ITA for the carry back of losses.

Previous years' unabsorbed business losses, if any, are first set off against the current year's profits, and then unabsorbed depreciation is set off. Carried-forward business losses may be set off only against business income in successive years.

In the event of change of ownership due to merger or demerger, the accumulated business losses of the transferor entity may be set off against any business income of the transferee entity subject to restrictions applicable with respect to continuity of business and ownership. There are additional restrictions in the case of a merger whereby only certain kinds of entities or undertakings are able to offset such losses. Similarly, the unabsorbed depreciation of the transferor entity may be set off against any income of the transferee entity.

Rates

See Section II.i, *supra*.

Administration

Each resident company, and every non-resident company earning income in India or claiming benefit under a tax treaty, is required to file its tax returns with respect to every financial year before 31 October of the next financial year, or before 30 November in cases of companies required to submit transfer pricing reports. As part of their returns, resident companies are also required to disclose assets (including financial interests in any entity) located outside India, or the signing authority of any account located outside India. Further, persons withholding taxes on payments made to non-residents

8 Under the ITA, income is classified under the following heads: salaries, income from house property, profit and gains from a business or profession, capital gains and the catch-all heading of 'income from other sources'.

are also required to submit certain prescribed statements. Corporate tax liability must be discharged by way of advance tax (i.e., on the basis of 'pay as you earn' or PAYE). This is payable in four instalments by 15 June, 15 September, 15 December and 15 March.

It is compulsory for businesses with a turnover of 10 million rupees or more to have their accounts audited.

In cases where there is uncertainty as to the taxability of a transaction involving a non-resident (other than those that require valuation), the non-resident or resident entity counterparty may approach the Authority for Advance Rulings (AAR) for a ruling, subject to restrictions as to pendency of regular litigation on the matter. Recently, the availability of AAR rulings has been extended to questions pertaining to the applicability of a general anti-avoidance rule (GAAR) (see Section IX.i, *infra*) and questions pertaining to domestic transactions of a value greater than 1 billion rupees. The AAR is an independent, quasi-judicial body outside the tax department, and its rulings are binding on the tax authorities with respect to the particular transaction on which a ruling has been rendered. Under the regular litigation process, when a taxpayer is dissatisfied with the order of the assessing officer (who is the first authority responsible for determining the tax liability of a taxpayer), it can challenge the order before the Commissioner (Appeals), who is an officer within the tax department. Thereafter, it may challenge the order before the Income Tax Appellate Tribunal (ITAT) and, thereafter, the respective High Court and then the Supreme Court. In a number of cases, adverse orders passed by tax authorities have been reversed when challenged before tax tribunals and High Courts; however, while appealing a decision of a lower authority, the taxpayer is often required to deposit a significant portion of the disputed tax liability to be able to proceed with the appeal process. Separately, constitutional remedies can be sought at different stages of litigation by approaching the respective High Court or Supreme Court, which have the discretion to admit or reject such applications.

In transfer pricing matters, an alternative mechanism when the matter is pending before the assessing office (AO) is to approach the Dispute Resolution Panel (DRP). After the AO issues a draft order to the taxpayer (prior to the final order being passed), if the taxpayer has objections to the adjustments in the draft order, it has the option to either opt for the standard litigation process by filing objections with the AO or file objections with the DRP. If it opts to file objections before the DRP, then the DRP issues directions to the AO confirming, reducing or enhancing the adjustments. The directions issued by the DRP are binding on the AOs; however, the taxpayer is permitted to appeal against the orders of the AO passed pursuant to the directions of the DRP, and such an appeal can be directly filed with the ITAT instead of having to approach the Commissioner (Appeals).

Tax grouping

India does not provide for consolidated tax grouping.

ii Other relevant taxes

Direct taxes other than income tax[9] on taxable profits include tax payable on employees' salary, which must be deducted at source by the employer.

Indirect taxes are imposed on the sale of goods and services. While the liability to pay the tax is on the seller, the seller may pass on the burden to the purchaser.

Central sales tax at 2 per cent is levied on interstate trade, while value added tax is levied by state governments on the sale of goods. In the case of VAT, to avoid the cascading effect of taxation, credits are claimable on VAT already paid on the purchase of inputs. While states have the discretion to determine VAT rates, most states currently impose VAT at two basic rates of 5 and 14.5 per cent.

Excise duty is levied on the production or manufacture of goods in India, and rates vary depending on the goods involved. The general rate of excise duty is 12.36 per cent. Credit can be claimed for excise duty and service tax paid on the purchase of input goods and services against excise duty and service tax payable on sale of output.

Customs duty (ranging from 12.5 to 100 per cent) is imposed on the import of goods and specified exports. It consists of a basic customs duty, a countervailing duty instead of excise duty, and additional customs duty in lieu of state and local taxes.

Service tax at a rate of 12.36 per cent is imposed on services provided in India, other than those specified in the negative list. The place of the provision of a service is usually the place of the service recipient, subject to prescribed exceptions. Therefore, in most cases, services that are exported are not subject to service tax in India. Service tax is usually paid by the service provider but passed on to the consumer. Under the reverse charge mechanism applicable to specified services (including services provided by an entity not having an establishment or place of business in India), the service recipient is responsible for paying this tax.

India proposes to introduce a comprehensive goods and services tax subsuming most indirect taxes on the sale of goods and services.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

See Section II.i, *supra*, regarding corporate residence; as discussed in that section, an offshore company wholly controlled and managed in India would be classified as an Indian tax resident, taxable on its worldwide income. Control and management are considered to be located in the jurisdiction where decisions are taken with respect to affairs of policy and such other vital matters concerning the general and corporate affairs

9 Another important direct tax is wealth tax, which is imposed on the net wealth of all entities. However, it is not relevant for business entities, as buildings and land attached thereto are not subject to wealth tax as long as they are rented out or occupied by the taxpayer for business purposes or held as stock-in-trade. Further, assets such as shares and securities are not included within the ambit of the tax. The only important asset that could be covered is vacant land. Wealth tax is charged at 1 per cent of the net wealth (assets minus liabilities) above the taxable threshold of 3 million rupees.

of the company, which generally is the situs of the meeting of the board of directors of the company.

If a company incorporated outside India is considered to be a resident in India under the ITA, and if a tax treaty entered into by India applies to the company, the company will only be treated as a resident of one of the two countries based on the tiebreaker rule in the treaty.[10] According to judicial decisions, it is the place from which the day-to-day affairs of the company are carried out *de facto* as against the place in which the ultimate control lies (the criteria that determines a company's residence under the ITA).

ii Branch or PE

Under the ITA, a non-resident is considered to have Indian-sourced income to the extent of income (net of permissible deduction) attributable to its 'business connection'[11] in India. The meaning of 'business connection' is broader than the concept of PE in treaty law; it has been defined in an inclusive manner to include agency relationships, and has been judicially interpreted[12] as postulating an element of a real and intimate relationship and an element of continuity. Thus, branch offices and PEs are encompassed within its scope.

In the case of non-residents to whom a tax treaty applies, however, the ITA is applicable only to the extent that it is more beneficial. A PE of a non-resident business entity may be constituted if the non-resident entity has, *inter alia*, a fixed base, office or branch in India. The fixed base need not be owned by the non-resident.

A dependent agent may also constitute a PE if the agent habitually contracts or negotiates on the behalf of the foreign entity, but an independent agent may not constitute a PE for the entity engaging such agency. Generally, the mere fact that a non-resident is a holding company of a company incorporated in India would not render the Indian subsidiary a PE of the non-resident holding company in India. Further, under many of the tax treaties entered into by India, personnel through whom services are provided may constitute a PE in India if the duration for which such services are provided in India exceeds the number of days (as prescribed in the respective treaty) in any one-year period.

Under most of India's tax treaties, the income so attributable to a PE is determined as the amount of profits that the branch would have made if the PE were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions. The Supreme Court has held that where payments by the non-resident to its Indian PE are at arm's length, no further attribution is required. Such income (net of expenses incurred by such branch in generating such income) may be taxed at a rate of 40 per cent. In addition, any actual expenses incurred by the head office on account of the Indian branch or 5 per cent of total adjusted profit of the branch, whichever is lower, are deductible.

10 The 'place of effective management' of the company.

11 It is the corresponding domestic law concept of a 'permanent establishment'.

12 *CIT v. RD Aggarwal & Co* [1965] 56 ITR 20 (SC).

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

The ITA does not provide for a holding company regime. There is a limited participation exemption in certain circumstances. Dividends received by an Indian company from a foreign company, which is normally subject to corporate tax at a rate of 30 per cent, is taxable at 15 per cent if the Indian company holds a minimum of 26 per cent of the equity share capital of the foreign company; while this rate was previously only applicable on a year-on-year basis, recently, it has been extended indefinitely. Another such instance of limited participation exemption is DDT not being applicable to a holding company where it has been paid on such sum by its domestic subsidiary or where 15 per cent tax has been imposed on receipt of dividends from a foreign subsidiary.

ii IP regimes

CA 2013 has introduced the concept of a dormant company, which may be used to hold IP. India does not have a comprehensive IP regime but provides for the following specific tax benefits:

a costs incurred for the acquisition of patents and copyright are deductible in equal instalments over a 14-year period or until a re-transfer, whichever is earlier;

b costs of acquisition of know-how are deductible in equal instalments over a six-year period;

c capital expenditure on scientific research or payments made to approved research associations and companies is deductible up to 100, 175 and 125 per cent of such expenditure or payment; and

d income earned by approved research associations is exempt as long as it is utilised for scientific, statistical or social science research.

iii State aid

The petroleum and agriculture-related sectors are the prominent sectors in which state aid in the form of subsidies is granted.

iv General

While there has been growing uncertainty over the tax treatment of cross-border transactions, particularly in recent years, methods do exist to mitigate the risks arising from such uncertainty, including the application for advance rulings.

Benefits for specific sectors have also made doing business in India attractive. Important benefits include a tax exemption for undertakings set up in SEZs starting from the year in which they begin manufacture or provision of services, subject to prescribed conditions. The tax benefits are described below:

a a tax holiday of 100 per cent for the first five years and 50 per cent for the following five years for offshore banking units;

b a tax holiday of 100 per cent for the first five years and 50 per cent for the following five years for banking units of international financial services centres; and *c* for other undertakings, a tax holiday of 100 per cent for the first five years and 50 per cent for the following five years, plus a tax holiday of 50 per cent for another five consecutive years if certain conditions are met.

One important condition to avail of one of the above-mentioned benefits is that the SEZ unit claiming such benefit should not have been formed by the reconstitution of an already existing business. In this context, certain thresholds are applicable to the transfer of technical personnel from an existing SEZ unit to a new SEZ unit. Recently, the threshold has been increased from 20 to 50 per cent.

However, from financial year 2011–2012, SEZ units, which were earlier exempted from MAT at a rate of 18.5 per cent (as described in Section III.i, *supra*), are now subject to it.

The tax holiday previously applicable in the case of export-oriented undertakings and undertakings located in free trade zones has also been recently withdrawn.

Further, business entities operating in certain sectors (infrastructure, power, etc.) are also entitled to varying degrees of tax breaks, subject to prescribed conditions.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding outward-bound payments (domestic law)

Any person (including non-residents) responsible for paying a sum chargeable to tax under the ITA to a non-resident must deduct income tax payable on such sum[13] at the time of the credit of such income to the account of the payee or at the time of payment.

If the non-resident does not furnish his or her permanent account number,[14] tax must be withheld at the rate applicable to that income or 20 per cent, whichever is higher.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Tax exemptions are available for specific items such as dividends subject to DDT (which is taxed in the hands of the company and not the shareholder), the sale of shares of a listed company on the floor of the stock exchange (if held for more than a year) and income with respect to units of an equity-oriented mutual fund, etc.

iii Double taxation treaties

India is party to comprehensive double tax avoidance treaties[15] with more than 90 countries, of which at least 85 are in force, including those with Cyprus, France,

13 Tax must be withheld at the prescribed rates (which may be different from the tax payable on such sum).

14 The tax registration number.

15 They do not include limited double avoidance tax treaties, which provide relief only with respect to income from certain sources.

Germany, Japan, Luxembourg, the Netherlands, Singapore, the United Kingdom and the United States.

The tax treaty will apply to the taxpayer to the extent that it is more beneficial to the taxpayer than the ITA (provided treaty eligibility criteria are met). Further, domestic law also prescribes the following conditions in relation to availing of tax treaty benefits: the non-resident should obtain a tax residency certificate (TRC) pertaining to the relevant period from the government of the country in which he or she is a resident; the non-resident should also furnish certain prescribed particulars to the extent they are not contained in the TRC; and the non-resident should file tax returns in India.

The rates and incidence of tax prescribed differ from treaty to treaty, but a high-level comparison of the ITA and India's tax treaties is as follows:

<table>
<tr><th></th><th>ITA</th><th>Tax treaty</th></tr>
<tr><td colspan="3">Local withholding on outbound payments</td></tr>
<tr><td>Dividends from resident companies</td><td colspan="2">Since DDT is a tax on the paying company, treaties do not provide relief in this respect. Some treaties may provide for credit for underlying corporate taxes. However, despite such a provision, due to the basic corporate tax rate being 32% (inclusive of surcharge and cess), it may not be possible to avail credit on the additional 15% DDT (on profits after the 32% tax has been imposed), unless the tax rate in the other country is greater than 32%</td></tr>
<tr><td>Royalty or fees for technical services (FTS)</td><td>Wide definition of royalty that disregards factors such as control/use/location in India. Human intervention in the provision of technical services is required to subject them to Indian tax. 25% withholding</td><td>Narrower definition of royalty and FTS. Rates range between 10–20%</td></tr>
<tr><td>Interest paid on foreign-currency denominated loans</td><td>20% withholding</td><td rowspan="4">Rate between 5–20%</td></tr>
<tr><td>Interest paid on foreign-currency convertible bonds</td><td>10% withholding</td></tr>
<tr><td>Interest paid by companies and business trusts on foreign-currency loans and long-term bonds</td><td>5% withholding (up to 30 June 2017)</td></tr>
<tr><td>Other sources of interest</td><td>40% withholding</td></tr>
<tr><td>Business profits of a non-resident (income of a non-resident not falling under any of the above categories in the absence of a PE and including income falling under the above categories if there is a PE)</td><td colspan="2">See Section IV.ii. A PE under treaty law is narrower in scope than a business connection under the ITA. Tax treaties restrict the taxation of business profits to those profits attributable to a PE (as against a business connection under the ITA). However, tax treaties do not provide any relief on the tax rate applicable to such business profits</td></tr>
<tr><td>Capital gains</td><td colspan="2">See Section III.i, supra. Some treaties offer relief with respect to capital gains earned from transfer of shares of an Indian company by a company that is resident in the respective treaty country (and that does not primarily derive its value from immoveable property in India) by stating that only the country of the shareholder's residence has the taxing right*</td></tr>
<tr><td colspan="3">* Examples include India's tax treaties with Cyprus, Mauritius, the Netherlands and Singapore</td></tr>
</table>

	ITA	*Tax treaty*
Withholding on inbound payments		
Foreign dividends	Subject to certain conditions, a reduced 15% tax rate applies for Indian companies that receive dividends from foreign companies in which they hold a minimum of 26% equity share capital. A 30% tax rate applies for other dividend receipts	Rate between 5–25% (for tax payable in the source country)
Other kinds of income received from outside India by Indian residents	See Section II.i. In the absence of a tax treaty, the ITA provides for a foreign tax credit subject to certain conditions. In such cases, no underlying tax credit is available	The treaties provide for credit for foreign taxes (on the corresponding income) paid in accordance with the provisions of the treaty

iv Taxation on receipt

See Section VI.iii, *supra*.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

There is no restriction on debt-to-equity ratios, but under the GAAR (which will be effective from 1 April 2015), the Revenue has the power to re-characterise equity as debt and debt as equity.

ii Deduction of finance costs

Specific finance costs, such as insurance premiums, interest on borrowings, bonuses and commissions, are deductible. See Section III.i, *supra*, regarding deductibility of expenses.

iii Restrictions on payments

Under the new CA 2013, dividends can be paid or declared by any company for any financial year only out of the current year's profits or previous year's accumulated profits (arrived at after allowing for depreciation), or out of both. If profits are insufficient to pay dividends in a particular year, the company is permitted to pay it out of the previous year's reserves, subject to the prescribed rules.

Some restrictions under the earlier CA 1956 in this regard have been removed; especially, the inability to declare dividends if the company fails to redeem its preference shares, and the requirement to transfer the prescribed profit percentage (not exceeding 10 per cent) to the reserves of the company before any dividend is declared or paid.

iv Return of capital

Share buy-back is the most common method employed for capital reduction, as it does not require court approval.

A company is permitted to buy back its own shares up to a level of 10 per cent of its total paid-up capital and free reserves, subject to authorisation by the board of the company and other conditions. One key condition is that debts owed by the company must be less than twice the paid-up capital and reserves post-buy back. Buy-back is permitted of more than 10 per cent and up to 25 per cent of the total paid-up capital and reserves if it is approved by a three-quarters majority at the general meeting of shareholders. Listed companies must comply with additional restrictions.

Buy-back of shares is not tax-neutral. Until recently, it was taxable as capital gains from which relief could be claimed by non-residents investing through treaty jurisdictions where the tax treaty takes away or reduces India's right to impose tax on capital gains from the transfer of an Indian company's shares. From this year, such gains have instead been made subject to a 20 per cent tax in the hands of the company buying back the shares as additional tax payable by the company on the profits distributed by way of such buy-back. Further, apart from the absence of relief being available in cases of capital gains, the shareholder could face difficulties in claiming a foreign tax credit in its country of residence (as in the case of DDT).

Companies are also permitted to reduce capital through extinguishing or reducing liability on unpaid share capital or reducing or extinguishing paid-up share capital. However, these methods are unpopular as they require confirmation by the court under CA 1956 and by a quasi-judicial body under CA 2013. Further, such reduction of capital, to the extent the company possesses accumulated profits, is treated as distribution of dividends on which DDT is payable.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Commercially, there are different methods that could be adopted for acquisition of the business of an Indian company by a foreign company – primarily, share acquisition, merger or demerger, and asset acquisition. Each method has advantages and disadvantages, both from a commercial and tax perspective. Direct acquisition of shares of an Indian company is preferable where the shares have been held by a non-resident situated in a favourable treaty jurisdiction on account of which it would not be liable to capital gains tax in India on the transfer of such shares. Where the shares of the Indian company are not so held, in the case of listed shares held for more than one year, however, they can be acquired on the stock exchange through the 'bulk deal' mode. Long-term capital gains from listed securities sold on the floor of the stock exchange are exempt from capital gains tax. The withholding obligations with respect to this alternative would not apply as the sum involved is not subject to tax liability in the first instance.

Further, asset acquisition in the form of acquisition of a business as a going concern[16] by a local subsidiary is also possible, as the business as a whole is considered a

16 The consideration payable should be for the business as a whole as against being the sum total of the consideration attributable to individual assets, in which case the gains would be

capital asset and the transfer thereof is subject to long-term capital gains at a rate of 20 per cent (without any benefit of indexation for inflation) if such business has been in existence for longer than three years, irrespective of the period for which the individual assets of the company have been held. For the purposes of determining capital gains, the net worth of the entity (as reflected in its books) is taken as the cost of acquisition. As this is a domestic transaction, and there is no specific provision for withholding under the ITA, no withholding obligation is applicable.

In terms of financing alternatives, while interest is generally preferred as it can be used as a method of repatriation of profits, there are exchange control restrictions with respect to debt financing not in the nature of securities compulsorily convertible into equity. Further, if any such expenditure has been incurred in relation to earning exempt income, (especially dividends, which are taxable in the hands of the company and exempt in the hands of the shareholders) the same cannot be deducted in calculating taxable profits.

ii Reorganisation

Domestic mergers or demergers are tax neutral subject to certain conditions, the most important of which are the following: in the case of demergers, the transferee company issues shares to the shareholders of the transferor company on a proportionate basis; and in the case of mergers and demergers, shareholders holding at least three-quarters in value of the shares in the transferor company become shareholders of the transferee company (other than by way of shares already held, if any, by such shareholders in the transferee company). Therefore, an acquired business can be consolidated with an existing business in a tax-neutral manner.

Under CA 1956, while a foreign company can merge or demerge into an Indian company, the reverse is not permitted. Such merger or demerger into an Indian company is tax neutral subject to satisfaction of the above conditions. However, under CA 2013, the reverse is also permitted, although the relevant provisions are yet to be notified. Further, no specific provisions that would make them tax-neutral have been introduced to date.

Capital gains from the transfer of shares of an Indian company as a consequence of the merger of two foreign companies is tax neutral if at least 25 per cent of the shareholders of the transferor foreign company continue as shareholders of the transferee foreign company, and if such transfer does not attract capital gains in the country in which the transferor company is incorporated.

The transfer of shares of an Indian company as a consequence of the demerger of a foreign company into another foreign company is tax-neutral if shareholders holding no less than three-quarters in value of the shares of the demerged foreign company continue as shareholders of the resulting foreign company, and such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.

computed for each asset separately.

iii Exit

Although not permitted under CA 1956, under CA 2013, an Indian company can relocate its *situs* by merging with a foreign company. These provisions of CA 2013 are yet to be notified. From a tax perspective, there are no penalties for a change in tax residence status arising from such relocation, although there can be tax consequences on the outbound merger.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

The GAAR, introduced by the Finance Act 2012 and modified by the Finance Act 2013, aim at checking tax avoidance by investors. An arrangement would be considered an 'impermissible avoidance arrangement' if its main object was to obtain a tax benefit and if satisfies one or more of the following:

a non-arm's-lengthdealings;
b misuse or abuse of the provisions of the domestic income tax provisions;
c lack of commercial substance; and
d an arrangement similar to that employed for non *bona fide* purposes.

In such a case, the tax authorities have been given broad powers to subject the arrangement to such tax treatment as they deem appropriate, including denial of benefits under applicable tax treaties. The GAAR would only be invoked if a minimum tax benefit of 30 million rupees is obtained due to the arrangement. Factors such as the holding period of the investment, availability of an exit route and payment of taxes in connection with the arrangement may be relevant but not sufficient for determining commercial substance. Invocation of the GAAR by the tax authorities, if objected to by the taxpayer, must be approved by an approving panel, which is an independent body chaired by a retired High Court judge, a senior member of the tax office and a reputed academic or scholar with expertise in taxation or international trade and business. The GAAR will be applicable to tax benefits obtained from 1 April 2015; however, it will not be applicable if the tax benefit pertains to income earned by FIIs not claiming treaty benefits, to investment in offshore derivative instruments in FIIs or to structures already in place before August 2010.

Exchange of information

The government has taken specific steps for obtaining tax-related information from various countries. A key development in this regard is India's ratification of the Convention on Mutual Administrative Assistance in Tax Matters, which provides a multilateral basis for, *inter alia*, information exchange on request, automatic exchange of information, simultaneous tax examinations and assistance in tax collection.

Notification of non-cooperative territories

The ITA also provides that transactions by residents with parties (that are not associated enterprises) located in offshore jurisdictions notified as non-cooperative territories[17] are subject to transfer pricing regulations. Deduction for the purposes of calculating taxable profits is not allowed with respect to payments made to financial institutions located in such jurisdiction unless the taxpayer furnishes an authorisation allowing the income tax authorities to seek relevant information from the financial institution on its behalf. Deduction with respect to other transactions with a person in such jurisdiction is also not allowed unless the taxpayer furnishes prescribed information. Income earned by residents of such jurisdictions from Indian sources is subject to an enhanced withholding tax of 30 per cent irrespective of a lower withholding rate provided under Indian law or an applicable tax treaty.

Last year, the government notified Cyprus as a non-cooperative jurisdiction.

ii Controlled foreign corporations

There are no rules for controlled foreign corporations in India.

iii Transfer pricing

The ITA contains transfer pricing provisions according to which any income arising from an international transaction (a transaction between two or more associated enterprises where either or both enterprises are non-residents) is required to be computed having regard to the arms'-length price. Modes of calculation of the arm's-length price are provided in the ITA. Recently, the term 'international transaction' has been defined with retrospective effect. Important among these transactions are the following, which were previously considered to be outside the scope of transfer pricing on account of the absence of an element of income or gain in such transaction: capital financing; and a business restructuring or reorganisation transaction, irrespective of the fact that it has a bearing on the profit, income, losses or assets of associated enterprises at the time of the transaction or at any future date.

However, in the second landmark *Vodafone* ruling,[18] the Bombay High Court recently held that transfer pricing would be triggered only when an element of real 'income' is involved, and that notional income or hypothetical income is not subject to transfer pricing regulations.

From the perspective of providing certainty to investors, provisions were introduced in 2012 to enable taxpayers to make an application for entering into an advance pricing agreement (APA) with the authorities, determining the arm's-length price or specifying the manner in which it must be calculated, in relation to international transactions to be entered into by that person for a period of up to five years. Recently, APAs have been permitted to be rolled back for a period of up to four years.

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17 Such notification can be made under the ITA if such jurisdiction has not signed a tax information agreement with India or does not adequately exchange information with India.

18 *Vodafone India Services Pvt Ltd. v. Union of India*, writ petition No. 871 of 2014.

APAs can be unilateral, involving only the Indian tax authorities, or bilateral, involving both the Indian tax authorities and the tax authorities of the jurisdiction in which the related associated enterprise is situated. So far, five unilateral APAs have been entered into. Some bilateral APAs are also expected to be entered into shortly.

To reduce transfer pricing disputes arising with respect to determination of the arm's-length price, the ITA provides for the framing of safe-harbour rules. Safe-harbour rules prescribe thresholds, the satisfaction of which binds the tax authorities to accept the transfer price declared by the assessee. According to the safe-harbour rules notified by the government, which are applicable for five financial years beginning from 2012–2013, an assessee can opt for the safe-harbour regime for a period of its choice, but not beyond financial year 2016–2017.

iv Tax clearances and rulings

See Section III.i, *supra*, for a basic understanding of advance rulings.

These rulings are statutorily required to be rendered within a six-month period. While such rulings have been rendered within six months to two years, they may not be final, as either the taxpayer or the tax department have the option of approaching the High Court or Supreme Court against such ruling to seek constitutional remedies.

Although it is not mandatory, where there are significant risks from tax uncertainty, obtaining an advance ruling is highly preferable for investors proposing to do business in or with India on account of the high level of certainty offered with respect to the tax consequences of their transactions.

X YEAR IN REVIEW

Against a backdrop of high inflation and worsening current account deficit, there was a relaxation of the investment caps for FDI in certain sectors. FDI under the automatic route has been permitted for certain activities in the railways sector. The sectoral cap for FDI in defence has been increased; however, it continues to fall under the government approval route. The approval of the Cabinet Committee on Security may be required in cases of investment above 49 per cent in the railways and defence sectors. The extent of construction activities in which FDI is permitted has also been liberalised.

It has been clarified that foreign investment (by way of equity shares and fully and mandatorily convertible preference shares or debentures) containing an optionality clause (especially, to give an option to the investor to exit upon non-fulfilment of pre-determined conditions) can be issued, subject to such clause not being used by the foreign investor to exit with an assured return. Additionally, subject to credit concentration norms applicable to non-banking financial companies, no approval is now required by a non-resident shareholder of an Indian listed company to pledge its shares in favour of a non-banking financial company.

Further, the pricing guidelines applicable in respect of the transfer or issue of unlisted shares between a resident and a non-resident and for exit pursuant to optionality clauses have been revised. The only requirement now is that the price should be on an arm's-length basis as per internationally accepted pricing methodology.

SEBI has notified the SEBI (Foreign Portfolio Investors) Regulations 2014 to rationalise the foreign investment regime. Key changes include classifying investment up to 10 per cent of equity of an Indian company as portfolio investment; merging FIIs, sub-accounts and qualified foreign investors into a new class – 'foreign portfolio investor'; providing single window clearance through designated depository participants; and adopting a risk-based know-your-client approach for foreign investors, divided into low, medium and high-risk categories. SEBI has also included subscription to offshore derivative instruments within the 10 per cent investment restriction; therefore, an ultimate beneficial owner's FPI investments and multiple subscriptions to offshore derivative instruments for the same portfolio company will now be clubbed together to calculate the 10 per cent investment restriction.

Subject to the satisfaction of prescribed conditions, unlisted Indian companies have been allowed to list themselves on overseas stock exchanges through the depository receipt mechanism without the requirement of simultaneous or prior listing in India. This initiative is likely to provide a major boost for many sectors, and also offer exits to private equity players looking to monetise their investments. This option is available for a two-year period running from 11 October 2013. Capital raised in this way may be used for offshore purposes, but if not so used within 15 days it should be repatriated to India for domestic purposes. While this option was introduced in 2013, such listings could not happen until June 2014, as SEBI had not prescribed the disclosure obligations for such listings. The government recently prescribed that SEBI shall not mandate any disclosures, unless a company lists in India.

Recently, a new regime has been introduced to replace the earlier regime on depositary receipts (New DR Scheme). The New DR Scheme, *inter alia*, allows issuance of unsponsored depository receipts, removes the requirement for prior approval for issuance of depository receipts (subject to exchange control regulations), removes end-use restrictions and limits transfer of underlying securities to the foreign depository.

The overseas direct investment (ODI) limit for Indian companies, which was reduced to 100 per cent for a short period, has been reinstated to 400 per cent of the net worth of the Indian entity; however, this comes with a caveat that any ODI or financial commitment of more than US$1 billion in a particular financial year will require approval by the Reserve Bank of India, even if such ODI or financial commitment is within the eligible ODI limit of 400 per cent.

Heightened suspicions in the context of poor corporate governance standards have led to instances of global PE funds carrying out post-investment due diligence in their portfolio companies. Another manifestation of global investors asserting their rights is the recent institution of investment arbitration proceedings against India, particularly in light of developments such as, *inter alia*, retrospective taxation and cancellation of licences pursuant to court rulings. For example, in the recent coal block judgment of the Supreme Court of India in the *Manohar Lal Sharma* case,[19] the Court declared the allocation of coal blocks by the government to be null and void as the process followed for allocation was arbitrary and contrary to the procedure established by law.

19 *Manohar Lal Sharma v. the Principal Secretary & Ors.* Writ Petition ((Crl) No. 120 of 2013).

In addition, for various reasons (including regulatory restriction, fundraising and exchange rate fluctuations) there has been an increased appetite among Indian companies having an international presence or looking to establish such presence to shift their holding company structures from India to reputed offshore jurisdictions.

From a companies law perspective, CA 2013 has introduced many restrictions in the case of private companies that were earlier applicable only in the case of public companies – for example, restrictions applicable to the kinds of share capital and restrictions applicable for private placement of securities. CA 2013 also introduced corporate social responsibility for companies meeting certain net worth, turnover or net profits thresholds. They must annually spend 2 per cent of the company's average net profits of the preceding three financial years on social projects, or explain why such spending has not taken place. It is debatable whether this obligation is voluntary or mandatory. The Companies (Corporate Social Responsibility) Rules, 2014 were also notified earlier this year to provide operative guidance for the implementation of the obligations laid down in CA 2013 and Schedule VII thereto.

CA 2013 has also imposed restrictions on the number of subsidiaries an Indian company may have.[20] A company is not permitted to make investments through more than two layers of investment companies. The term 'investment companies' is defined as companies whose principal business is acquisition of shares, debentures or other securities; however, this provision does not prevent a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of that country.

Under rules issued pursuant to CA 2013, structuring different economic rights for different classes of equity shareholders may become difficult given that even private companies are required to comply with rules when issuing equity shares with differential voting rights or dividends. Existing equity shares issued with differential voting rights will continue to have the rights provided at the time of their issuance, and have accordingly been grandfathered. Moreover, preference shares issued by private companies cannot have voting rights.

CA 2013 for the first time codified the duties of directors and introduced significant changes to the composition of boards of directors. Every company is required to appoint one resident director on its board. Listed companies and specified classes of public companies are required to appoint independent directors and female directors on their boards.

In relation to securities law, SEBI has notified the SEBI (Real Estate Investment Trusts) Regulations, 2014 and the SEBI (Infrastructure Investment Trusts) Regulations, 2014 to attract investments into real estate and infrastructure.

SEBI has also introduced the SEBI (Investment Advisers) Regulations, 2013 to regulate investment advisory services and the SEBI (Research Analysts) Regulations, 2014 to regulate independent research analysts, intermediaries employing research analysts and research analysts providing recommendations in public media.

SEBI has further rolled out a consultation paper on 'Crowdfunding in India' with the aim of allowing start-ups and small and medium-sized enterprises to raise early stage

20 This provision has not yet been notified into law.

capital of relatively small sums from a broad investor base. Further, insider trading norms in India are under review to ensure a level playing field in the securities market and to safeguard the interests of small investors. Some of the other developments (apart from those regarding the companies and securities laws) affecting corporates are discussed below.

India has signed an 'in-substance' agreement with the US in relation to the US Foreign Account Tax Compliance Act (FATCA) with effect from 11 April 2014. Consequently, financial institutions in India are now required to make FATCA disclosures (through the Central Board for Direct Taxes) to the US Internal Revenue Service – this would primarily relate to investments by account holders liable to tax in the US. SEBI plans to issue guidelines to help financial institutions in India to identify accounts of persons liable to tax in the US.

Indian courts have often taken a pro-arbitration approach towards dispute resolution, as seen from the Supreme Court ruling in the *Enercon* case,[21] which held that an arbitration agreement is valid insofar as the intention of the parties to resolve disputes by arbitration is clear, irrespective of non-conclusion of the main contract.

The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 was introduced to replace the century-old Land Acquisition Act, 1894. The new law has introduced various changes pertaining to land acquisition, including:

a the scope of projects for which land acquisition can be conducted;
b the extent of consent required from unwilling buyers and other affected parties;
c the computation of compensation;
d compulsory rehabilitation;
e the extension of the law to purchases from willing buyers in the case of purchases exceed certain thresholds; and
f re-transfers in the case of non-use beyond prescribed time limits.

However, while the new law has come into force, rules required under the law to govern several operational aspects have not yet been issued.

From a tax perspective, some of the key changes introduced in the 2014–2015 budget (other than those discussed earlier) are as follows:

a securities held by an FPI are to be considered 'capital assets': gains arising on the disposal or transfer of a range of listed securities shall be taxed as capital gains (and not business income) under Indian domestic law. Funds that have previously taken the position that such income results in business income may need to re-visit their fund structure due to this development, especially if they are situated in jurisdictions such as the UK and the US, whose treaties do not contain favourable capital gains provisions;
b partial tax pass-through will apply for real estate investment trusts and infrastructure investment trusts; and

21 *Enercon (India) Ltd & Ors v. Enercon GmBH*, AIR 2014 SC 3152.

c a lower 5 per cent withholding rate on foreign loans and long-term infrastructure bonds, which was earlier applicable only up to July 2015, has been extended to all foreign loans and long-term bonds up to July 2017.

Some of the key tax rulings and their relevant context are discussed below.

To nullify the Supreme Court's ruling the landmark *Vodafone* decision,[22] in 2012, India retrospectively made certain offshore share transfers subject to Indian tax where the foreign company's shares derive, directly or indirectly, 'substantial' value from assets located in India. In this regard, the decision in *Sanofi Pasteur Holdings SA*[23] is significant. The deciding state High Court has clarified that the retrospective amendment on indirect share transfers will not affect treaty interpretation. Further, in the recent *Copal* case,[24] the Delhi High Court concluded that the term 'substantial' should be read at least as being synonymous with 'majority' (i.e., at least 50 per cent). This ruling brings about much-needed certainty at a time when there is no legislative or judicial guidance for interpreting what amounts to 'substantial' value.

The tax authorities have also initiated transfer pricing scrutiny on intra-group share subscriptions on the ground that shares were issued at less than market price. Notices have been sent to Shell, HSBC Securities and Standard Chartered in relation to their respective inbound transactions. As mentioned in Section IX.iii, *supra*, the Bombay High Court ruling in the *Vodafone* case has ruled that the Indian tax authorities do not have jurisdiction to tax such transactions.

XI OUTLOOK AND CONCLUSIONS

Various steps have been taken to promote investments since the new government has taken office. As previously mentioned, it is considered to have a pro-business approach with particular emphasis on, *inter alia*:

a improving the ease of doing business in India;
b adhering to timelines for granting approvals;
c refraining from the introduction of taxes with retrospective application;
d replacing the existing adversarial approach with a trust-based approach in relation to interactions with citizens and businesses; and
e continuous engagement with investors to address their concerns.

All of this has led to a surge in the stock markets since the declaration of the election results. Several structural reforms are expected in the upcoming budget for 2015–2016. In addition, more clarity is expected in relation to the implementation of the GAAR, which is expected to come into force from 1 April 2015.

22 *Vodafone International holdings BV v. Union of India* [2012] 341 ITR 1 (SC).
23 *Sanofi Pasteur Holding SA v. The Department of Revenue* [TS-57-HC-2013 (AP)].
24 *DIT v. Copal Research Mauritius Limited, Moody's Analytics, USA*, decision dated 14 August 2014 [WP(C) 2033/2013].

Appendix 1

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