

# INDIA: FOREIGN DIRECT INVESTMENT

The Policy and Regulatory Framework

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**IMPORTANT STATISTICS**

Size	3.3 Million sq kms. World's 7th largest nation
Population	Over 1.1 Billion people, World's 2nd most populous nation
Political set up	Parliamentary democracy since independence from British rule in 1947
Written Constitution	Preamble: "Justice - social, economic and political, liberty of thought, expression, belief, faith and worship, equality of status and opportunity, and to promote among them fraternity assuring the dignity of individual and the unity of the Nation".
Fundamental Rights	Guaranteed by the Constitution.
State Religion	Secular State - there is no state religion
Directive principles of State Policy	Promotion of peoples' welfare in a social order
Union of India	28 Federal States and 7 Union Territories.
Parliament	Two Houses - Lok Sabha (Lower House) and Rajya Sabha (Upper House).
Head of State	President
Head of Government	Prime Minister
Independent Judiciary	Supreme Court - highest judicial authority in India High Court - head of judicial hierarchy in the State.
Language	Official language is Hindi, but English is used for official purposes and is widely read and spoken.

**IMPORTANT LAWS GOVERNING BUSINESS**

India has an exhaustive legal framework governing all aspects of business. Some of the important ones include:

**Corporate****Companies Act, 1956**

Governs all Corporate Bodies.

**Competition Act, 2002**

Law to ensure free and fair competition in the market.

**Consumer Protection Act, 1986**

Law relating to protection of consumers from unscrupulous traders/manufacturers.

**Contract Act, 1872**

Law relating to contracts in India.

**Environment Protection Act, 1986**

Provides framework for seeking environmental clearances.

**Foreign Exchange Management Act, 1999**

Regulates foreign exchange transactions including foreign investment.

**Labour****Factories Act, 1948**

Law regulating labour in factories.

Industrial Disputes Act & Workmen Compensation Act

Labour laws dealing with disputes.

**Industries (Development & Regulation) Act, 1951**

Governs all industries.

**Dispute Settlement****Arbitration and Reconciliation Act, 1996**

Law relating to alternate redressal of disputes amongst parties.

**Taxation****Central Excise Act, 1944**

Governs duty levied on manufacture.

**Customs Act, 1962**

Deals with import regulations.

**Customs Tariff (Amendment) Act, 2003**

The Act puts in place a uniform commodity classification code based on globally adopted nomenclature system for use in all trade-related transactions.

**Income Tax Act, 1961**

Governs direct taxes on income of all persons, both corporate and non-corporate as well as residents and non-residents.

**Sales Tax Act, 1948**

Governs the levy of tax on sales.

## Sector Specific

### **Electricity Act 2003**

Regulates generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interests of consumers and supply of electricity to all areas.

### **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002**

Seeks to put in place securitisation and asset foreclosure laws creating a legal framework for establishment of Asset Reconstruction Companies.

## Other Laws

### **Information Technology Act, 1999**

Law governing E-commerce transactions.

### **Money Laundering Act**

Prevents money laundering and provides for confiscation of property derived from, or involved in, money laundering.

### **Patents Act, Copyright Act, Trade Marks Act**

Protect intellectual property rights.

### **Securities and Exchange Board of India Act, 1992.**

Law relating to protection of interests of investors in securities and regulation of the securities market.

### **Right to Information Act, 2005**

Sets out right of every citizen to access information under the control of public authorities and to promote transparency and accountability in the working of every public authority. Provides for constitution of a Central Information Commission and State Information Commission.

### **Special Economic Zones Act, 2005**

#### **A comprehensive Act :**

Provides for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto.

Provides for fiscal and economic incentives for developer of / units in SEZ.

The Industrial Policy Resolution of 1956 and the Statement on Industrial Policy of 1991 provides the basic framework for the overall industrial policy of the Indian Government. In fact, the process of liberalisation started in India with the Statement on Industrial Policy of 1991.

We outline below those aspects of the Industrial Policy which are of interest and relevance for a first-time investor into India.

### Licensing

Since 1991 the Government has substantially removed bureaucratic control on industry. Licensing has been completely abolished except in :

- Two (2) Units reserved for public sector - atomic energy and railways
- Five (5) industries in which Industrial Licensing is compulsory viz., hazardous chemicals, industrial explosives, distillation and brewing of alcoholic drinks, all types of electronic aerospace and defence equipment, cigarettes;
- Manufacture of items reserved for Small Scale Sector;
- Proposals attracting locational restrictions.

The exemption from Licensing also applies to all substantial expansion of existing units.

### Procedure for Obtaining Industrial Licence

- All industrial undertakings subject to compulsory industrial licensing are required to submit an application in the prescribed format, i.e. FC-IL, to the Entrepreneurial Assistance Unit of SIA, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Udyog Bhawan, New Delhi – 110011.
- The application should be submitted along with a crossed demand draft of US\$ 58 (approx. INR 2500/-) drawn in favour of the Pay & Accounts Officer, Department of Industrial Development, payable at State Bank of India, Nirman Bhawan Branch, New Delhi.
- Approvals are generally given within 4-6 weeks of filing the application.

### Industrial Entrepreneurs Memorandum (IEM)

Industrial undertakings exempt from industrial licence, including existing units undertaking substantial expansion, are required to file an IEM in Part A with the SIA, Department of Industrial Policy and Promotion, Government of India, and obtain an acknowledgment. No further approval is required. Immediately after the commencement of commercial production, Part B of IEM has to be filed in the prescribed format. The facility for amendment of existing IEMs has also been provided.

### Procedure

- (a) The IEM can be submitted to the EAU of the SIA in person or by post along with a crossed demand draft of INR 1,000/- (approx. US\$ 23) drawn in favour of "The Pay & Accounts Officer, Department of Industrial Development," payable at State Bank of India, Nirman Bhawan Branch, New Delhi for up to 10 items proposed to be manufactured in the same unit. For more than 10 items, an additional fee of INR 250 (approx. US\$ 5-6) for up to 10 additional items needs to be paid through crossed demand draft.
- (b) A computer acknowledgement containing the SIA Registration Number (for future reference) is issued across the counter immediately, if delivered in person, or sent by post, if received through post. No further approval from SIA is required.
- (c) All Industrial undertakings also need to file information in Part 'B' of the IEM at the time of commencement of commercial production to EAU in SIA. No fee is required for filing part B. All industrial undertakings whether exempt or not from compulsory industrial licensing, are required to submit a monthly production return in the proforma at the following address every month, so as to reach the Industrial Statistics Unit (ISU) by the 10th of the following month, along with a copy to the concerned Administrative Ministry/ Department/ Authorities.

*Joint Director  
Industrial Statistics Unit (ISU)  
Department of Industrial Policy & Promotion  
Room No. 326, Udyog Bhawan  
New Delhi – 110 011  
Fax: + 91 - 11 - 2301 4564*

*This information is used to compile the Index of Industrial Production (IIP).  
Details and the prescribed format are available at the website: <http://dipp.nic.in>.*

In the case of small scale industrial undertakings, the monthly production return should be submitted to the appropriate State Government or Commissioner of Industries and to the Department of Small Scale and Agro & Rural Industries, Government of India along with a copy to the Small Industries Service Institute.

- (e) An IEM would be cancelled/ deleted from the SIA records if, on scrutiny, it is found that the proposal contained in the IEM is licensable.

## Location

Industrial Approval is required from the Central Government for industries proposed to be located in cities with a population of more than one million (as per 1991 census).

- Industries of polluting nature may be located outside 25 km of the periphery of cities with population of more than one million, or in prior designated Industrial Areas. Local zoning, land use regulations and environmental regulations also apply.
- Industries like Electronics, Computer software and Printing are exempt from such locational restriction.

The cities with population of more than one million (as per 1991 census) are as under:

Greater Mumbai	U.A	Kochi	U.A
Kolkata,	U.A	Coimbatore	U.A
Delhi	U.A	Vadodara	U.A
Chennai	U.A	Indore	U.A
Hyderabad	U.A	Patna	U.A
Bangalore	U.A	Madurai	U.A
Ahmedabad	U.A	Bhopal	M.C
Pune	U.A	Visakhapatnam	U.A
Kanpur	U.A	Varanasi	U.A
Nagpur	U.A	Ludhiana	M.C
Lucknow	U.A	<i>Note:</i>	
Surat	U.A	<i>U.A = Urban Area</i>	
Jaipur	U.A	<i>M.C = Municipal Corporation</i>	

## Policy relating to Small-Scale Undertakings

A small-scale industrial (SSI) unit is an industrial undertaking having an investment of less than INR 10 million in plant and machinery. This limit can be extended to INR 50 million in certain cases.

- Equity from an industrial undertaking (either foreign or domestic) up to 24% is permitted in the small-scale sector. SSI status is lost if equity from another company (including foreign equity) exceeds 24% unless the Industrial Undertaking undertakes an export obligation of 50%.
- There are 35 items reserved for the small-scale sector ranging from food and allied industry to plastic and chemical products.
- Manufacture of items reserved for the small-scale sector requires an industrial licence.

- SSI units enjoy a number of concessions, privileges and preferences such as excise duty exemption / concession up to specified limits on turnover, inapplicability of some labour laws, concessional finance from scheduled banks, etc.

## Procedure for Obtaining Carry on Business Licence

A small scale unit manufacturing small scale reserved item(s), on exceeding the small scale investment ceiling in plant and machinery by virtue of natural growth, needs to obtain a Carry-on-Business (COB) Licence. No export obligation is fixed on the capacity for which the COB licence is granted. However, if the unit expands its capacity for the small scale reserved item(s) further, it needs to apply for and obtain a separate industrial licence.

The application for COB licence should be submitted in revised form "EE", which can be downloaded from the web site (<http://dipp.nic.in>) along with a crossed demand draft of INR 2,500 (approx. US\$ 58) drawn in favour of the Pay & Accounts Officer, Department of Industrial Development, payable at State Bank of India, Nirman Bhawan, New Delhi.

The Indian Government's attitude towards foreign investment has changed significantly during the past decade. Until the 1980s, foreign investment was permitted only in cases where a desired technology was not obtainable on any other terms. With the introduction of the Statement on Industrial Policy of 1991, the government began taking a more liberal attitude. Automatic approval was granted in specified high-priority industries for up to 51 per cent direct foreign investment and in trading companies engaged primarily in export activities. In 2000, the Foreign Direct Investment (FDI) policy was further liberalised and now foreign investment up to 100 per cent for new and existing companies / firms, is permitted under the automatic route (i.e. without requiring prior approval) for all items/activities except for a few specific sectors.

### Government Policy on Foreign Equity Investment

Foreign investment is allowed in all areas other than the following sectors in which foreign investment is prohibited:

- Retail Trading (except Single Brand Retail Trading)
- Atomic Energy
- Lottery Business/ Gambling & Betting
- Agriculture (excluding floriculture, horticulture, seed development, animal husbandry, pisciculture and cultivation of vegetables, mushrooms etc.)
- Plantations (excluding Tea plantation)

For all other sectors, there are two approval routes for foreign investment in India:

- automatic route under delegated powers exercised by the Reserve Bank of India (RBI),
- approval by the Government through the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance.

### Automatic Route

#### Foreign Direct Investments (FDI)

- FDI up to 100 per cent for new and existing companies/joint ventures /firms, is permitted under the automatic route for all items/activities except the following:
  - proposals that require compulsory industrial licensing
  - where the foreign collaborator has an existing venture/tie-up in India in the same field ('same field' means 1987 NIC code) as on January 12, 2005, with the exception of following cases which would not require prior FIPB approval :

- » Investment by a Venture Capital Fund registered with SEBI<sup>1</sup>
- » Existing joint venture has less than 3% investment by either party
- » Existing joint venture is defunct or sick
- acquisition of shares held by resident shareholders of an existing Indian company in the following cases :
  - Indian company is engaged in financial services sector; Where SEBI (Substantial Acquisition of Shares and Takeover) Regulation, 1997 is triggered.
- proposals falling outside notified sectoral policy/caps or sectors in which FDI is not permitted (please refer to Chapter 4 for details)

#### Downstream investment

Subsequent investment in India by foreign-owned Indian holding companies (commonly referred to as "Downstream investments") are allowed in accordance with the FDI guidelines mentioned above.

Prior approval of FIPB is required to act as a holding company. Domestic funds cannot be leveraged by the foreign-owned Indian holding company for downstream investments.

#### Procedure for Automatic Route

The foreign investor is not required to obtain any prior approval. Only a post facto filing is required to be made by the company in India which is receiving the foreign investment. This filing entails submission of notifications to the concerned regional office of RBI in the prescribed form within 30 days of receipt of inward remittances and within 30 days after issue of shares by the Indian company to the foreign investor.

#### FIPB Route

- For all cases of Foreign Investment where the project does not qualify for automatic approval, as given above, prior approval is required from the FIPB under the Ministry of Finance.
- The proposal for foreign investment is decided on a case-to-case basis depending upon the merits of the case and in accordance with the prescribed sectoral policy (please refer to Chapter 4 for details).
- Generally, preference is given to projects in high priority

<sup>1</sup>Securities and Exchange Board of India (SEBI) is the Indian capital markets regulator established with the prime objective of protecting the interests of investors in securities, promoting the development of, and regulating, the securities market in India.

industries, infrastructure sector, those having export potential, large-scale employment opportunities, linkages with agro sector, social relevance or relating to infusion of capital and induction of technology.

- Dividends are freely repatriable (i.e. without any foreign exchange neutrality conditions).

- **Procedure for FIPB Route**

Applications should be submitted in either Form FC-IL or a plain paper giving all necessary details of the proposal. No fee is payable. The proposal submitted to FIPB should include information on whether the applicant has had or has any existing financial / technical collaboration or trade mark agreement in India in the same field for which approval has been sought along with details and justification for proposing the new venture.

**Decision of the FIPB is conveyed within 30 days of submitting the application.** For a review of the factors that FIPB takes into account for granting FDI approvals, please refer to Annexure I.

## Government Policy on Foreign Technology Transfer

For promoting an industrial environment which accords priority to the acquisition of technological capability, foreign technology induction is encouraged both through FDI and through foreign technology collaboration agreements. Foreign collaboration agreements are permitted either through the automatic approval route or with prior approval from the Government.

### Automatic Approval

No prior approval is required in respect of all those foreign technology agreements, which involve:

- a lump sum payment of up to US\$ 2 million
- royalty payable up to 8 per cent on exports and 5 per cent on net domestic sales<sup>2</sup>, subject to a total payment of 8 per cent on sales over a 10 year period, without any restriction on the duration of royalty payments
- Within the overall cap of 8 per cent / 5 per cent as above, royalty is payable up to 2 per cent for exports and 1 per cent for domestic sales on use of trademarks and brand name of the foreign collaborator without technology transfer.<sup>3</sup>

<sup>2</sup> Royalty is to be calculated on the basis of the net ex-factory sale price of the product, exclusive of excise duties, minus the cost of standard bought-out components and the landed cost of imported components, irrespective of the source of procurement, including ocean freight, insurance, customs duties, etc.

<sup>3</sup> Royalty for trademark/brand name cannot be paid in addition to the royalty rates of 5 per cent and 8 per cent for technology transfer.

## Procedure

A post-facto filing of the foreign technology collaboration agreement is required to be made to the concerned regional office of RBI.

### Government Approval

Government approval from the Ministry of Industry is necessary for the following categories of foreign technical collaboration agreements:

- Proposals attracting compulsory licensing (please refer to Chapter 2 for details)
- Items of manufacture reserved for the small-scale sector
- Proposals where the foreign collaborator has an existing venture/tie-up in India in the same field ('same field' means 1987 NIC code) as on January 12, 2005, (certain exceptions have been outlined earlier)
- Proposals not meeting any or all of the parameters for automatic approval

It is permissible for a Company registered in India to issue equity shares against lumpsum fee and royalty in convertible foreign currency already due for payment / repayment, subject to meeting all applicable tax liabilities and procedures.

### Procedure

Applications in respect of such proposals should be submitted in Form FC-IL to the Secretariat for Industrial Assistance, Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, Udyog Bhavan, New Delhi. After due consideration by the Project Approval Board, the decision is conveyed within 4 to 6 weeks of filing the application.

### Hiring of Foreign Technicians / Personnel

Indian firms/companies may engage the services of foreign nationals on short-term assignments without prior approval of RBI. However, the following conditions should be satisfied:

- The foreign national rendering services in India holds a valid visa i.e. employment, business, tourist etc. (a valid employment visa is essential in case the stay of foreign national in India exceeds three months).
- The amount of remittance sought for such services is in accordance with the terms of contract entered into by the applicant firm/company with the foreign national/company.

Foreign nationals/ Indian citizens who are not permanently resident in India and have been deputed by a foreign company to its office / branch / subsidiary / JV in India are allowed to make recurring remittances abroad for family maintenance up to 100% of their net salary. Further, up to 75% of salary of a foreign national/ Indian citizen deputed by a foreign company to its Indian office / branch / subsidiary / JV can be paid abroad by the foreign company subject to the foreign national / Indian citizen paying applicable taxes in India.

### Investment by Way of Acquisition of Shares

Foreign investors looking at acquiring equity in an existing Indian company through stock acquisitions can do so without obtaining approvals except in financial services sector, provided:

- (i) such investments do not trigger off the takeover provisions under SEBI's (Substantial Acquisition of Shares and Takeover) Regulations, 1997; and
- (ii) the non-resident shareholding after transfer complies with sectoral limits under FDI policy.  
As per RBI valuation norms, acquisition price should not be lower than
  - Prevailing market price, in case of listed companies
  - Fair market value as per Controller of Capital Issues (CCI) valuation guidelines, in case of unlisted companies

Acquisitions may be made from an existing Indian company which is either a privately held company or a company in which public is interested i.e., a company listed on stock exchange, provided a resolution to this effect has been passed by the Board of Directors of the Indian Company.

Acquisition of shares of a public listed company is subject to SEBI guidelines and requires prior approval from FIPB. SEBI's Take-Over Code Regulations require that any person acquiring 15 per cent or more of the voting capital in a public listed company should make a public offer to acquire a minimum 20 per cent stake from the public.

### Investment by Non Resident Indians (NRIs)

- For all sectors excluding those falling under Government Approval, NRIs (which also includes Persons of Indian Origin - PIOs) are eligible to bring investment through the automatic route of RBI. The Government through the FIPB considers all other proposals, which do not fulfill any or all of the criteria for automatic approval.
- Further, under the non-repatriation scheme (i.e. capital is not repatriable outside India), NRIs are permitted to invest even in those sectors where sectoral caps are prescribed under the FDI policy. NRIs are also permitted to purchase and sell shares/convertible debentures under the portfolio investment scheme through a branch designated by an authorised dealer for the purpose and duly approved by the RBI, subject to fulfillment of certain conditions.

The total holding by each NRI cannot exceed 5% of the total paid up equity capital or 5% of the paid up value of each series of convertible debentures issued by an Indian company. Further, the total holdings of all NRIs put together cannot exceed

10% of paid up equity capital or paid up value of each series of convertible debentures. This limit of 10% may be increased to 24% by the concerned Indian company by sanction of the shareholders through a special resolution.

### Investment by Foreign Institutional Investors

A registered Foreign Institutional Investor (FII) may, through SEBI, apply to RBI for permission to purchase the shares and convertible debentures of an Indian company under Portfolio Investment Scheme.

FII's are permitted by RBI to purchase shares/convertible debentures of an Indian company through registered brokers on recognised stock exchanges in India. They are also permitted to purchase shares/convertible debentures of an Indian company through private placement/ arrangement.

The total holding by each FII / SEBI approved sub-account of FII cannot exceed 10 per cent of the total paid-up equity capital or 10 per cent of the paid-up value of each series of convertible debentures issued by an Indian company. Further, the total holdings of all FIIs/sub-accounts of FIIs put together cannot exceed 24 per cent of paid-up equity capital or paid-up value of each series of convertible debentures. This limit of 24 per cent may be increased to the specified sectoral cap / statutory ceiling, as applicable, by the Indian company concerned by passing a Board of Directors' resolution followed by sanction of the shareholders through a special resolution to that effect.

### Authorities dealing with Foreign Investment

#### Foreign Investment Promotion Board (FIPB)

The FIPB (which functions under the Ministry of Finance) is the nodal agency for all matters concerning Foreign Direct Investment (FDI) as well as its promotion into the country. It maintains flexibility of purposeful negotiations with investors and considers project proposals in totality, with a view to maximising FDI into the country. The FIPB meets once every week ensuring speedy disposal of applications and communicates the Government's decision to the applicant within 6 weeks.

The main functions of FIPB, inter-alia includes:

- Ensuring expeditious clearance of the proposals for foreign investment
- Periodically reviewing the implementation of proposals cleared earlier
- Reviewing the general and sectoral policy guidelines and in consultation with Administrative Ministries, incorporating a set of transparent rules for each of these sectors

- Undertaking investment promotion activities including establishment of contact with and inviting selected international companies to invest in India in appropriate projects.

#### **The FIPB comprises of:**

- Secretary, Department of Economic Affairs – Chairman
- Secretary, Department of Industrial Policy and Promotion – Member
- Secretary, Department of Commerce – Member
- Secretary (Economic Relations), Ministry of External Affairs – Member

Other Secretaries and top officials of financial institutions, banks, and professional experts of industry and commerce, are co-opted onto the FIPB as and when necessary.

For more details, visit the website at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/fipb/fipb\\_index.htm](http://finmin.nic.in/the_ministry/dept_eco_affairs/fipb/fipb_index.htm)

#### **Secretariat for Industrial Assistance (SIA)**

The SIA, functioning with the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, acts as a gateway to industrial investment in India. It provides a single window clearance for Entrepreneurial Assistance and facilitates the processing of investors' applications requiring government approval. Broadly SIA:

- Assists entrepreneurs and investors in setting up projects and monitors the implementation of these projects;
- Liaises with State Governments and other governmental bodies for seeking necessary clearances;
- Notifies all Government policy relating to investment and technology.

For more details, visit the website at <http://dipp.nic.in>

This web site has the facility of online chat between 4.00 pm to 5.00 pm (Indian Standard Time: GMT+5 ½ hrs; summer time: 4½ hrs) on all working days where investors can ask questions relating to FDI Policies and related issues.

#### **Foreign Investment Implementation Authority (FIIA)**

The FIIA is also constituted within the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry. FIIA aims at facilitating:

- Quick implementation of FDI approvals;
- Resolution of operational difficulties faced by foreign investors, in consultation with the concerned Ministries/State Governments (for this purpose Fast Track Committees have

been set up in 30 Ministries / Departments – details of these Committees are available at the website <http://dipp.nic.in>).

#### **Direct Contact with Investors**

FIIA periodically writes to the approval holders of FDI mega projects (with investment of US\$ 21 million or more), which are under implementation to get a direct feedback on any difficulties being faced by them in the implementation of their projects, which can be followed by FIIA with respective Ministries/State Governments. All fresh FIPB approvals issued since September 2001 contain information on FIIA and its e-mail address ([fiia@ub.nic.in](mailto:fiia@ub.nic.in)) for investors to approach FIIA in case of any difficulties. Investors experiencing difficulties in the implementation of their projects can also approach FIIA through the website (<http://dipp.nic.in>)

#### **Investment Commission**

Investment Commission was established in 2004 for attracting domestic and foreign investors to India. The Commission is delegated broad powers authorising it to engage in, discuss and invite both domestic and foreign businesses to invest in the country. The Commission acts as the single window facilitator for investors coming into India.

#### **Project Approval Board (PAB)**

##### **The PAB was constituted to undertake:**

- o Detailed reviews in respect of pendencies of letters of intent, industrial licences and foreign collaborations. The review by PAB identifies delays in various agencies involved and fixes targets for clearing arrears.
- o Review the progress of implementation of letters of intent and industrial licences upto the stage of actual commissioning of capacity.

The PAB provides a forum at which policy questions that affect a large number of applications are brought up and resolved.

#### **Reserve Bank of India (RBI)**

The RBI, India's central bank, was established on April 1, 1935 and nationalised on January 1, 1949. Its basic purpose is to secure monetary stability and develop India's financial structure in line with national socio-economic objectives and policies. The main functions of RBI are as follows:

- Formulate, implement and monitor the monetary policy to ensure flow of credit to productive sectors.
- Prescribe parameters of banking operations within the country's banking and financial system functions.

- Administer external trade and payment, for promoting orderly development and maintenance of foreign exchange market in India.

The RBI also acts as a banker to Central/State Governments, commercial banks, state cooperative banks and some financial institutions. Further, RBI acts as an agent of the Government in respect of India's membership of International Monetary Fund. For more details, visit the website at [www.rbi.org.in](http://www.rbi.org.in)

## Investment Facilitation Channels

### Business Ombudsperson

To facilitate expeditious redressal of grievances and attend to complaints relating to delays in grant and implementation of industrial approvals and facilitate their disposal, the Government has appointed the Additional Secretary & Financial Adviser, Ministry of Commerce and Industry, Udyog Bhavan, New Delhi-110011, as BUSINESS OMBUDSPERSON [e mail: [nc@ub.nic.in](mailto:nc@ub.nic.in)].

### Grievances Officer-cum Joint Secretary

Grievances and complaints are received by the Grievances Officer-cum-Joint Secretary, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Udyog Bhavan, New Delhi-110011, either through post or through the mail box. Any such communication is handled speedily and appropriate steps are taken to redress the grievance.

Prior to 2000, foreign direct investment (FDI) was allowed up to specified percentages (50 per cent, 51 per cent and 74 per cent) in certain specific sectors only and all other sectors were closed to FDI. In 2000, with a view to promoting foreign investment and aligning the Indian economy with the global economy, the FDI policy was inversed to permit FDI in all sectors with the exception of a few sectors in which FDI is either prohibited or restricted.

**The prevailing FDI limits for different sectors are as follows.**

### Advertising and Films

Advertising industry: FDI is permitted up to 100 per cent through the automatic route.

Film industry: FDI in all film-related activities, such as film financing, production, distribution, exhibition, marketing etc., is permitted up to 100 per cent for all companies under the automatic route.

### Agriculture (including plantation)

No FDI/NRI/OCB investment is permitted in agriculture, other than in Tea sector (including tea plantations), wherein 100 per cent FDI is allowed. Proposals for FDI in tea plantations, require prior approval of the FIPB and are subject to the following conditions

- Compulsory disinvestment of 26 per cent equity in favour of an Indian partner/Indian public within a period of five years
- Prior approval of the State Government is required for any future change in land use.

FDI up to 100% on the automatic route is permitted in Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, Aquaculture, cultivation of vegetables and mushrooms under controlled conditions and services related to agro and allied sectors.

100% FDI in processing and warehousing of Coffee and Rubber is now permitted under the automatic route.

### Asset Reconstruction Companies

FDI upto 49% permitted with prior FIPB approval. Where any individual investment exceeds 10% of the equity, such investor shall not hold any controlling interest in the ARC. Investments by FIs are not allowed.

### Atomic Energy

Under this sector, the following three activities are permitted to

receive FDI/NRI investments after approval from the FIPB:

- Mining and mineral separation,
- Value addition per se to the mining and mineral separation products,
- Integrated activities (comprising of both the above). FDI up to 74 per cent is permitted in both pure value addition and integrated projects.

For pure value addition projects as well as integrated projects with value addition up to any intermediate stage, FDI is permitted up to 74 per cent through joint venture companies with Central/State PSUs in which equity holding of at least one PSU is not less than 26 per cent. However, in exceptional cases, FDI beyond 74 per cent will be permitted subject to clearance of the Atomic Energy Commission before FIPB approval.

### Banking

- o Public Sector Banks – FDI and portfolio investment allowed up to 20% under the automatic route. Voting rights for shareholders is limited to 1%.
- o Private Sector Banks – FDI (from all sources) up to 74% is allowed under the automatic route. Voting rights per shareholder is restricted to 10%. (On May 4, 2005, the Cabinet approved an amendment to the Banking Regulation Act, linking voting rights to shareholding. A notification by RBI giving effect to the amendment is still awaited.
- o A foreign bank may operate in India through only one of three channels viz., branch/es (ii) a wholly-owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74% in a private bank.

### Broadcasting

#### TV software production

100 per cent FDI permitted subject to:

- all future laws on broadcasting and no claim of privilege or protection by virtue of approval accorded
- not undertaking any broadcasting from Indian soil without Government approval

Setting up hardware facilities such as Uplinking Hubs, etc.

FDI limit up to 49 per cent inclusive of both FDI & Portfolio Investment to set up uplinking hub (teleports) for leasing or hiring out their facilities to the broadcasters.

#### Cable Networks

FDI limit upto 49per cent inclusive of both FDI & Portfolio Investment. Companies with minimum 51 per cent of paid up share capital held by Indian citizens, are eligible for providing cable TV services under the Cable Television Network Rules (1994).

### Direct-To-Home

Maximum 49 per cent foreign equity including FDI/ NRI//FII. Within the foreign equity, FDI component should not exceed 20per cent.

### Terrestrial Broadcasting FM

Licensee has to be a company registered in India under the Companies Act. No direct investment is allowed by foreign entities and NRIs. Limited portfolio investments by FII / NRI / PIO is permitted, subject to such ceiling as may be decided from time to time; at present the prescribed ceiling is 20 per cent.

### Terrestrial TV

No private operator is permitted.

Note : 26 per cent cap is imposed for purposes of uplinking from India with respect to all forms of foreign investment in TV channels devoted to news and current affairs. The investment cap does not apply to pure entertainment channels.

### Cigarettes

Up to 100 per cent foreign equity is allowed subject to industrial licensing. Automatic route is not available.

### Civil Aviation & Airports

FDI up to 49 per cent is permitted for scheduled air transport services/ domestic scheduled passenger airlines under the automatic route. However, no direct or indirect equity participation by foreign airlines is allowed. NRI investment is permitted up to 100 per cent under the automatic route.

For non-scheduled air transport services/non-scheduled airlines, chartered airlines and cargo airlines, FDI upto 74 per cent is permitted under the automatic route. NRI investment is permitted up to 100 per cent under the automatic route.

100 per cent FDI permitted under the automatic route for Maintenance, Repair and Overhaul (MRO), flying training institutes and technical training institutions.

FDI up to 100% is permitted under the automatic route for helicopter services / sea plane services requiring DGCA approval.

FDI up to 74 per cent and NRI investment up to 100 per cent under the automatic route is permitted for ground handling services subject to sectoral regulations and security clearances.

In case of Airports, FDI is permitted up to 100 per cent in Greenfield airports. FDI is permitted up to 100 per cent

in existing airports. (FDI beyond 74 per cent requires FIPB approval).

### Coal and Lignite

FDI is permitted up to 100 per cent for private Indian companies, which set up or operate power projects and coal or lignite mines for captive consumption.

A company setting up coal processing plants is allowed FDI up to 100 per cent subject to compliance with the condition that it will not do coal mining and supply the washed or sized coal to parties supplying raw coal to coal processing plants instead of selling it in the open market.

100 per cent FDI is permitted under the automatic route in captive mining of coal or lignite for consumption by eligible users.

FDI is permitted up to 50 per cent under the automatic route in all the above cases subject to the condition that such investment shall not exceed 49 per cent of the equity of a PSU.

### Commodity Exchanges

Composite foreign investment (FDI + FII) is permitted up to 49% with prior FIPB approval. FDI is capped at 26% while FII is capped at 23%.

FII can purchase only in secondary market  
5% equity limit by each foreign investor / entity, including persons acting in concert.

### Credit Information Companies (CIC)

Foreign investment in CICs permitted upto 49%  
Investment by registered FIIs permitted up to 24% (within the overall limit of 49%) only in listed CICs  
Prior approval of the Government and regulatory clearance from RBI required  
Foreign investment subject to the Credit Information Companies (Regulation) Act, 2005

FII investment subject to following conditions:  
No single entity to hold more than 10% (directly/ indirectly)  
Any acquisition in excess of 1% to be reported to RBI  
FIIs not to seek representation on Board of CICs based upon their shareholding

### Drugs and Pharmaceuticals

FDI up to 100 per cent in the case of bulk drugs, their intermediates and formulations thereof, is allowed under the

automatic route.

However, FIPB approval is required for manufacture of bulk drugs by the use of recombinant DNA technology and specific cell/tissue targeted formulations and those that require compulsory licensing.

### Defence

FDI, including NRI investment, in this sector is permitted up to 26 per cent subject to prior approval of the government and compliance with the security and licensing requirements and guidelines issued by the Ministry of Defence.

According to the guidelines for production of arms and ammunitions, the management of the applicant company/ partnership should be in Indian hands with majority representation on the Board as well as the Chief Executive being resident Indians. Further, there would be a three year lock-in period for transfer of equity from one foreign investor to another foreign investor.

### Hotels and Tourism

FDI in this sector is permitted up to 100 per cent on the automatic route.

### Insurance

FDI in the insurance sector is permitted up to 26 per cent under the automatic route subject to obtaining license from the Insurance Regulatory & Development Authority (IRDA).

### Lottery Business, Gambling & Betting

FDI / foreign technical collaboration in any form is prohibited in Lottery Business, Gambling & Betting.

### Mass Rapid Transport System

FDI up to 100 per cent is allowed under the automatic route in mass rapid transport systems, including associated real estate development, in all metropolitan cities.

### Mining

FDI is allowed up to 100 per cent under the automatic route for activities such as exploration and mining of gold and silver (and minerals other than diamonds and precious stones), metallurgy and processing.

For exploration and mining of diamonds and precious stones, FDI is allowed up to 100 per cent under the automatic route. FDI upto 100% is permitted with prior government approval for mining and mineral separation of titanium bearing minerals and ores, its value addition and integration activities subject to

sectoral regulations and the Mines and Minerals (Development & Regulation) Act, 1957. Following conditions would apply:

- o Value-addition facilities to be set-up within India along with transfer of technology
- o Disposal of tailings during the mineral separation to be carried out in accordance with regulations framed by the Atomic Energy Regulatory Board.

For companies which seek to set up 100 per cent wholly owned subsidiaries in the mining sector, permission may be given subject to the condition that the applicant has no existing joint venture for the same area and/or the particular mineral.

### Non-banking Financial Services

FDI/NRI investments allowed in 18 specified activities subject to minimum capitalisation norms indicated below: (i) Merchant Banking (ii) Underwriting (iii) Portfolio Management services (iv) Investment Advisory Services (v) Financial Consultancy (vi) Stock Broking (vii) Asset Management (viii) Venture Capital (ix) Custodial Services (x) Factoring (xi) Credit Rating Agencies (xii) Leasing and Finance (xiii) Housing Finance (xiv) Forex Broking (xv) Credit Card Business (xvi) Money Changing Business (xvii) Micro Credit (xviii) Rural Credit.

Minimum Capitalisation Norms (Foreign Equity)

- o US\$ 0.5 million upfront - where the foreign equity is up to 51 per cent .
- o US\$ 5 million upfront - where the foreign equity is more than 51 per cent but up to 75 per cent.
- o US\$ 50 million (US \$ 7.5 million upfront and US \$ 42.5 million in 24 months) - where the foreign equity is more than 75 per cent.

For non-fund based NBFCs, the minimum capitalisation norms has been fixed at US \$ 0.5 million.

Foreign investors bringing in at least US \$ 50 million have now been permitted to set up 100 per cent operating subsidiaries without having to disinvest a minimum of 25 per cent of its equity to Indian entities. Joint Venture operating NBFCs, having up to 75 per cent foreign investment, have been allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries complying with the minimum capitalisation norms.

FDI in this sector is permitted under the automatic route subject to compliance with the guidelines issued by RBI. Petroleum

### Other than Refining

100% FDI is permitted under the automatic route in respect of the following subject to existing policy and regulatory framework in the petroleum sector.

- Oil Exploration
- Petroleum Product Pipelines
- Petroleum Products Marketing
- Laying of Natural Gas/LNG pipelines

Market study and formulation and investment financing in the petroleum sector.

### Refining

In case of Public Sector Units, FDI is permitted to 49% with prior FIPB approval.

The condition of compulsory divestment up to 26% equity within five years for actual trading and marketing of petroleum products has been done way with.

### Pollution Control and Management

For activities like manufacture of pollution control equipment and consultancy for integration of pollution control systems, FDI is permitted up to 100 per cent under the automatic route.

### Ports and Harbours

Up to 100 per cent FDI is allowed through the automatic route for construction and maintenance of ports and harbours (BOT projects).

### Postal Services

FDI up to 100 per cent is permitted for courier services excluding distribution of letters, subject to grant of prior approval by the government.

### Power

FDI in the power sector is permitted up to 100 per cent, in respect of projects relating to electricity generation, transmission and distribution, other than atomic reactor power plants. There is no limit on the project cost and quantum of the FDI.

### Print Media

FDI up to 100% is permitted in publishing/printing scientific and technical magazines, periodicals and journals.

In the news and current affairs category, for instance newspapers, FDI has been allowed up to 26%. However, this is further subject to certain conditions:

- o The largest shareholder must hold at least 51% equity;
- o Three – fourth (3/4) of directors and all executive and editorial staff have to be resident Indians.

### Real Estate

FDI up to 100% under the automatic route is permitted in:

- o Townships
- o Housing
- o Built-up infrastructure
- o Construction-development projects (including but not restricted to – Housing, Commercial premises, Hotels, Resorts, Hospitals, Educational institutions, Recreational facilities, City and regional level infrastructure).

subject to certain conditions (such as minimum area to be developed, minimum capitalisation to be US\$ 10 million for a wholly owned subsidiary and US\$ 5 million for a JV with an Indian partner – minimum 3 years lock-in from the completion of capitalisation).

However, investment by NRIs is not subject to above conditions for construction development projects.

Investment in Special Economic Zones, hotels, hospitals and industrial parks (satisfying prescribed conditions) are exempted from the above requirement.

### Roads and Highways

Investment by the private sector, including FDI, is permitted up to 100 per cent through the automatic route for the construction and maintenance of roads, highways, vehicular bridges and tunnels and toll roads.

### Satellite

FDI up to 74 per cent with prior FIPB approval is permitted for establishment and operation of satellites.

Stock Exchanges, depositories and clearing corporations  
Foreign investment up to 49% is permitted with separate FDI cap of 26% and FII cap of 23%

- o FDI will be allowed with specific prior approval of FIPB; and
- o FII will be allowed only through purchases in the secondary market.

### Telecommunications

Composite FDI holding of up to 74% is permitted in Basic, Cellular, Unified Access Services, National /International Long Distance, V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS), ISPs with gateways, radio-paging and end-to-end bandwidth.

100% FDI is permitted in ISPs not providing gateways, Infrastructure Providers providing dark fibre, electronic mail and voice mail, subject to the condition that such companies would divest 26% of their equity in favour of the Indian public in 5 years (provided these companies are listed in other parts of the world).

The above services would be subject to licensing and security requirements.

- FDI up to 100 per cent is allowed in the manufacturing of telecom equipment under the automatic route.

### Trading

100% FDI is permitted under the automatic route for wholesale cash and carry trading and trading for exports

100% FDI permitted with FIPB approval for –

- a) Trading of items sourced from small scale sector
- b) Test marketing of such items for which a company has approval for manufacture

51% FDI permitted with FIPB approval for Single Brand product retailing subject to the following conditions:

- i) Products to be sold should be of a 'Single Brand' only
- ii) Products should be sold under the same brand internationally
- iii) 'Single Brand' product-retailing would cover only products which are branded during manufacturing.

### Venture Capital Fund (VCF) and Venture Capital Company (VCC)

Offshore venture capital funds / companies are allowed to invest in domestic venture capital funds / companies subject to SEBI's investment norms and other regulations

## Investment through Global Depository Receipts (GDRs) / American Depository Receipts (ADRs) / Foreign Currency Convertible Bonds (FCCBs)

Indian companies are permitted to raise capital in the international market through the issue of GDRs/ADRs/FCCBs, subject to certain restrictions. Foreign investment through GDRs/ADRs/FCCBs is also treated as FDI.

Issue of ADRs / GDRs does not require any prior approvals (from Ministry of Finance / FIPB or RBI) except where the FDI after such issue would exceed the sectoral caps/ policy requirements, in which case prior approval from FIPB would be required.

Issue of FCCBs up to US\$ 500 million to a person resident outside India is allowed under the automatic route without requiring any prior approval from the Government or RBI: - Only companies listed on the stock exchange are allowed to raise capital through GDRs/ADRs/FCCBs. End use of FCCB proceeds have to comply with ECB norms. Any convertible instrument issued by a listed company, has to be mandatorily convertible or redeemable within 18 months.

## Mobilisation of Funds through Preference Shares

Companies registered in India can mobilise foreign investment through issue of preference shares for financing their projects / industries. Foreign investment through preference shares is treated as FDI. All preference shares have to be redeemed out of accumulated profits / fresh capital within a period of 20 years as per Indian Company Law. The proposals are processed either through the automatic route or FIPB route as the case may be.

The following guidelines apply:

- Foreign investment in preference shares is considered as part of share capital and falls outside the External Commercial Borrowings (ECB) guidelines/ caps. Issue of preference shares is permissible only as rupee denominated instrument in accordance with Indian Companies Act.
- Preference shares, carrying a conversion option, are considered as foreign direct equity for purposes of sectoral caps on foreign equity. If the preference shares are structured without conversion option, they fall outside the FDI cap.
- The dividend rate should not exceed the limit prescribed by

the Ministry of Finance (currently fixed at 300 Basis Points above State Bank of India's Prime Lending Rate)

- Duration for conversion shall be as per the maximum limit prescribed under the Companies Act (20 years) or what has been agreed to in the shareholders' agreement, whichever is less.
- Issue of preference shares should conform to guidelines prescribed by SEBI (in case of listed Indian companies), RBI and other statutory requirements.

## Mobilisation of Funds through External Commercial Borrowings (ECBs)

Companies registered in India (other than financial intermediaries<sup>4</sup>) are allowed to raise ECBs from any internationally recognised source such as banks, Financial Institutions, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity holders.

Non-Government Organisations (NGOs) engaged in micro finance activities are eligible to avail ECB subject to prescribed conditions. Overseas organisations and individuals may provide ECB to such NGOs subject to prescribed safeguards.

ECB can be raised from Foreign Equity holders holding the prescribed minimum level of equity in the Indian borrower company.

- ECB up to USD 5 million – minimum equity of 25% held directly by the lender;
- ECB more than USD 5 million – minimum equity of 25% held directly by the lender and debt-equity ratio not exceeding 4:1 (i.e. the proposed ECB not exceeding four times the direct foreign equity holding).

A Company can issue equity shares against ECBs in convertible foreign currency already due for payment / repayment, subject to meeting all applicable tax liabilities and procedures.

The prevailing ECB policy stipulates certain end-use restrictions.

### ECB proceeds can only be utilised for

- o import of capital goods, new projects, modernization / expansion. This window can be availed only for projects in real sector - industrial sector and infrastructure sector - in India. Rupee expenditure is permitted up to:

<sup>4</sup> Financial Intermediaries like banks and non-banking finance companies are not permitted to raise ECBs except in relation to financing the restructuring in certain specified sectors.

- USD 100 million for borrowers in infrastructure sector under approval route; and
- USD 50 million for other borrowers under approval route.
- o overseas acquisition by Indian Companies
- o 1st stage acquisition of shares in disinvestment process and in the public offer stage under the Government's disinvestment program.
- ECBs are not permitted for working capital/on-lending / investment in capital market / in real estate.
- Utilisation of ECB proceeds is not permitted for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate.

ECBs should be compliant with the prescribed minimum average maturities:

Minimum 3 years average maturity for ECBs equal to or less than US\$ 20 million equivalent, otherwise 5 years

'All-in-cost ceiling' has also been prescribed as given below.

- 3-5 years maturity                      200 basis points over 6-month LIBOR\*
- > 5 years maturity                    350 basis points over 6-month LIBOR\*

*\* for the respective currency of credit or applicable benchmark Guarantees / standby letter of credit by financial intermediaries are not permitted.*

The approval requirements for ECBs have been significantly liberalised. No prior approvals are required in respect of ECBs complying with the prescribed minimum maturity and "all-in-cost" ceilings. All other ECBs require prior approval from an empowered committee of RBI.

Indian corporates raising ECBs have to retain the funds abroad until the time of their utilisation.

The current guideline for prepayment of ECBs states that prepayment up to US\$ 500 million can be done without any approvals, subject to compliance with the minimum average maturity of the loan.

### Foreign Currency Exchangeable Bonds (FCEBs)

In FY 2007-08, the government notified the Foreign Currency Exchangeable Bonds Scheme for Issue of Foreign Currency Exchangeable Bonds (FCEB). The salient features of the Scheme are:

- FCEBs are bonds expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency.
- FCEB is issued by an Issuing Company which is part of the promoter group of a listed company whose equity is offered and which is engaged in a sector eligible to receive FDI (Offered Company) and holds shares in the Offered Company. The FCEB is subscribed to by a person resident outside India and is exchangeable into equity share of the Offered Company on the basis of any equity related warrants attached to debt instruments.
- The investment under the scheme is required to comply with the FDI policy as well as the ECB Policy requirements. The proceeds of FCEB are to be used in accordance with end uses prescribed under the ECB policy. The proceeds from such investments are not permitted to be utilized for investments in the capital market or in real estate in India.
- The proceeds of FCEB can be invested by the issuing company overseas by way of direct investment including in JVs or WOS subject to the existing guidelines on Indian Direct Investment in JVs or WOS abroad.

### Significant Exchange Control Regulations

Exchange control is regulated under the Foreign Exchange Management Act (FEMA), 1999. The Indian Rupee is fully convertible for current account transactions, subject to a negative list of transactions that are prohibited / require prior approval.

A foreign-invested Indian company is treated on par with other locally incorporated companies. Accordingly, the exchange control laws and regulations for residents apply to foreign-invested companies as well.

Under the FEMA, foreign exchange transactions have been divided into two broad categories - current account transactions and capital account transactions. Transactions that alter the assets or liabilities outside India of a person resident in India or in India, of a person resident outside India have been classified as capital account transactions. All other transactions would be current account transactions.

## Current Account Transactions

**Prior approval of the RBI is required for acquiring foreign currency above certain limits for the following purposes:**

- Holiday travel over USD 10,000 per person p.a.
- Gift over USD 5,000 / donation over USD 10,000 per remitter / donor p.a.
- Business travel over USD 25,000 per person per visit
- Foreign studies as per estimate of institution or USD 100,000 per academic year, whichever is higher
- Consultancy services procured from abroad over USD 1,000,000 per project
- Remittance for purchase of Trade Mark / Franchise
- Reimbursement of pre incorporation expenses over USD 100,000

**Certain specified remittances are prohibited:**

- Remittance out of lottery winnings
- Remittance of income from racing / riding etc. or any other hobby
- Remittance for purchase of lottery tickets, banned / prescribed magazines, football pools, sweepstakes etc
- Payment of commission on exports made towards equity investments in Joint Ventures/ Wholly Owned subsidiaries abroad of Indian Companies.
- Payment of commission on exports under the Rupee State Credit Route
- Payment related to “Call Back Services” of telephones

## Capital Account Transactions

Capital account transactions can be undertaken only to the extent permitted. RBI has prescribed a list of capital account transactions, which inter alia include the following:

- transfer or issue of any foreign security by a resident/ security by a non resident;
- borrowing/ lending in foreign exchange;
- export/ import of currency;
- transfer / acquisition of immovable property in / outside India;
- remittances exceeding USD 200,000 p.a. (over and above ceilings prescribed for other remittances mentioned above) by a resident individual for any current account or capital account transaction.

Under the Foreign Exchange Management Act, 1999 regulations, resident individuals are permitted to remit up to USD 200,000

per FY (Apr-Mar) for any permitted current or capital account transaction or a combination of both subject to specified terms and conditions. This is in addition to facility of foreign travel up to USD 25,000. All other transactions which are otherwise not permissible under FEMA and those in the nature of remittance for margins or margin calls to overseas exchanges / overseas counterparty are not allowed under the Scheme.

## Miscellaneous

**Repatriation of Capital:** Foreign capital invested in India is generally repatriable, along with capital appreciation, if any, after the payment of taxes due on them, provided the investment was on repatriation basis.

**Acquisition of immovable property in India:** Generally foreigners are not permitted to acquire immovable property except in certain cases, where the property is required for the business of the Indian branch / office / subsidiary of the foreign entity. NRI/ PIOs are also permitted to acquire certain properties (except agricultural land).

**Royalties and Technical Know-how Fees:** Indian companies that enter into technology transfer agreements with foreign companies are permitted to remit payments towards know-how and royalty under the terms of the foreign collaboration agreement, subject to limits (Please refer to Chapter 3).

**Dividends:** Dividends are freely repatriable after the payment of Dividend Distribution Tax by the Indian company declaring the dividend. No permission of RBI is necessary for effecting remittance, subject to specified compliances

**Other Remittances:** No prior approval is required for remitting profits earned by Indian branches of companies (other than banks) incorporated outside India to their Head Offices outside India. Remittances of winding-up proceeds of a branch / liaison office of a foreign company in India are permitted subject to RBI approval. Remittances of winding-up proceeds of a project office of a foreign company in India are permitted under the automatic route subject to fulfillment of necessary compliances.

## Netting

The RBI does not permit netting of payments for remittances and requires that all accruals from overseas be repatriated into the country.

## Outbound Investment Regulations

Direct Investment by Indian parties in Joint Ventures (JVs) and Wholly Owned Subsidiaries (WOS) abroad is encouraged. Such overseas investment by Indian parties can be made by way of setting up wholly owned subsidiaries, taking up equity in a joint venture company or for acquisition of overseas business, provided the overseas JV or WOS is engaged in a bona fide business activity.

Resident corporates and registered partnership firms can invest in a joint venture/wholly owned subsidiary abroad on an automatic basis, without prior reference to RBI up to a total value of investment not exceeding 400 per cent of its net worth (as on the date of last audited balance sheet of the investing company) provided:

- Investment is in a bona fide business activity;
- Investment is not in a foreign entity engaged in real estate or banking business.
- Automatic route is not available for investments by an Indian entity engaged in financial services sector or in a foreign entity engaged in financial services sector.

### **The funding of such investments can be by one or a combination of the following sources:**

- drawal of foreign exchange from an AD Bank in India;
- capitalisation of exports;
- swap of shares (valuation to be done by Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country);
- Balances in EEFC accounts of investing companies;
- Other domestic resources including loans, equity and other contingent liabilities like guarantees;
- Proceeds of ADR/GDR issues by investing company;
- Proceeds of ECB raised by the investing company.

The investment ceiling of 400 per cent of net worth does not apply where investment is made out of EEFC account balance or ADR/GDR proceeds.

Proposals for overseas investment not falling under the automatic route as given above, have to be referred to the RBI for prior approval.

A foreign company looking at setting up operations in India has the following alternative options for formulating its entry strategy:

### Operating as an Indian Company

Through:

- Wholly owned subsidiaries
- Joint Ventures

### Wholly owned Subsidiary company

A foreign company can set up a wholly owned subsidiary company in India for carrying out its activities. Such subsidiary is treated as an Indian resident and an Indian Company for all Indian regulations (including Income Tax, FEMA and Companies Act), despite being 100 per cent foreign owned. At least two members are mandatory.

### Joint Venture with an Indian Partner preferably with majority equity participation

Though a wholly owned subsidiary has been the most preferred option, foreign companies have also been setting up shop in India by forging strategic alliances with Indian partners. The trend in this respect is to choose a partner who is in the same field/area of activity and has sufficient experience and expertise in his line of activity.

The foreign investment guidelines for setting up an Indian subsidiary company or participating in a joint venture company with an Indian partner have been discussed in Chapter 3.

### Incorporation of a Company

#### **Incorporation of a company with the Registrar of Companies (“RoC”) is a two-step process:**

1. Obtaining approval from RoC for the name of the Indian Company. Minimum 4 alternative names are required to be given for consideration. The name of the company should clearly reflect the main objects of the company.
2. Drafting Memorandum and Articles of Association of the Company and obtaining Certificate of Incorporation.

### Operating as a Foreign Company

Through:

- Liaison Office
- Project Office
- Branch Office

### Liaison/Representative Office

Setting up a liaison or representative office is a common practice for foreign companies seeking to enter the Indian markets. Prior approval from RBI is required for setting up a Liaison Office followed by registration with the RoC. The role of such offices is limited to collecting information about the possible market and providing information about the company and its products to prospective Indian customers. Such offices act as “Listening and transmission posts” and provide a two-way information flow between the foreign company and the Indian customers. A liaison office is not allowed to undertake any business activity other than liaison activities in India and cannot, therefore, earn any income in India, in terms of the approval granted by RBI.

### Project Office

Foreign companies planning to execute specific projects in India can set up temporary project /site offices in India for this purpose. RBI has granted general permission to a foreign entity for setting up a project office in India, subject to fulfillment of certain conditions. The foreign entity only has to furnish a report to the jurisdictional Regional Office of RBI giving the particulars of the project / contract and register the Project Office with the RoC.

### Branch Office

Foreign companies engaged in manufacturing and trading activities abroad can set up Branch Offices in India for the following purposes, with the prior approval of RBI and subsequent registration with RoC:

- Export/Import of goods
- Rendering professional or consultancy services
- Carrying out research work, in which the parent company is engaged
- Promoting technical or financial collaborations between Indian companies and parent or overseas group company
- Representing the parent company in India and acting as buying/selling agent in India
- Rendering services in Information Technology and development of software in India
- Rendering technical support to the products supplied by parent/group companies
- Foreign airline/shipping company

In general, manufacturing activity cannot be undertaken through a branch office. Foreign companies can, however, establish branch office / unit for manufacturing in a SEZ subject to fulfillment of certain conditions.

## Registrar of Companies (ROC)

The ROC plays a crucial role in the governance of Companies Act, the nodal law on regulating companies doing business in India. The ROC is primarily responsible for:

- Ensuring adherence to the filing and registration requirements under the Companies Act
- Collecting and making publicly available information on companies registered within its jurisdiction
- Bringing non-compliant companies and officers to Court, where necessary

In a nutshell, the ROC has two distinct, but complementary roles – (i) facilitating business and commerce by providing a vehicle for the incorporation of companies, registration of documents and charges, and (ii) assisting in regulation of business and commerce by striking-off and/or prosecuting companies which fail to comply with their statutory obligations under the Companies Act.

*For more details, visit the website at <http://dca.nic.in>*

The law relating to income tax is contained in the Income Tax Act, 1961. There are specific statutes for other taxes. Central tax statutes are passed by the Parliament and state tax statutes by the State Assemblies. Tax rates and duties are reviewed annually when budgets/ Finance bills are presented. Amendments to the statutes are made through the annual Finance Acts or specific Amendment Acts every year. Finance Bill is enacted after it is approved by both houses of parliament and assented by the President of India. The Finance Act 2008 was notified on May 10, 2008.

This chapter gives an overview of the direct and indirect tax regime prevalent in India.

### Direct Tax

#### Rate of Tax

#### Corporate Tax

The Finance Act 2007 had specified the following rates, which have not been changed by the Finance Act 2008:

Company	Where taxable income exceeds INR 10 Million*	Other cases
Domestic company	33.99% (30% plus surcharge of 10% Plus education cess of 3%)	30.9% (30% plus education cess of 3%)
Foreign Company	42.23% (40% plus surcharge of 2.5% and education cess of 3%)	41.2% (40% plus and education cess of 3%)

\* Marginal relief is provided in cases where incremental tax liability exceeds incremental income.

#### Individual Tax

Residents / Not Ordinary Residents and Non Residents	Maximum effective rate of tax is 33.99% (30% plus surcharge of 10% and education cess of 3%), where taxable income exceeds INR 1 million p.a. Otherwise Maximum effective rate of tax is 30.9% (30% plus education cess of 3%).
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#### Dividend Tax

With effect from financial year 2003-04, dividend income is exempt in the hands of the shareholders. However, a dividend distribution tax @ 16.995 per cent (15% plus surcharge of 10 per cent and education cess of 3%) is levied on Companies

declaring dividend.

In order to mitigate the cascading effect of DDT, the Finance Act, 2008 provides that any dividend received by a domestic company during any financial year from its subsidiary shall be allowed to be reduced from the dividend to be paid/distributed/ declared by such domestic company, for the purpose of computation of DDT, provided the following conditions are fulfilled:

- The dividend so received by the domestic company had been subjected to DDT; and
- The domestic company is not the subsidiary of any other company.

#### Minimum Alternate Tax (MAT)

With an object to bring zero tax companies under tax net, MAT @ 10 per cent (plus applicable surcharge and education cess) of book profits is levied on companies whose tax payable under normal Income Tax provisions is less than 10 per cent of book profits. However, an exemption has been granted in case of profits of units set up under 100 per cent SEZ scheme in respect of income arising on or after April 1, 2005.

The effective MAT rate is as follows:

Company	Where taxable income exceeds INR 10 Million	Other cases
Domestic company	11.33%	10.3%
Foreign Company	10.557%	10.3%

A credit of such tax paid under MAT provisions by a company wef financial year 2005-06 shall be allowed against the tax liability which arises in subsequent seven years under the normal provisions of the IT Act.

## Capital Gains Tax

Particulars	Tax rates	
	Resident	Non-residents
Short Term capital assets (other than (b) below (Note 1))	Normal corporate / individual tax rates	Normal corporate / individual tax rates
Short term capital assets – being shares & units of equity oriented fund, which have been charged to Securities Transaction Tax (STT)	15%	15%
Long term capital assets- being listed shares in a co. or unit of an equity oriented fund, which have been charged to STT	Exempt	Exempt
Other long term capital asset	20%	20%
Surcharge and education cess, as applicable, would also be levied		

### Notes:

1. Short-term capital asset is one which is held for a period of less than three years (one year in case of shares/securities).

Indexation of cost of acquisition and improvement of a long-term capital asset of any nature is available to resident tax payers. However, the benefit of indexation is available to Non-residents only on long-term capital asset other than shares/debentures. Further, in case of long term capital assets-being listed shares in a company or unit of an equity oriented fund, which have not been charged to STT, the same may be taxed @ 10% (plus applicable surcharge and education cess) without giving any indexation benefit at the option of the taxpayer.

### Computation of Total Income – General

- All incomes accruing or arising in India are taxable in India subject to Double Taxation Avoidance Agreement with the country of residence of the person.
- Taxable income is computed for uniform accounting year, that is, the fiscal year from April 1 to March 31.
- The taxable income is called “Total Income”, which is computed after adding certain disallowances, such as loss on sale of asset and miscellaneous expenditure written off, and reducing certain allowances/benefits from the book profits.

## Depreciation

Depreciation is allowed separately at following rates for computing taxable income:

Factory Building	10%
Furniture & Fittings	10%
Plant & Machinery (general)	15%
Computers	60%
Motorcar, other than those used in a business of running them on hire	15%
Intangible assets (such as know how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature).	25%

For certain priority items, such as energy saving devices and pollution control equipment, depreciation is allowed at higher rates. Undertakings engaged in the business of generation or generation and distribution of power have the option to claim tax depreciation at the above-mentioned rates or on straight-line basis at rates prescribed under the Income-tax Rules, 1962. The rates vary from 1.95% to 33.40%.

In case of a new asset, depreciation for the full year is allowed only if the asset is put to use for 180 days or more during the fiscal year, otherwise depreciation is allowed only at half the prescribed rate.

Additional depreciation of 20% of actual cost of new plant and machinery is allowed in the year in which a new manufacturing industrial undertaking is set up or in the year of expansion of an existing manufacturing industrial undertaking.

### Incentive Provisions

#### Special Economic Zones (SEZs)

##### For units set up in SEZs

With effect from the assessment year (AY) 2006-07 (FY 2005-2006) undertakings set up in SEZs are eligible for income tax holiday for 10 years (100 percent exemption for first 5 years and 50 percent exemption for the next 5 years), on the profits derived from exports from the year in which such undertaking begins manufacturing or commences its business activities. Further, a deduction of 50 percent of profits is available for another 5 consecutive years, after the first 10 years, if certain conditions are met.

### **For developers of SEZs**

A 10-year tax holiday (10 consecutive Assessment Years out of 15 years) has been extended to undertakings involved in developing / developing and operating / maintaining and operating notified SEZs after March 31, 2006.

The salient features and benefits of the SEZ Scheme are given in Chapter 8.

For Offshore Banking Units (OBUs) set up in SEZs Banking Units in SEZ entitled to tax holiday of 100% for first 5 years and 50% for next 5 years. Similar deduction available to units of International Financial Services Centre

### **100% Export Oriented Unit (100% EOU) Scheme**

The 100% EOU Scheme was introduced by the Government in 1980 with a view to promote exports.

- o 100% EOUs are extended a host of incentives and facilities, including duty free imports of all types of capital goods, raw material, and consumables as well as tax deductions against export income.
- o These units are permitted to be set up for a varied range of business activities including manufacture, services, software development, agriculture, aquaculture, animal husbandry, floriculture, horticulture and sericulture.

Undertakings set-up in EOUs are eligible for a deduction of 100% of export profits derived therefrom for 10 years up to 31st March 2009.

The exemption from Minimum Alternate Tax enjoyed by these units has been withdrawn with effect from April 1, 2007.

The salient features and benefits of the EOU Scheme are given in Chapter 8.

### **Electronic Hardware Technology Park (EHTP) Scheme and Software Technology Parks of India (STPI) Scheme.**

In a bid to enhance the export potential of the electronics industry and develop an efficient electronic component and information technology industry, the EHTP and STP schemes have been announced which offer a package of incentives and facilities like duty free imports in line with the EOU scheme, deemed exports benefits and tax holidays. Export oriented IT enabled services like call center services, data processing, medical transcription etc. are also eligible to be registered under the STP scheme.

The Directors of STPs in respect of STP proposals and the Designated Officers in respect of EHTP proposals accord

approval subject to compliance with the set of conditions as are applicable to EOUs.

Undertakings set-up in EHTPs or STPs, are eligible for a deduction of 100% of export profits derived therefrom for 10 years up to 31st March 2010

The exemption from Minimum Alternate Tax enjoyed by these units has been withdrawn from April 1, 2007.

The salient features and benefits of the STPI Scheme are given in Chapter 8.

### **Setting up of Industrial Parks**

#### **For developers of Industrial Parks**

100% tax holiday is available to the developers of Industrial parks for any ten consecutive assessment years out of fifteen years beginning from the year in which the undertaking or the enterprise develops an industrial park, provided it the Industrial Park is notified on or before 31st March 2009.

#### **For units set up in Industrial Parks in specified States**

Income tax holiday and exemption from CENVAT for manufacture of specified goods is available for units set up in specified areas in the States of Uttarakhand and Himachal Pradesh and North east states subject to fulfillment of prescribed conditions.

### **Tax Holiday in Respect of Infrastructure Project /Power / Housing**

Undertakings engaged in prescribed infrastructure projects are eligible for 10-year tax holiday as set out below: -

- A "10-year tax holiday" in a block of 20 years will be extended to undertakings engaged in developing / operating and maintaining / developing, operating and maintaining infrastructure facilities like roads, bridges, rail systems, water supply projects, water treatment systems, irrigation projects, sanitation and sewerage systems or solid waste management system.
- A "10-year tax holiday" in a block of 15 years has also been extended to undertakings involved in developing / operating and maintaining, / developing, operating and maintaining, ports, airports, inland waterways or inland ports. Similar benefit to navigational channel in the sea. A similar exemption has also been extended to undertakings set up before March 31, 2010 for generation/ generation and distribution of power.

- A “10-year tax holiday” in a block of 15 years to undertakings which:
  - o is set up in any part of India for the generation or generation and distribution of power and begins to generate power before March 31, 2010; or
  - o starts transmission or distribution by laying a network of new transmission or distribution lines before March 31, 2010;
  - o undertakes substantial renovation and modernization of the existing network of transmission or distribution lines before March 31, 2010.
- A 10 year tax holiday to any undertaking carrying on business of laying and operating a cross country natural gas distribution network, including pipelines and storage facilities being an integral part of such network, subject to certain specified conditions. The deduction would be available for 10 consecutive years in a block of 15 years beginning with year in which the undertaking lays and begins to operate the cross country natural gas distribution network.

### Tax Holiday in respect of other Facilities

A 100% tax holiday for first 5 years and a deduction of 30% (25% in case the assessee is not a company) of profits for the next 5 years has been extended to undertakings engaged in the business of processing, preservation & packaging of fruits & vegetables or in the integrated business of handling storage and transportation of food grains, starting operation on or after April 1, 2001.

A 100% tax holiday for a period of 10 consecutive years is available to a company carrying on scientific research & development subject to fulfillment of certain conditions. The time limit for obtaining approval from the prescribed authority is up to March 31, 2007.

If certain conditions are met, deduction is available of one and one-half times of scientific research expenditure incurred by a company on an approved in-house R&D facility by a company engaged in the business of bio-technology or in the manufacture or production of drugs, pharma, electronic equipments, computers, telecom equipments etc. This weighted deduction is available till Financial year 2006-07. The Finance Act, 2007 has extended this benefit upto FY 2011-12.

The Finance Act, 2008 has allowed a weighted deduction of one and one fourth times of any sum paid for scientific research to a domestic company, if such company, has as its main object the scientific research and development; is approved by the

prescribed authority, in the prescribed manner; and fulfils such other conditions as may be prescribed.

### Hotels and Convention Centers

The Finance Act, 2007 provides a 5 year 100% tax holiday commencing from the initial year (subject to certain conditions) in respect of profit derived from the business of hotels (two, three and four star) and convention centers located in specified areas. This tax holiday would be available provided the construction is completed and operations are started during the period April 1, 2007 to March 31, 2010.

The Finance Act, 2008 has provided a 5 year tax holiday in respect of profits derived from the business of new Two star, Three star and Four star category hotels located in specified district having a World Heritage Site. The hotel should start functioning between April 1, 2008 and March 31, 2013.

### Hospitals

The Finance Act 2008 provides a 5 year tax holiday in respect of profits derived from business of operating and maintaining hospital located anywhere in India (other than the excluded area), subject to fulfillment of certain conditions. The hospital should start functioning between April 1, 2008 and March 31, 2013.

Taxation of Know-how Fee in the Hands of Foreign Companies Under domestic law, the royalties/technical fees payable to non residents having a permanent establishment in India are taxed on net basis. On the other hand, the royalties/technical fees payable to non residents not having a permanent establishment in India are taxed on gross basis. Concessional tax rates, as given below, apply if the agreement relates to a matter included in industrial policy or the agreement has been approved by the Government of India:

For Contracts entered on or after 1st June 2005	10%
For contracts entered into after 31st May 1997 but before 1st June 2005	20%
For contracts entered into on or before 31st May 1997	30%

Surcharge and education cess as applicable would also be levied.

### Fringe Benefit Tax

An additional tax termed as “Fringe benefit tax” has been introduced with effect from Financial Year 2005-06. It provides for levy of an additional tax @ 30% (plus applicable surcharge

and education cess) in the hands of the employer on the taxable value of fringe benefits provided to the employees other than perquisites on which tax is paid / payable by the employee.

### Commodities Transaction Tax

- A new tax called CTT has been introduced by Finance Act 2008. CTT is applicable on taxable commodities transaction entered in a recognized association.
- The tax is proposed to be levied at the following rates on the transactions undertaken by the seller or purchaser, as the case may be:

Taxable commodities transaction	Rate	Payable by
Sale of an option in goods or an option in commodities derivative	0.017% of option premium	Seller
Sale of an option in goods or an option in commodities derivative, where option is exercised	0.125% of the settlement price of the option	Purchaser
Sale of any other commodity derivative	0.017% of the price at which the commodity derivative is sold	Seller

### Double Tax Avoidance Conventions

Double Tax Avoidance Treaties override the Indian Income-tax Act provisions to the extent they are more beneficial to the Assessee (concessional tax rates applicable under certain double tax avoidance conventions that India has signed with various countries is given in a tabular form under Annexure 3).

Relief is granted in respect of income chargeable to tax, both under the Income Tax Act of India and the Income Tax laws in that other country, in order to promote mutual economic relations, trade and investment.

### Advance Rulings

To facilitate proper planning and to avoid any future disputes under the Income Tax Act, a non-resident can approach the high-powered Authority for Advance Rulings ("AAR") to determine the income tax aspects of any proposed or current transaction. Advance ruling can also be sought by a resident to determine the tax liability of a non-resident with whom a transaction has been undertaken or proposed to be undertaken.

With effect from 1 October 1998, certain notified residents may also apply to the Authority for Advance Rulings to seek a ruling in respect of issues relating to computation of total income. Such advance rulings would be binding on the person seeking it in relation to the transaction and the Income Tax department cannot challenge the same unless there is some change in the facts or law affecting that transaction.

The AAR has been constituted under the Income-tax Act, 1963 in order to help taxpayers plan their income-tax matters well in advance and to avoid long drawn out and expensive litigation. A non-resident applicant can seek advance ruling on any question of law or fact in relation to a transaction, which has been undertaken or is proposed to be undertaken by the non-resident applicant.

For more details, visit the website at <http://finmin.nic.in>

### Central Board of Direct Taxes (CBDT)

The CBDT is a statutory authority formed under the Central Board of Revenue Act, 1963. It governs matters relating to levy and collection of direct taxes, and formulation of policy concerning administrative reforms and changes for the effective functioning of Income-tax Department.

For more detail, visit the website at [http://finmin.nic.in/the\\_ministry/dept\\_revenue/cbdt/](http://finmin.nic.in/the_ministry/dept_revenue/cbdt/)

## OTHER DIRECT TAXES

### Wealth Tax

Wealth tax is charged in respect of the net wealth as on March 31st every year (referred to as 'valuation date'). Wealth tax is charged both on individuals and companies at the rate of 1% of the amount by which the 'net wealth' exceeds INR 1.5 million (approx. US\$ 25,000). The term 'net wealth' broadly represents excess of prescribed assets over the concerned debts. Prescribed Assets include guest house & residential house, motor cars, jewellery-bullion-utensils of gold & silver etc., yachts, boats, aircraft, urban land & cash in hand. A debt is an obligation to pay liquidated or certain sum of money incurred in relation to those assets, which are included in the 'net wealth'.

### Transfer Pricing

Detailed provisions relating to transfer pricing had been introduced by the Finance Act, 2001 in order to facilitate the computation of reasonable, fair and equitable profits and tax

in India in the case of businesses carried on by multinational companies. Simply put, Transfer Pricing is the process of adjusting the prices of cross-border transactions between related / associated parties. The transfer pricing provisions generally follow the OECD guidelines relating to the same. However, there are certain fundamental differences in that the Indian provisions require the computation of an “arms length price” as against the internationally accepted norm of arms length range. Further the arms length price is to be computed as the “arithmetic mean” of comparable results. A variance of around 5% of the mean may be opted for.

The new Section 92 of the Income Tax Act, 1961, provides that the price of any transaction between associated enterprises, either or both of whom are non resident for tax purposes (‘international transaction’), shall be computed having regard to the arm’s length principle.

Two enterprises are considered to be associated if there is direct/indirect participation in the management or control or capital of an enterprise by another enterprise or by same persons in both the enterprises.

In determining whether there is participation in management or control, various factors are taken into consideration including:

- Direct / indirect shareholding having 26% or more of voting power
- Advancing of loans of 51% or more of total assets
- Appointment of more than 50% of the board of directors,
- Goods manufactured are sold under influenced prices
- Dependence on IPRs owned by either party

### Determination of “arms length price”

A very important aspect of the concept of Transfer Pricing is the process of determining the arm’s length price. The Central Board of Direct Taxes (CBDT) has prescribed five methods for determining the arm’s length price.

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost plus method
- Profit Split Method
- Transactional Net Margin Method

The choice of the appropriate method is determined with respect to the nature and class of transaction, the classes of associated persons, the functions performed by them and other relevant factors.

### Burden of Proof and Assessment

The burden of proving that the international transactions are in accordance with the arms length principle lies with the taxpayer. For this purpose, the Income Tax Act requires the maintenance of prescribed information and documents relating to international transactions undertaken between associated enterprises. Failure to do so attracts very stiff penalties.

Also, it is mandatory to obtain an accountant’s certificate in a prescribed format in respect of all international transactions between associated enterprises. Such report would have to contain prescribed particulars of the transaction, and would have to be filed with the tax authorities by October 31 (in case of companies) of the relevant assessment year, along with the tax return.

Once the accountants certificate has been filed with the tax return, the concerned tax officer may call for the prescribed documentation in the assessment proceedings. Based on available information, the tax officer may adjust or recompute the prices used in international transactions. Such an adjustment would attract tax and interest on the additional amount. Potentially, a penalty of 100% to 300% of the tax on the adjusted amount could also be levied.

With the approval of the commissioner of income tax, the tax officer may refer the case for a detailed review to specially appointed Transfer Pricing Officers (TPO). The order of such TPO would have to be considered by the Assessing officer in finalising this assessment.

### INDIRECT TAXES

#### Customs Duty

Customs or import duties are levied by the Central Government of India on the goods imported into India or exported from India. The rate at which customs duty is leviable on the goods depends on the classification of the goods determined under the Customs Tariff. The Customs Tariff is generally aligned with the Harmonised System of Nomenclature (HSN).

The peak rate of BCD is currently pegged at 10% for all goods other than agricultural and other specified products.. However, the Central Government has the power to generally exempt goods of any specified description from the whole or any part of duties of customs leviable thereon. In addition, preferential/

concessional rates of duty are also available under various Trade Agreements.

The customs duties are levied on the transaction value of the imported goods. General principles adopted for valuation of the goods under the Customs Act are in conformity with the WTO agreement on customs valuation.

The types of customs duties applicable are as follows: -

- Basic Customs Duty (BCD) - this is calculated at the effective rate applied to the landed value of the goods, which comprises the CIF value of the goods and the landing charges (i.e. 1% of the CIF value of the goods).
- Additional Customs Duty in lieu of excise or Countervailing Duty (CVD) is equivalent to the excise duty applicable on like goods manufactured in India. This is calculated on the landed value and the basic customs duty. However, on most of the consumer goods intended for retail sale, duty is calculated based on the Maximum Retail Price (MRP) printed on their packs. The Finance Act 2008 has reduced the peak rate of excise duty, and consequently the rate of CVD, to 14% w.e.f March 1, 2008. In addition, Education Cess (EC) @ 2% and Secondary and Higher Education Cess (SHEC) @ 1% are also levied on the CVD. Computers are chargeable to additional duty in terms of the Customs Additional Duty Rules, 2004.

In addition to the above, Education Cess (EC) @2% and Secondary and Higher Education Cess (SHEC) @ 1% are also levied on the aggregate of duties of customs (except safeguard duty, countervailing duty and antidumping duty).

Goods attracting customs duties at bound rates under international commitments (for example, IT Agreement, Indo-US Textile Agreement) have been exempted from this cess.

- Additional Duty of Customs in lieu of Sales Tax/VAT (ADC): In addition, all imports are chargeable to an additional duty of customs @ 4% in lieu of sales tax/VAT with few exceptions. The exemptions inter alia include:
  - o Goods which are fully exempt from basic customs duty and Additional Duty of Customs in lieu of excise.
  - o Goods for export promotion schemes under which imports are allowed at zero duty.
  - o Imports by 100% EOUs and units in EHTPs/STPs or SEZs.
  - o DTA clearance of 100% EOUs / EHTPs / STPs / SEZ units, provided such goods are not exempt from sales tax /VAT.

ADC is calculated on the aggregate of the assessable value of the imported goods, the total duties of customs (i.e. BCD and CVD) and the applicable EC & SHEC.

With effect from 14/09/2007, the Central Government has introduced a refund mechanism in relation to the ADC paid on imported goods. The notification issued in this regard provides that the ADC paid @ 4% in relation to goods imported for the purpose of trading in India would be available as a refund to the importer by the customs authorities at the port of import subject to fulfillment of the conditions prescribed under the notification.

Authority for Advance Rulings (AAR) gives advance rulings on issues related to customs duties for setting up a joint venture in India. The Finance Bill 2005 brought about the following amendments in the Advance Ruling provision.

- Facility of seeking an advance ruling to be made available to an existing Joint Venture in India.
- Central Government to be empowered to notify any class or category of person as eligible for availing the benefit of an advance ruling.
- Advance rulings may also be sought with regard to determination of the Rules of Origin of goods and matters relating thereto.

### CENVAT (Excise Duty)

Central Value Added Tax (CENVAT) is a duty of excise levied by the Central Government on manufacture or production of movable and marketable goods in India. The duty is levied at the rates specified in the Excise Tariff. The two types of excise duties that may be levied are the Basic Excise Duty (BED) and Special Excise Duty (SED). The SED is levied only on the class of goods like cars, and aerated waters meant for consumption by the affluent class.

The rate at which excise duty is leviable on the goods depends on the classification of the goods under the Excise Tariff. The Excise Tariff is primarily based on the Harmonised System of Nomenclature (HSN). The Government has w.e.f. April 1, 2005 adopted an eight digit classification under the Excise Tariff so as to bring it in conformity with the Customs Tariff.

The excise duty on most of the consumer goods, which are intended for retail sale is chargeable on the basis of the Maximum Retail Price (MRP) printed on the package of the goods. However, abatements are admissible at the rates ranging from 20% to 50% are admissible from the MRP for the purposes

of charging BED as well as SED. The other goods are generally chargeable to duty on the 'transaction value' of the goods sold to an independent buyer. In addition, the Central Government has the power to fix tariff values for charging ad valorem duties on the goods.

Under the rationalized structure, the three duty rates comprising of BED and SED under the rationalised structure are Nil, 8%, 12% and 14%. In addition, there are some goods which attract a CENVAT of 24%. The Finance Act 2008 has reduced the peak CENVAT rate from 16% to 14%. In addition there are general exemptions granting partial or complete exemption to specified goods from payment of excise duties. The education cess @ 2% and SHEC @ 1% are also applicable on the aggregate of excise duties.

The central excise duty is a modified VAT wherein a manufacturer is allowed credit of the excise duty paid on locally sourced goods and the CVD and ADC paid on imported goods. The CENVAT credit can be utilised for payment of excise duty on the clearance of dutiable final products manufactured in India. The Finance Act 2004 has also introduced the integration of goods and services tax. Therefore manufacturers of dutiable final products would also be eligible to avail CENVAT credit of the service taxes paid on input services used both in or in relation to manufacture of final products and clearances of final products from the place of removal. In addition, CENVAT credit would be admissible on the following input services:

- Services used in relation to setting up, modernization, renovation or repairs of a factory or a premises of a service provider or an office relating to such factory
- Advertisement or sales promotion services
- Services in relation to procurement of inputs
- Activities relating to management of business such as accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry and security.

Authority for Advance Rulings (AAR) gives advance rulings on issues related to excise duty for setting up a joint venture in India. The proposed amendments discussed earlier would be applicable to excise and service taxes as well.

### Sales Tax

Sales tax is levied on the sale of virtually all movable goods in India at the Central or State level. Indian regulatory framework has granted power to State Legislature to levy sales tax on goods sold within that State. Such sales are, therefore,

chargeable to sales tax/VAT at the rates applicable under the sales tax/VAT law of the relevant State.

All goods sold in the course of interstate trade are subject to Central Sales Tax (CST) and the current rate of CST is either 3% or the State sales tax rate, whichever is higher. Where goods are bought and sold by registered dealers, for use as inputs in the manufacture of other goods or activities (such as mining or telecommunication networks), the rate of sales tax is 4%, provided Form 'C' is issued by the purchasing dealer. In the absence of Form 'C', the applicable rate would be rate of VAT on such goods in the originating State.

CST is sought to be phased out by the year 2010. While the rate of CST was reduced from 4% to 3% w.e.f April 1, 2007, the Central Government has proposed to further reduce the rate of CST from 3% to 2% once the Centre and the States have reached an agreement on the compensation for revenue losses, if any, consequent to the reduction in the CST rate. This proposal is in line with the proposed phase out of the CST by 1 April 2010. In the interim, CST continues to coexist with the State VAT. Inter State procurement, on which CST is charged by the originating State is not eligible for input tax credit.

### VAT

State level sales tax was replaced by Value Added Tax w.e.f. April 1, 2005 in a majority of Indian states. Further, the sales tax regimes in the the States of Tamil Nadu and Puducherry were replaced with VAT from January 1, 2007 and June 1, 2007 respectively. The State of Uttar Pradesh has implemented VAT w.e.f. January 01, 2008. Accordingly, the sales tax legislations in force in these States now stand repealed. With the introduction of VAT in the State of Uttar Pradesh, the process of replacement of State level sales tax with VAT has been completed.

- Under the VAT regime the VAT paid on goods purchased from within the State will be eligible for VAT credit. The input VAT credit can be utilized against the VAT/Central Sales Tax (CST) payable on the sale of goods. It is thus ensured that cascading effect of taxes is avoided and only the value addition is taxed.
- Currently, there is no VAT on imports into India. Exports are zero rated. This would mean that while exports are not charged to VAT, VAT charged on inputs purchased and used in the manufacture of export goods is available to the purchaser as refund.
- The State VAT is charged on uniform tax rates of 1%, 4% and 20%. Goods other than those notified to be covered under the above rates are charged at a Revenue Neutral

Rate (RNR) of 12.5%. Most goods will thus be charged at this RNR.

- Turnover thresholds have been prescribed so as to keep out small traders from the ambit of the VAT. A tax under composition schemes at a lower rate may be levied on such small traders in lieu of the VAT.
  - VAT registered dealers need to issue serially numbered invoices with prescribed particulars.
  - The periodicity of filing of VAT returns will remain the same as prescribed in the erstwhile sales tax regime.
  - A comprehensive self assessment of VAT has been introduced.
  - Turnover taxes, surcharges, additional surcharges and the special additional tax have been abolished, excepting certain States such as Gujrat and Kerala.
  - Entry taxes will continue, if vatable, except where they are in lieu of octroi.

Budget 2006 had taken a major step by indicating the date of 1st April, 2010 for the introduction of a national, integrated Goods and Services Tax (GST). Budget 2007 has reiterated the commitment towards introduction of the GST by the said date. The Empowered Committee of State Finance Ministers is working with the Central Government in order to introduce GST by the above date. In this regard, a Joint Working Group (JWG) was constituted by the Empowered Committee to study global GST models and identify suitable models for introduction in India. The JWG submitted its report in November 2007 to the Empowered Committee for its consideration.

### Octroi Duty / Entry Tax

'Entry Tax' is a tax on entry of goods into the State from outside the State for use, consumption or sale therein. Entry tax continues to exist under the VAT regime, though in most States it has been made vatable and can be set-off against the output VAT liability in the State. The only exception is where entry taxes have been imposed in lieu of Octroi.

Entry tax is leviable on purchase value defined to mean the amount of the valuable consideration paid or payable by a person for the purchase of any goods. The value of the specified goods can be ascertained from the original invoice for purchase of such goods.

Octroi is a municipal levy which is levied at the time of entry of specified goods into the limits of the relevant Municipal Corporation. Thus, Octroi can be leviable, if there is movement of goods from one city to another in the same State, in the

event the cities fall under the jurisdiction of two different Municipal Corporations.

### Stamp Duty

Stamp duty is levied at various rates on documents such as bills of exchange, promissory notes, insurance policies, contracts effecting transfer of shares, debenture, and conveyances for transfer of immovable property. Transfer of shares in India is subject to a stamp duty levy @ 0.25% on market value.

### R&D Cess

R&D Cess of 5% is levied on all payments made for import of 'technology'. The term 'technology' includes import of designs, drawings, publications and services of technical personnel (the amount leviable to cess includes technical personnel's living costs in India).

### Service Tax

Service tax is levied on specified 'taxable services' rendered in India at the rate of 12% of the gross value of taxable services. In addition an EC @ 2% and SHEC of 1% is also leviable. Thus the effective rate of service tax is 12.36%. Service tax is currently leviable on about 100 services identified under Chapter V of the Finance Act, 1994 (the Act).

The Finance Act 2008 has amended the scope of some existing categories of taxable services and included the following new categories of services within the net of service tax:

- services provided in relation to information technology;
- software for use in the course or furtherance of business or commerce (such as software development);
- up-gradation including right to use IT software for commercial exploitation and IT software supplied electronically;
- asset management services under unit linked insurance business plans;
- services of a recognized stock exchange in relation to securities;
- services of a recognized association or a registered association in relation to sale or purchase of any goods or forward contracts;
- services of a processing and clearing house in relation to processing, clearing and settlement transactions in securities, goods or forward contracts;
- services in relation to transfer of right to use tangible goods not chargeable to sales tax/VAT (such as charter hire of vessels and equipment); and
- Internet telecommunication services (the earlier category

of internet telephony services has been replaced by this category)

The taxability of the above services will come into effect from May 16, 2008, as notified by the Finance Act, 2008.

Further, the threshold limit of service tax exemption for small service providers has been increased from the present level of INR 8 lakhs to INR 10 lakhs with effect from April 1, 2008. Consequently, the limit for obtaining service tax registration has also been increased vide the Finance Act 2008 from INR 7 lakhs to INR 9 lakhs.

The Service Tax Rules, 2004 provides that service recipients, liable to pay service tax, receiving services in more than one premise or office, and having a centralized billing or accounting system can opt for centralized registration by making an application to the Commissioner of Central Excise within whose jurisdiction the premise or office, from where the centralized billing or accounting is done, is located.

Service tax was earlier charged on the gross value of the services which have been rendered. The Central Government has introduced the Service Tax (Determination of Value) Rules, 2006. The highlights of these rules are detailed below:

- Where the consideration received for taxable service is not wholly or partly in money, the value of taxable service would be equal to the gross amount charged by the service provider for similar service as sole consideration to any other person.
- Where such value of similar service is not available, the value of taxable service shall be determined by the service provider and shall not be less than the cost of provision of such services.
- Any expenditure or costs incurred in providing taxable services shall be included in the value of such services.
- Only such expenditure as is incurred as a pure agent of the service receiver shall be excluded from the value of taxable services.
- In case of services imported into India, the value of taxable services will be equal to the actual consideration charged.
- The Central Excise Officer has powers to question the valuation of such services and to re-determine the value after giving reasonable opportunity of being heard to the assessee.

In light of the integration of goods and services tax brought into existence through the Finance Act, 2004, a service provider can avail CENVAT credit of excise duties paid on capital goods and

inputs used for providing output services, apart from availing CENVAT credit of the service taxes paid on input services. The CENVAT Credit Rules have been further amended vide Finance Act, 2008 to provide, with effect from April 01, 2008, the following options to a provider of both taxable and exempt output services, using common inputs or input services and opting not to maintain separate accounts as was required earlier:

- either reverse the credit attributable to the inputs and input services used for providing exempted service, to be worked out in a manner prescribed in the rules; or
- pay 8% amount of the value of the exempted services, as determined in terms of the provisions of the Finance Act, 1994.

Further, the Finance Act 2008 has also prescribed a procedure to enable the provider of output services to take credit on inputs and capital goods on the basis of an invoice/challan/bill issued by its other office (effective April 1, 2008)

The services provided from outside India to a recipient in India are taxable services in terms of the Services (Provided from Outside India and Received in India) Rules, 2006 and hence subject to service tax. In terms of these Rules where the taxable services are provided from outside India and received in India, the service recipient is required to get registered and to pay the tax in accordance with the relevant provisions of law. The taxable services under these rules shall not to be treated as output services for the purpose of availment of CENVAT credits on inputs/input services.

Also, the Central Government has vide Export of Service Rules, 2005 (Export Rules) provided that no service tax is chargeable on export services. The benefit of exemption from service tax would be available on exported services, subject to the fulfillment of the the conditions prescribed under the Export Rules..

With effect from March 1, 2008, the Export Rules, 2005 have been modified so as to grant the benefit of exports to certain services namely, management, maintenance and repair services, technical testing and analysis services and technical inspection and certification services, subject to the condition that these services are provided remotely through the internet or any electronic network including a computer network in relation to goods or materials or any immovable property situated outside India at the time of provision of service. As a parallel measure, a simultaneous amendment has been made in the Taxation of Services (Provided from Outside India and Received in India)

Rules, 2006 with effect from March 1, 2008 to tax similar services under the reverse charge mechanism.

As an alternative, the service provider can also discharge the service tax on exports and claim a rebate of the service tax paid.

In addition to the rebate of tax paid on the exported services, rebate/refund provisions has also been notified with regard to the service tax paid on input services and excise duty paid on input goods used in providing the exported services.

E-payment of service tax has been made mandatory for certain categories of large assesseees w.e.f October 1, 2006.

### **Central Board of Excise and Customs (CBEC)**

CBEC is part of the Department of Revenue under Ministry of Finance, Government of India. It is responsible for formulation of policy concerning levy and collection of Customs and Central Excise duties, and administration of matters relating thereto.

The CBEC is the administrative authority for its subordinate organisations like Custom Houses, Central Excise Commissionerates and the Central Revenues Control Laboratory.

For more details, visit the website at [www.cbec.gov.in](http://www.cbec.gov.in)

### **Some other Indirect Taxes**

Some states also provide for levies such as :

- Works Contract Tax - Tax imposed on the value of goods transferred in the execution of a works contract.
- Turnover Tax - Tax imposed on the value of turnover in excess of a certain limit.
- Purchase Tax - Tax imposed on the value of goods purchased from unregistered dealers.

The thrust of the Government's incentive schemes is towards development of infrastructure, information technology and promotion of exports. This chapter outlines the features and benefits of the following four main incentive schemes:

- Scheme for Export Oriented Units
- Special Economic Zones
- Software/Hardware Technology Park Scheme
- Industrial Parks

### 100% Export Oriented Units (EOUs)

The 100% Export Oriented Units (EOU) scheme is a scheme focusing on promotion of exports through grant of various incentives and benefits to registered industrial units. Since its launch, the scheme has yielded far-reaching results and has re-triggered India's economic growth through increased exports and FDI.

#### What is an EOU?

A 100 per cent EOU is an industrial unit operating under customs bonding, which has undertaken to export its entire production of goods and services, except permissible sales in Domestic Tariff Area (DTA). Such units may be engaged in export of all kinds of goods & services (barring trading activities) including repair, remaking, testing, calibration, quality improvement, up-gradation of technology and re-engineering activities, etc for export in freely convertible foreign currency (subject to prescribed conditions).

#### Can a DTA Unit convert to EOU?

- » An existing DTA unit may also apply and convert into an EOU
- » No concession in duties and taxes will be available for plant, machinery and equipment already installed

#### Salient Features of EOU scheme

- No licence required for import.
- No export / foreign exchange earning commitment - to be positive net foreign exchange earner (NFE) cumulatively over initial 5 years
- Duty free goods (other than capital goods & spares) to be utilized in two years. Further extension possible.
- 100 per cent EOUs can sell goods / services locally against

payment in foreign exchange.

- Upto 50 per cent of exports value can be sold locally with concessional duties and taxes (subject to positive NFE).
- Supplies from the DTA to EOUs regarded as 'deemed exports', entitling DTA suppliers to certain export benefits.

#### FDI Policy

- 100 per cent FDI permissible.
- Exemption from industrial licensing requirement for items reserved for SSI sector.

#### Income-tax Incentives

- Tax holiday on export profits till March 31, 2010.
- Exemption from Minimum Alternate Tax, enjoyed by these units, has been withdrawn with effect from financial year 2007-08.

#### Indirect tax Incentives

- Nil import duty
- Nil Excise Duty on procurement of goods from the DTA.
- Reimbursement of Central Sales Tax (CST) paid on inter-state purchases from DTA.
- Reimbursement of duty paid on furnace oil, procured from domestic oil companies, as per the notified drawback rates.

#### Liberal Exchange Controls

- 100 per cent export earnings maintainable in Dollar A/c - minimal restrictions on business payments outside India from dollar balances.
- Extended credit period (1 year) for export realization.
- Re-export of defective imports / imports on loan basis permitted without G.R<sup>5</sup> waiver.

<sup>5</sup> for every export of goods from India, the exporter is required to give a declaration in Form G.R regarding the correctness of the value of exports stated in the invoice, as also an undertaking to realise and repatriate the same to India within the prescribed time period. Besides certain prescribed exemptions, every other case of non-furnishing of declaration requires a formal waiver from RBI.

## Other Incentives

- Sub-contracting permissible
- Inter-unit transfer of goods / services permitted
- Capital goods may also be transferred / given on loan basis to other EOUs (with prior permissions).
- Scrap / waste / remnants / unutilised materials / surplus or obsolete capital goods may be exported or sold in the DTA on payment of duties.
- Job work on behalf of domestic exporters for direct export allowed.
- EOUs permitted to:
  - Export goods for holding / participating in overseas exhibitions
  - Export goods for display / sales in permitted shops overseas
  - Set-up show rooms / retail outlets at International airports

## Procedures

- All applications should be in the prescribed form and submitted to the Development Commissioner (DC) along with a demand draft of INR 5,000/- (approx US\$ 116) drawn in favour of “the Pay & Accounts Officer, Department of Commerce, Ministry of Commerce and Industry” payable at New Delhi.
- Proposals which satisfy the following conditions, are eligible for a fast-track approval (within 2 weeks) from the Development Commissioner:
  - Activity proposed does not attract compulsory licensing or falls under services sector, except software and IT-enabled services;
  - Location is in conformity with the prescribed parameters;
  - Units undertake to achieve positive net foreign exchange earnings;
  - Unit is amenable to bonding by Customs Authorities.
- Proposals which do not satisfy the above conditions are sent by the Development Commissioner for further consideration by the Board of Approvals, which conveys its decision within 45 days.

## Special Economic Zones (SEZs)

**Special Economic Zones (SEZ)** is a policy initiative devised by Indian Government to liberalise the trade and investment environment in India. The Indian SEZ Policy focuses on creation of an internationally competitive and hassle-free environment

for exports. It is rated as the most visionary, ambitious and far-reaching initiative of the Indian government.

At present there are more than 40 operational SEZs in India. Over 207 SEZs have been notified and around 601 are in various stages of approval

### What is an SEZ?

An SEZ is a specifically delineated, duty free area notified as such by the Ministry of Commerce under the Special Economic Zones Act, 2005 ('SEZ Act') which is considered to be outside the customs territory of India for the purposes of carrying out authorized activities.

### Development of SEZs

SEZs are notified by the Ministry of Commerce and can be set up by private developers or by Central / State Governments, or jointly by any two or more of the above on a contiguous, vacant land. The Zones are required to have a minimum area which is as under:

Type	Total Area
Multi- product	Minimum area requirement: 1000 hectares (200 hectares in specified areas*). Maximum area capped at : 5000 hectares)
Multi – services	100 hectares ( 50 hectares in specified areas*)
Sector specific	100 hectares ( 50 hectares in specified areas*)
Port/ Airport based SEZ	100 hectares
Gems & Jewellery Sector Specific SEZ Biotech & Non-conventional Energy	10 hectares and minimum built up processing area of 50,000 sq.meters.
Sector Specific SEZ	10 hectares and minimum built up processing area of 40,000 sq.meters.
IT Sector Specific SEZ	10 hectares and minimum built up processing area of 100,000 sq.meters
Free Trade & Warehousing Zone	40 hectares and minimum built up processing area of 100,000 sq.meters

\*Specified areas are Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Tripura, Himachal Pradesh, Uttranchal, Sikkim, J&K, Goa and UTs.

### Who should set up a unit in SEZ?

Export oriented manufacturers and service providers (including

IT and ITES providers, BPOs, contract manufacturers, etc.) have huge growth potential in Indian SEZs. IT hardware and software and telecom equipment suppliers can also set up units in SEZs for supply to domestic market.

### FDI Policy

100 per cent FDI permitted under automatic route for developing the Zone. For units in SEZs, FDI Policy of Government of India will apply.

### Income Tax incentives

#### For developers of SEZs

##### Income Tax Incentives

- 100% tax deduction for 10 years out of 15 years beginning with the year in which the SEZ is notified by the government
- Exemption from Dividend Distribution Tax
- Exemption from Minimum Alternate Tax

### Indirect Tax Incentives

- Exemption from customs duty on import of capital goods/raw material into the SEZ for authorized operations;
- Exemption from excise duty on local procurement of capital goods/raw materials;
- Exemption from CST on inter-State purchases subject to submission of statutory declaration Form I;
- Exemption from payment of service tax on the input services which are procured by SEZ unit;
- In addition, goods sold from DTA units to the SEZ unit would attain the status of physical exports. In light of this, the sale of goods to a SEZ unit will be regarded as 'exports' and the DTA unit will be eligible for export benefits as admissible under the FTP;
- Exemption from ADC in lieu of sales tax/VAT on goods manufactured within the SEZ unit and sold to Domestic Tariff Area (DTA).
- Exemption from VAT as per State Government policy;
- Exemption from payment of stamp duty as per State Government policy

#### No minimum export obligation

- SEZ units to be net foreign exchange earners at the end of 5 years calculated cumulatively
- No limit on DTA sales provided full import duty is paid

- Supplies of IT hardware and software and telecom equipment to domestic markets, supply of goods and services to other SEZ/EOU/STPI units are counted towards calculation of foreign exchange earning.

### Fiscal benefits to a SEZ Unit

- 15 year income-tax deduction on export profits beginning with the year in which the unit begins to manufacture, produce or provide services – 100% for initial 5 years, 50% for the next 5 years and up to 50% for the balance 5 years equivalent to profits ploughed back for re-investment
- Tax deduction only for physical export
- Exemption from MAT
- Same indirect tax benefits as the SEZ Developer
- Exemption from electricity duty
- Exemption from payment of stamp duty as per state government policy

### Liberal Exchange Controls

- 100% export earnings maintainable in foreign exchange in Special Foreign Currency Account – minimal restrictions on business payments outside India
- Unlimited credit period for export realization
- Branches of foreign companies in SEZ are eligible to undertake manufacturing activities.

### Offshore Banking Units

Offshore Banking Unit means a branch of a bank in India located in the SEZ with the permission of RBI. Offshore Banking Units shall provide cheaper finance at international rates to Units in SEZs. Banks setting up Offshore Banking Units in SEZs entitled to tax deduction (beginning with the year in which they obtain requisite approvals) of 100% for first 5 years and 50% for next 5 years. Similar deduction available to units of International Financial Services Centre.

### Procedures

- Proposals for setting up SEZ may be submitted to the State Government which would forward the same to the BOA along with the specified commitments for consideration and approval. Proposals may also be submitted directly to the Board of Approval (BOA) in the Ministry of Commerce, in which case, the applicant, on receipt of the approval, would

have to obtain the concurrence of the State Government within a prescribed time-limit. On acceptance of the proposal by the Board, the Department of Commerce issues a Letter of Permission, which is treated as “Agreement” for availing exemption under Section 80-IA of the Income Tax Act.

- In respect to proposals for setting up units in SEZ, the procedure is the same as given in EOU Scheme (approval process typically takes about 45 days).

### Software Technology Park (STP) Schemes

Software Technology Parks (STP) scheme is a 100% export oriented scheme for encouraging development and export of computer software from India. The STP scheme has yielded excellent and far-reaching results over the years, enabling India to remain competitive in the global market and positioning at the pinnacle of the global software industry.

There are 34 operational STP National Centers in India. A STP Unit can be set up even outside these designated centres.

Who should set up a unit in STP?

Export oriented service providers (including software developers, BPO, call centres, medical transcriptions, etc.).

#### Salient Features of STP scheme

- Single window clearance
- Duty free import of hardware and software permitted. Import of second hand capital goods also permitted.
- 100% Foreign Equity permitted
- No export / foreign exchange earning commitment - to be positive Net Foreign Exchange cumulatively over initial 5 years.
- Duty free goods (other than capital goods & spares) to be utilised in two years. Further extension possible.
- Capital goods can be sourced on lease or on free of cost basis.
- Re-export of capital goods is permitted
- Capital goods imported under the Scheme can be used for commercial training purposes inside the custom bonded premises;
- STP units can sell software / services locally against payment in foreign exchange.
- Upto 50 per cent of exports value can be sold locally with concessional duties and taxes (subject to positive Net Foreign Exchange).
- Supplies from the DTA to STP units regarded as 'deemed exports', entitling DTA suppliers to certain export benefits.

### FDI Policy

- 100 per cent FDI permissible. No approvals required.

### Income-tax Incentives

- 100% tax deduction of export profits till 31 March 2010.
- Exemption from Minimum Alternate Tax, enjoyed by these units has been withdrawn with effect from April 1, 2007.

### Eligible IT-enabled services –

- » Back-Office Operations
- » Call Centres
- » Content Development or animation
- » Data Processing
- » Engineering and Design
- » Geographic Information System Services
- » Human Resources Services
- » Insurance Claim Processing
- » Legal Databases
- » Medical Transcription
- » Payroll
- » Remote Maintenance
- » Revenue Accounting
- » Support Centres and
- » Web-site Services

### Indirect tax Incentives

- Nil import duty
- Nil Excise Duty on procurement of goods from bonded warehouses in the DTA.
- Reimbursement of Central Sales Tax (CST) paid on purchases from DTA.
- Rebate/Refund of input service taxes.

### Liberal Exchange Controls

- 100% export earnings maintainable in Dollar A/c - minimal restrictions on business payments outside India from dollar balances.
- Extended credit period (1 year) for export realisation.
- Re-export of defective imports / imports on loan basis permitted without G.R. waiver.

### Other benefits

- Concessional lease rentals in STP zones for initial 3 years
- Sub-contracting permissible

- Inter-unit transfer of goods / services permitted (with prior permissions)
- Capital goods may also be transferred / given on loan basis to other STP units (with prior permissions)

### Procedures

- Applications in the prescribed form should be submitted to the concerned Directors of STPs or the Designated Officers of EHTPs for automatic approval, and to the Ministry of Information Technology for Government approval. The application should be accompanied with a demand draft of INR 2500/- (approx. US\$ 58) drawn in favour of “the Pay & Accounts Officer, Department of Commerce, Ministry of Commerce and Industry” payable at New Delhi. Decision on proposals under the automatic route is conveyed within two weeks, while those requiring government approval take six weeks.

### Industrial Park Scheme

#### Setting up of Industrial Parks

The Industrial Parks Scheme has been introduced with a view to enhance the development of infrastructure facilities for the purposes of industrial use.

Secretariat for industrial Assistance, Department of Industrial Policy and Promotion (DIPP) accords approval to set up Industrial Parks, which meet all the criteria laid down for automatic approval like minimum area required to be developed, minimum number of industrial units to be provided, minimum investment on infrastructure development etc.

A new scheme has been notified by the CBDT in January, 2008. As per the new scheme, the automatic approval route has been done away with and all undertakings are required to make an application to CBDT, which accords its approval for the same on fulfillment of certain conditions like date of commencement of the Industrial Park, allocable area, minimum number of industrial units, minimum constructed floor area, etc., as laid down in the new scheme.

The Central Government has also notified “The Industrial Park Scheme 2008”, key features being:

1. The date of commencement of the Industrial Park should be on or after the 1st day of April 2006 and not later than 31st of March 2009;
2. The area allocated or to be allocated to industrial units shall not be less than ninety per cent of the allocable area;

3. There shall be a minimum of thirty industrial units located in an industrial park;
4. For the purpose of computing the minimum number of industrial units; all units of a person and his associated enterprises will be treated as a single unit.
5. The minimum constructed floor area shall not be less than 50,000 square meters;
6. Industrial units to undertake only specified manufacturing activity.

### For developers of Industrial Parks

100% tax deduction is available to the developers of Industrial Parks (notified on or before 31st March 2009) for any 10 consecutive assessment years out of 15 years beginning from the year in which the undertaking or the enterprise develops and begins to operate an industrial park.

### Units in Industrial Parks in specified States

Income tax holiday and exemption from CENVAT for manufacture of specified goods is available for units set up in specified areas in the States of Uttarakhand and Himachal Pradesh subject to fulfillment of prescribed conditions.

Also, units set up in Sikkim and North East States are entitled to income tax exemption and CENVAT incentive in form of refund of duty paid in cash as prescribed under the relevant notification.

#### Procedures

Applications under automatic route are dispensed with within 15 days. Proposals not meeting the parameters under automatic route requires the approval of the Empowered Committee set up in the DIPP, whose decision is intimated within 6 weeks.

Application in Form-IPS-I (2 sets in case of automatic approval, and 6 sets in case of government approval route) should be made to Entrepreneurial Assistance Unit of the SIA accompanied with a demand draft of US\$ 125/- in favour of “Pay and Accounts Officer, Department of Industrial Policy and Promotion” payable at New Delhi.

## Guidelines for the Consideration of FDI Proposals by the FIPB<sup>6</sup>

The Guidelines are meant to assist the FIPB to consider proposals in an objective and transparent manner. These would not in any way restrict the flexibility or bind the FIPB from considering the proposals in their totality or making recommendation based on other criteria or special circumstances or features it considers relevant. Besides these are in the nature of administrative Guidelines and would not in any way be legally binding in respect of any recommendation to be made by the FIPB or decisions to be taken by the Government in cases involving Foreign Direct Investment (FDI).

These guidelines are issued without prejudice to the Government's right to issue fresh guidelines or change the legal provisions and policies whenever considered necessary.

**These guidelines stand modified to the extent changes have been notified by Secretariat for Industrial Assistance from time to time.**

The following Guidelines are laid-down to enable the Foreign Investment Promotion Board (FIPB) to consider the proposals for Foreign Direct Investment (FDI) and formulate its recommendations;

1. All applications should be put up before the FIPB within 15 days and it should be ensured that comments of the Administrative Ministries are placed before the Board either prior to/or in the meeting of the Board.
2. Proposals should be considered by the Board keeping in view the time frame of 30 days for communicating Government decision (i.e. approval of FM/CCEA or rejection, as the case may be).
3. In cases in which either the proposal is not cleared or further information is required, in order to obviate delays presentation by applicant in the meeting of the FIPB should be resorted to.
4. While considering cases and making recommendations, FIPB should keep in mind the sectoral requirements and the sectoral policies vis-a-vis the proposal(s).
5. FIPB would consider each proposal in totality (i.e. if it includes apart from foreign investment, technical collaboration/industrial licence) for composite approval or otherwise. However, the FIPB's recommendation would relate only to the approval for foreign financial and technical collaboration and the foreign investor will need to take other prescribed clearances separately.
6. The Board should examine the following while considering proposals submitted to it for consideration:
  - I. Whether the items of activity involve industrial licence or not and if so the considerations for grant of industrial licence must be gone into;
  - II. Whether the proposal involves technical collaboration and if so the source and nature of technology sought to be transferred;
  - III. Whether the proposal involves any mandatory requirement for exports and if so whether the applicant is prepared to undertake such obligation (this is for items reserved for small scale sector as also for dividend balancing, and for 100% EOUs/ EPZ units);
  - IV. Whether the proposal involves any export projection and if so the items of export and the projected destinations;
  - V. Whether the proposal has concurrent commitment under other schemes such as EPCG Scheme etc;
  - VI. In the case of Export Oriented Units (EOUs) whether the prescribed minimum value addition norms and the minimum turn over of exports are met or not;
  - VII. Whether the proposal involves relaxation of locational restrictions stipulated in the industrial licensing policy;
  - VIII. Whether the proposal has any strategic or defence related considerations, and
  - IX. Whether the proposal has any existing joint venture or technology transfer/trademark agreement in the same field in India, and if so whether this agreement is sick or defunct; the investment by either party is less than 3% & investment is by FVCI. The detailed circumstance in which it is considered necessary to set-up a new joint venture/ enter into new technology transfer (including trade mark), and proof that the new proposal would not in any way jeopardize the interest of the existing joint venture or technology/ trade mark partner or other stake holders.
7. While considering proposals the following may be prioritized :
  - (a) Items/activities covered under Government route (i.e. those which do not qualify under automatic route).
  - (b) Items falling in infrastructure sector.
  - (c) Items which have an export potential
  - (d) Items which have large scale employment potential and especially for rural people.
  - (e) Items, which have a direct or backward linkage with agro business/farm sector.

<sup>6</sup> Source : SIA Manual on "Investing in India : A Comprehensive Manual for Foreign Direct Investment - Policy and Procedures".

- (f) Item which have greater social relevance such as hospitals, human resource development, life saving drugs and equipment.
- (g) Proposals, which result in induction of technology or infusion of capital.

**8. The following should be especially considered during the scrutiny and consideration of proposals:**

- (a) The extent of foreign equity proposed to be held (keeping in view sectoral caps if any - e.g. 24% for SSI units, 49% for air taxi/airlines operators, 74% in basic/cellular/ paging in Telecom sector etc).
  - (b) Extent of equity with composition of foreign/NRI/resident Indians.
  - (c) Extent of equity from the point of view whether the proposed project would amount to a holding company/ Wholly owned Subsidiary/a company with dominant foreign investment (i.e. 75% or more) Joint Venture.
  - (d) Whether the proposed foreign equity is for setting up a new project (Joint Venture or otherwise) or whether it is for enlargement of foreign/NRI equity or whether it is for fresh induction of foreign equity/NRI equity in an existing Indian company.
  - (e) In the case of fresh induction of foreign/NRI equity and/or cases of enlargement of foreign/ NRI equity in existing Indian companies whether there is a resolution of the Board of Directors supporting the said induction/ enlargement of foreign/NRI equity and whether there is a shareholders agreement or not.
  - (f) In the case of induction of fresh equity in the existing Indian companies and/or enlargement of foreign equity in existing Indian companies, the reason why the proposal has been made and the modality for induction/enhancement [i.e. whether by increase of paid up capital/authorised capital, transfer of shares (hostile or otherwise) whether by rights issue, or by what modality].  
Cases pertaining to FIPB approvals, which involve increase in the non-resident equity within the approved percentage of non-resident equity in a joint venture company and enhancement of paid-up capital in a wholly owned subsidiary do not require FIPB approval provided the intent for increase in the amount of foreign equity is duly notified to SIA and formal documentation by way of intimation is made to SIA within 30 days of receipt of funds and allotment of shares (to non-resident shareholders).
  - (g) Issue/transfer/pricing of shares will be as per SEBI/RBI guidelines.
  - (h) Whether the activity is an industrial or a service activity or a combination of both.
  - (i) Whether the item of activity involves any restriction by way of reservation for the small scale sector.
  - (j) Whether there are any sectoral restrictions on the activity (e.g. there is ban on foreign investment in real estate while it is not so for NRI investment).
  - (k) Whether the item involves only trading activity and if so whether it involves export or both export and import, or also includes domestic trading and if domestic trading whether it also includes retail trading.
  - (l) Whether the proposal involves import of items which are either hazardous, banned or detrimental to environment (e.g. import of plastic scrap or recycled plastics).
9. In respect of activities to which equity caps apply, FIPB may consider recommending higher levels of foreign equity as compared to the prescribed caps, keeping in view the special requirements and merits of each case.
10. In respect of other industries/activities the Board may consider recommending 51 per cent foreign equity on examination of each individual proposal. For higher levels of equity up to 74 per cent the Board may consider such proposals keeping in view considerations such as the extent of capital needed for the project, the nature and quality of technology, the requirements of marketing and management skills and the commitment for exports.

**11. FIPB may consider recommending proposals for 100 % foreign owned holding/ subsidiary companies based on the following criteria:**

- (a) where only “holding” operation is involved all subsequent/ downstream investments to be carried out would require prior approval of the Government;
  - (b) where proprietary technology is sought to be protected or sophisticated technology is proposed to be brought in;
  - (c) where at least 50% of production is to be exported;
  - (d) proposals for consultancy; and
  - (e) proposals for industrial model towns/industrial parks or estates.
12. In special cases, where the foreign investor is unable initially to identify an Indian joint venture partner, the Board may consider and recommend proposals permitting 100 per cent foreign equity on a temporary basis on the condition that the foreign investor would divest to the Indian parties (either individual, joint venture partners or general public or both) at least 26 per cent of its equity within a period of 3-5 years.

13. Similarly in the case of a joint venture, where the Indian partner is unable to raise resources for expansion/ technological upgradation of the existing industrial activity the Board may consider and recommend increase in the proportion/percentage (up to 100 per cent) of the foreign equity in the enterprise.
- 14. In respect of trading companies, 100 per cent foreign equity may be permitted in the case of the activities involving the following:**
- (i) exports;
  - (ii) bulk imports with ex-port/ex-bonded warehouse sales;
  - (iii) cash and carry wholesale trading;
  - (iv) other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group.
15. In respect of the companies in the infrastructure/ services sector where there is a prescribed cap for foreign investment, only the direct investment should be considered for the prescribed cap and foreign investment in an investing company should not be set off against this cap provided the foreign direct investment in such investing company does not exceed 49 per cent and the management of the investing company is with the Indian owners.
16. No condition specific to the letter of approval issued to a foreign investor would be changed or additional condition imposed subsequent to the issue of a letter of approval. This would not prohibit changes in general policies and regulations applicable to the industrial sector.
17. Where in case of a proposal (not being 100% subsidiary) foreign direct investment has been approved up to a designated percentage of foreign equity in the joint venture company the percentage would not be reduced while permitting induction of additional capital subsequently. Also in the case of approved activities, if the foreign investor(s) concerned wished to bring in additional capital on later dates keeping the investment to such approved activities, FIPB would recommend such cases for approval on an automatic basis.
18. As regards proposal for private sector banks, the application would be considered only after “in principle” permission is obtained from the Reserve Bank of India (RBI).
19. The restrictions prescribed for proposals in various sectors as obtained, at present, are given in the annexure - II and these should be kept in view while considering the proposals.

### Part I: Press Note No. 2 of 2004 series

#### 1. Limit for FDI under automatic route in private sector banks

- a. In terms of the Press Note no. 2 (2004 series) dated March 5, 2004 issued by Ministry of Commerce & Industry, Government of India, FDI up to 74% from all sources will be permitted in private sector banks on the automatic route, subject to conformity with the guidelines issued by RBI from time to time.
- b. For the purpose of determining the above-mentioned ceiling of 74% FDI under the “automatic route” in respect of private sector banks, following categories of shares will be included.
  - (i) FDI investment under Portfolio Investment Scheme (PIS) by FIIs, NRIs and shares acquired prior to 16.9.2003
  - (ii) IPOs,
  - (iii) Private placements,
  - (iv) ADRs/GDRs, and
  - (v) Acquisition of shares from existing shareholders [subject to (d) below]
- c. It may be clarified that as per Government of India guidelines, issue of fresh shares under automatic route is not available to those foreign investors who have a financial or technical collaboration in the same field. This category of investors requires FIPB approval.
- d. It may be further clarified that, as per Government of India guidelines, automatic route is applicable to transfer of existing shares in a banking company from residents to non-residents within the sectoral equity cap. This category of investors require approval of FIPB followed by “in principle” approval by Exchange Control Department (ECD), RBI. The “fair price” for transfer of existing shares is determined by RBI broadly on the basis of SEBI guidelines for listed shares and erstwhile CCI guidelines for unlisted shares. After receipt of “in principle” approval, the resident seller can receive funds and apply to ECD, RBI for obtaining final permission for transfer of shares.
- e. Under the Insurance Act, the maximum foreign investment in an insurance company has been fixed at 26%. Application for foreign investment in banks, which have joint venture/ subsidiary in insurance sector, should be made to RBI. Such applications will be considered by RBI in consultation with Insurance Regulatory and Development Authority (IRDA).
- f. Foreign banks having branch presence in India are eligible for FDI in the private sector banks subject to the overall cap of 74% mentioned above with the approval of RBI.

#### 2. Limit for FDI in public sector banks

FDI and portfolio investment in nationalised banks are subject to overall statutory limits of 20% as provided under Section 3 (2D) of the Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80. The same ceiling would also apply in respect of such investments in State Bank of India and its associate banks.

#### 3. Voting rights of foreign investors

In terms of the statutory provisions under the various banking acts, the voting rights, when exercised, which are stipulated as under:

Private sector banks – [Section 12 (2) of Banking Regulation Act, 1949]

No person holding shares, in respect of any share held by him, shall exercise voting rights on poll in excess of ten per cent of the total voting rights of all the share holders

Nationalised Banks – [Section 3(2E) of Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80]

No shareholder, other than the Central Government, shall be entitled to exercise voting rights in respect of any shares held by him in excess of one per cent of the total voting rights of all the share holders of the nationalised banks  
State Bank of India (SBI) – (Section 11 of State Bank of India Act, 1955)

No shareholder, other than RBI, shall be entitled to exercise voting rights in excess of ten per cent of the issued capital (Government, in consultation with RBI can raise the above voting rate to more than ten per cent).

SBI Associates – [Section 19(1)&(2) of SBI (Subsidiary Bank) Act, 1959]

No person shall be registered as a shareholder in respect of any shares held by him in excess of two hundred shares. No shareholder, other than SBI, shall be entitled to exercise voting rights in excess of one per cent of the issued capital of the subsidiary bank concerned.

#### 4. Approval of RBI and reporting requirements

- i. Under extant instructions, transfer of shares of 5 per cent and more of the paid-up capital of a private sector banking company, requires prior acknowledgments of RBI. For FDI of 5 per cent and more of the paid-up capital, the private sector banking company has to apply in the prescribed form to the Department of Banking Operations and Department in the Regional office of RBI, where the bank's Head Office is located.
- ii. Under the provisions of FEMA 1999, any fresh issue of shares of a banking company, either through the automatic route or with the specific approval of FIPB, does not

require further approval of Exchange Control Department (ECD) of RBI from the exchange control angle. The Indian banking company is only required to undertake 2-stage reporting to the ECD as follows:

- a. In the first stage, the Indian company has to submit a report within 30 days of the date of receipt of amount of consideration indicating the name and address of foreign investors, date of receipt of funds and their rupee equivalent, name of bank through whom funds were received and details of Government approval, if any.
- b. In the second stage, the Indian banking company is required to file within 30 days from the date of issue of shares, a report in form FC-GPR together with a certificate from the Company Secretary of the concerned company certifying that various regulations have been complied with. The report will also be accompanied by a certificate from a Chartered Accountant indicating the manner of arriving at the price of the shares issued.

#### 5. **Conformity with SEBI Regulations and Companies Act provisions**

Wherever applicable, FDI in banking companies should conform to the provisions regarding shareholding and share transfer, etc. as stipulated by SEBI, Companies Act, etc.

#### 6. **Disinvestments by Foreign Investors**

In terms of regulation 10 and 11 of RBI Notification No. FEMA/20/2000-RB dated May 3, 2000 issued under FEMA 1999; disinvestments by foreign investors would be governed by the following:

- i. Sale of shares by non-residents on a stock exchange and remittance of the proceeds thereof through an authorized dealer does not require RBI approval.
- ii. Sale of shares by private arrangement requires RBIs prior approval. RBI grants permission for sale of shares at a price that is market related and is arrived at in terms of guidelines indicated in Regulation 10 above.

#### 7. **All commercial banks, which either have foreign investments or intending to have foreign investments, need to observe the above guidelines.**

## **Part 2 : Roadmap for Presence of Foreign Banks in India and Guidelines on Ownership and Governance in Private Banks**

On February 28, 2005, the Reserve Bank of India issued the roadmap for banking sector reforms:

- **Two phased roadmap for presence of foreign banks in India and setting up of wholly-owned subsidiaries (WOS).**
  - Phase I (between March 2005 and March 2009) – detailed guidelines issued for foreign banks setting up WOS or converting existing branches into WOS in consonance with FDI policy issued by Ministry of Commerce & Industry on 5 March 2004 (given above). The guidelines mainly cover eligibility criteria, minimum capitalization of Rs 300 crores (INR 3 billion), capital adequacy of 10%, at least 50% resident Indian directors and sound corporate governance requirements. RBI may prescribe market access and national treatment limitation consistent with WTO.
  - Only private sector banks identified by RBI for restructuring would be eligible for FDI.
  - Phase II roadmap to be developed after review of experience gained in Phase I.
- **Guidelines on ownership and governance in private sector banks to ensure**
  - Diversified ownership and control
  - Shareholders holding more than 5%, directors and the CEO to be “fit and proper” as per RBI guidelines
  - No single shareholder or group to control directly or indirectly more than 10% of paid up capital unless approved by RBI.
  - Minimum net worth of Rs 300 crores to be maintained at all times
  - Transparent and fair policies and processes.
- **RBI has announced a liberalized policy and simplified procedures for Indian banks setting up offices/subsidiaries outside India.**

# Tax Rates under Double Taxation Avoidance Treaties

Name of the Country	Interest	Dividend*	Royalty (Refer Note m)	Fee for Technical Services (Refer Note m)
Austria	10%	10%	10%	10%
Armenia	10%	10%	10%	10%
Australia	15%	15%	10% (b) In other cases 15%	No specific provision. However, it can be covered under Royalty
Bangladesh	10%	10%(c) 15% in other cases	10%	No specific provisions(e)
Belarus	10%	10%(i); 15% in other cases	15%	15%
Belgium	10%(k); 15% in other cases	15%	10%(f)	10%(f)
Brazil	15%	15%	25% if royalty arises from trademarks, 15% in other cases	No specific provision(e)
Bulgaria	15%	15%	15% if it relates to copyrights of literary, artistic or scientific work, 20% in other cases	20%
Canada	15%	15%(c); in other cases 25%	10%(b); In other cases 15%	10%(b); In other cases 15%
China	10%	10%	10%	10%
Czech Republic	10%	10%	10%	10%
Cyprus	10%	10%(c); in other cases 15%	15% (including fee for included services)	10% (for technical fees)
Denmark	10%(k); 15% in other cases	15%(l); 25% in other cases	20%	20%
Finland	10%	15%	10%(b) ; 15% in other cases	10%(b) ; 15% in other cases
France	10%(f)	10%(f)	10%(f)	10%(f)
Germany	10%	10%	10%	10%
Greece	21.115%(L)	Exempt	10.558%(m)	No specific provisions(e)
Hungary (Refer Note n)	10%(f)	10%(f)	10%(f)	10%(f)
Iceland refer note (u)	10%	10%	10%	10%
Indonesia	10%	10%(l); 15% in other cases	15%	No specific provision(e)
Ireland	10%	10%	10%	10%
Israel	10%	10%	10%	10%

Name of the Country	Interest	Dividend*	Royalty (Refer Note m)	Fee for Technical Services (Refer Note m)
Italy Refer note (p)	15%	15%(c); in other cases 25%	20%	20%
Japan Refer note (r)	10%	15%	20%	20%
Jordan	10%	10%	20%	20%
Kazakhstan	10%	10%	10%	10%
Kenya	15%	15%	20%	17.5% (for managerial, technical, professional or consultancy fee)
Kuwait Refer note (t)	10%	10%	10%	10%
Republic of Korea	10%(k); 15% in other cases	15%(d); 20% in other cases	15%	15%
Kyrgyz Republic	10%	10%	15%	15%
Libyan Arab Jamahiriya	21.115(l)	Exempt	10.558(m)	No specific provision(e)
Malaysia	10%	10%	10%	10%
Mauritius	21.115(L)	5%(c) ; 15% in other cases	15%	No specific provision(e)
Malta	10%	10%(l), in other cases 15%	15% including fee for included services	10% on fee for technical, managerial and consultancy services
Mongolia	15%	15%	15%	15%
Morocco	10%	10%	10%	10%
Namibia	10%	10%	10%	10%
Nepal	10%(o), in other cases 15%	10%(c), in other cases 15%	15%	No specific provision(e)
Netherlands	10%(f)	10%(f)	10%(f)	10%(f)
New Zealand	10%	15%	10%	10%
Norway	15%	15%(i) ; in other cases 25%	10%(f)	10%(f)
Oman	10%	10%(c) ; in other cases 12.5%	15%	15%
Philippines	10%(o); In other cases 15%	15%(c) ; in other cases 20%	15%	No specific provision(e)
Poland	15%	15%	22.5%	22.5%
Qatar	10%	5%(c) ; in other cases 10%	10%	10%
Portugal	10%	10%(i) 15% in other cases	10% including fee for included services	no specific provision however, it can be covered under Royalty
Romania	15%	15%(i); in other cases 20%	22.5%	22.5%
Russian Federation	10%	10%	10%	10%
Saudi Arabia	10%	5%	10%	No specific provision 10%(e)

Name of the Country	Interest	Dividend*	Royalty (Refer Note m)	Fee for Technical Services (Refer Note m)
Singapore	10%(k); in other cases 15%	10%(i); in other cases 15%	10%	10%
South Africa	10%	10%	10%	10%
Spain	15%	15%	20%(f), 10%(f) (b)	20%(f)
Sri Lanka	10%	15%	10%	No specific provision(e)
Sweden	10%(f)	10%(f)	10%(f)	10%(f)
Sudan	10%	10%	10%	10%
Syria	7.5%	Exempt	10%	No specific provision(e)
Slovenia	10%	5%(c); in other cases 15%	10%	10%
Switzerland	10%	10%	10%	10%
Tanzania	12.5%	10%(c); in other cases 15%	20%	20% on management & professional fees
Thailand	10% (o); in other cases 25%	15%(c) (h), 20%(i) (h)	15%	No specific provision(e)
Trinidad & Tobago	10%	10%	10%	10%
Turkey	10% (k); in other cases 15%	15%	15%	15%
Turkmenistan	10%	10%	10%	10%
Ukraine	10%	10%(i) in other cases 15%	10%	10%
United States of America	10%(k); in other cases 15%	15%(c) ; in other cases 25%	10%(b) In other cases 15%	10%(b) In other cases 15%
United Kingdom	10% (0); in other cases 15%	15%	10%(b) In other cases 15%	10%(b) In other cases 15%
United Arab Emirates	5% (k); in other cases 12.5%	10% (s);	10%	No specific provision(e)
Uganda	10%	10%	10%	10%
United Arab Republic	21.115%(L)	Exempt	10.558%(m)	No specific provision(e)
Uzbekistan	15%	15%	15%	15%
Vietnam	10%	10%	10%	10%
Zambia	10%	5% (j); in other cases 15%	10%	10% on managerial & consultancy fees

Notes:

- The treaty tax rates on dividend are not relevant in case of payment of dividend by Indian company since under the current Indian tax legislation, dividend distribution by such companies is exempt from Income Tax in the hands of recipient.
- For use of industrial, scientific or commercial equipment.
- If, beneficial owner is a company, which holds at least 10% of the capital of the company paying dividend
- If beneficial owner is a company, which owns 20% of capital of the company paying dividend/interest
- In absence of specific provision, it may be treated as business profits under respective treaties
- “Most Favored Nation” clause is applicable. The Protocol to the Treaty limits the scope and rate of taxation to that specified in similar Articles in Treaties signed subsequently by India with other OECD nations.

- (g) In most of the treaties the Interest attributable to financing of exports and imports, loan granted by specified institutions is subject to NIL or lower withholding tax rates.
- (h) Company paying dividend is engaged in industrial undertaking.
- (i) If beneficial owner is a company which holds at least 25% of the shares of the company-paying dividend
- (j) If the recipient is a company owning at least 25% of capital during the period of 6 months before date of payment
- (k) If paid on a loan granted by a bank / financial institution.
- (l) Tax rate under domestic tax laws is 20%, plus surcharge @2.5%, education cess of 3% is levied, effective tax rate being 21.115%.
- (m) The Prescribed tax rate for Royalty & Fees for technical services, under domestic tax laws is 10% (plus surcharge @2.5%, education cess of 3%, the effective tax rate being 10.558%). The rate would apply for payments under the agreement entered on or after 1st June, 2005.
- (n) As per the new DTA with Hungary, applicable from April 1, 2006.
- (o) If interest is received by a bank or financial institution
- (p) Protocol amending the DTAA with Italy (January 2006) stipulates rate of 10% for Dividend, Interest, Royalty and Fee for Technical Services.
- (q) The provisions of the DTAA will have effect in India in respect of income derived on or after April 1, 2007.
- (r) The protocol (notified by the Central Government on July 19, 2006) stipulates the new rate of 10% for Dividend, Interest, Royalty and Fee for Technical Services. In India, this new rate will be effective from April 1, 2007.
- (s) The protocol (notified by the Central Government on November 28, 2007) stipulates the new rate of 10% for Dividends. In India, this new rate will be effective from April 1, 2008.
- (t) As per the new DTA with Kuwait (notified by the Central Government on November 27, 2007), applicable from April 1, 2008.
- (u) As per the new DTAA with Iceland (notified by the Central Government on February 5, 2008), applicable from April 1, 2008.

## Summary of Selected Agencies / Departments Involved with Clearances / Approvals

Subject Matter	Concerned Ministry / Department	Website Address
Industrial Entrepreneur Memorandum for delicensed industries	Department of Industrial Policy and Promotion, SIA	<a href="http://dipp.nic.in">http://dipp.nic.in</a>
Approval for Industrial License / Carry-on-business license	Department of Industrial Policy and Promotion, SIA	<a href="http://dipp.nic.in">http://dipp.nic.in</a>
Approval for Technology Transfer: 1. Automatic route 2. Government approval (Project Approval Board)	Reserve Bank of India Department of Industrial Policy and Promotion, SIA	<a href="http://www.rbi.org.in">www.rbi.org.in</a> <a href="http://dipp.nic.in">http://dipp.nic.in</a>
Approval for financial collaboration: 1. Automatic route 2. Government approval (FIPB)	Reserve Bank of India Department of Economic Affairs	<a href="http://www.rbi.org.in">www.rbi.org.in</a> <a href="http://finmin.nic.in">http://finmin.nic.in</a>
Approval for Industrial Park 1. Automatic route 2. Non-Automatic Route (Empowered Committee)	Department of Industrial Policy and Promotion, SIA	<a href="http://dipp.nic.in">http://dipp.nic.in</a>
Registration as a Company & Certificate of Commencement of business	Department of Company Affairs (Registrar of Companies)	<a href="http://dca.nic.in">http://dca.nic.in</a>
Matters relating to FDI Policy	Department of Industrial Policy and Promotion, SIA	<a href="http://dipp.nic.in">http://dipp.nic.in</a>
Foreign Exchange Matters	Reserve Bank of India	<a href="http://www.rbi.org.in">www.rbi.org.in</a>
Taxation matters Direct taxation issues	Department of Revenue Central board of Direct Taxes	<a href="http://finmin.nic.in">http://finmin.nic.in</a> <a href="http://incometaxindia.gov.in">http://incometaxindia.gov.in</a>
Excise and Customs Issues	Central Board of Excise and Customs	<a href="http://www.cbec.gov.in">www.cbec.gov.in</a>
Import of goods	Directorate General of Foreign trade	<a href="http://dgft.delhi.nic.in">http://dgft.delhi.nic.in</a>
Environmental Clearances	Ministry of Environment and Forests	<a href="http://envfor.nic.in/">http://envfor.nic.in/</a>
Overseas Investment by Indians	Overseas Investment Division, Reserve Bank of India	<a href="http://www.rbi.org.in">www.rbi.org.in</a>

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