

Key Taxation Issues for Foreign Subsidiaries in India

Presentation Organized by The German Engineering Federation (VDMA)

Hotel Mirage, Mumbai
December 14, 2010

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FLOW OF PRESENTATION

- ▲ Overview of Corporate Tax Provisions
- ▲ Key Issues
 - ▶ Deputation/ secondment – *how to structure*
 - ▶ Management fee – *issues around it*
 - ▶ PAN for foreign companies – *a quick debate*
 - ▶ EPC contracts – *basic rules*
 - ▶ Social security norms for expatriates – *recent amendments, impact*
- ▲ Key Provisions of the Direct Tax Code (DTC)
- ▲ About CCI

CORPORATE TAX PROVISIONS – AN OVERVIEW

CORPORATE TAX PROVISIONS

- ▲ Scope of taxability based on **residential status**. Residential status determined on the basis of place of control and management
- ▲ Resident companies taxed on **worldwide income** in India
- ▲ Non resident companies taxed on income **received, accruing or deemed** to be accruing in India
- ▲ **Rates of Tax**

Assessee	Effective Tax Rate (%)
Indian Incorporated Companies	33.22
Foreign Companies	42.23

- ▲ All business related expenses allowed as **tax deductible** against business receipts

CORPORATE TAX PROVISIONS

- ▲ Business losses allowed to be **carried forward** upto 8 years for set off against future business profits
- ▲ **Minimum Alternate Tax (MAT)** at 18% is payable based on 'Book Profits'. Tax paid under MAT eligible for carry forward and set off against normal tax liability
- ▲ Industry/Sector/Area based tax **exemptions** available. SEZ are in focus
- ▲ Payment of dividend to parent company subject to **distribution tax** at 15%
- ▲ **Royalty & Fee for technical services** payable to parent subject to 10% tax withholding (subject to PAN availability). Generally available as credit to parent company
- ▲ **Transfer pricing documentation** necessary if quantum of transactions exceed INR 10million. *Safe Harbor Rules* and *Advance Pricing Authorities* non existing. **Key subject matter for litigation at all levels**

KEY ISSUES FOR DISCUSSION

DEPUTATION/ SECONDMENTS

Facts

- ▲ Parent Co (P Co) enters into a Technical Support Agreement (TSA) with Subsidiary Co (Sub Co)
- ▲ Also seconds its permanent staff as executive directors / senior management (qualified engineers) for routine operations and administration of Sub Co
- ▲ No formal Secondment agreement is executed
- ▲ Part salary of seconded staff paid by P Co, subsequently reimbursed by Sub Co
- ▲ Basic/ sketchy employment agreement between seconded staff and Sub Co

Issue

- ▲ Seconded employees treated as 'technical support/services' from parent company and thus reimbursement of salary/expenses gets treated as 'fee for technical services' under the TSA, which is subject to withholding tax at 10%
- ▲ Potential risk of Permanent Establishment (PE) for parent company since employees posted in India

DEPUTATION/ SECONDMENTS

Recommendations

- ▲ Through the **secondment agreement**, the P Co must
 - ▶ **fully relinquish its key rights** (viz. termination, determination of salary and job responsibilities, renewal of employment, reporting) in favour and at behest of Sub Co
 - ▶ indicate that secondments are **not consequent** to the TSA between P Co and Sub Co.
 - ▶ agree that salary/ expenses paid by P Co will be reimbursed on a **cost to cost** basis

- ▲ The TSA must specify scope of services/nature of support to be provided by P Co, in a manner that the support services are **mutually exclusive to secondment**

- ▲ Through the **employment agreement**, the Sub Co must exhibit that it
 - ▶ **Possess sole right** to fix or agree to specific scope of work, salary, termination criteria, reporting norms for the seconded employee
 - ▶ Treats the seconded employee **at par** with other employees

MANAGEMENT FEE

Facts

- ▲ Management Fee paid by a Sub Co to its P Co **for support on internal management functions** viz. finance, administration, reporting, marketing, legal support and such
- ▲ It is within the regulatory threshold i.e. FEMA allows that management/consultancy fee can be paid to a non-resident without any monetary ceiling
- ▲ Payment subject to 10% tax withholding. No service tax implication also if services not performed in India

Issues (consequent to a recent judgment in case of Gemplus India, a French subsidiary)

- ▲ All payments must satisfy the **arm's length principal**
- ▲ Must be **evidenced by a written instrument (agreement)** with clear description of services
- ▲ Internally, Sub Co must demonstrate need for such services and corresponding benefits **through appropriate documentation**
- ▲ **P Co to also maintain documentary evidence** to substantiate that services are rendered specifically for Indian subsidiary

PAN FOR FOREIGN COMPANIES

Issue

- ▲ Effective April 1, 2010, it is mandatory for foreign companies to quote their Permanent Account Number (PAN) if they are in receipt of sums which are **chargeable to tax in India**, in hands of such non-resident
- ▲ **If PAN not obtained, tax withholding to apply at a higher rate of 20%**
- ▲ Payment not tax deductible for payer if withholding requirements not met

Consequences

- ▲ Since onus rests with payer in India, PAN is demanded for every payment to a Non-resident **even when it is not chargeable to tax in India**
- ▲ Substantial **increase in overall cost of project** where agreement is to pay net of tax and grossing up is required
- ▲ Corresponding **credit of additional withholding tax** not available in home country (generally restricted to 10% as per most tax treaties)
- ▲ **Tax compliances** in India and potential **threat of PE** for recipient non-resident

PAN FOR FOREIGN COMPANIES

Apparent Conflict with IT Act

- ▲ Withholding rate of 20% is higher than the rate as per Double Tax Avoidance Treaties (DTAA) (generally 10-15%)
- ▲ Even though provisions of DTAA override domestic tax law, the higher rate of 20% is being enforced by the authorities. **To this extent, provisions of IT Act override DTAA**

Recommendations

- ▲ Obtain PAN. Process is not cumbersome
- ▲ Since onus of payment and tax withholding rests with payer, **convince the payer** if you believe that income is not subject to tax in India
- ▲ Explore the option of a **NIL tax withholding certificate** if time is on hand (2-4 months)

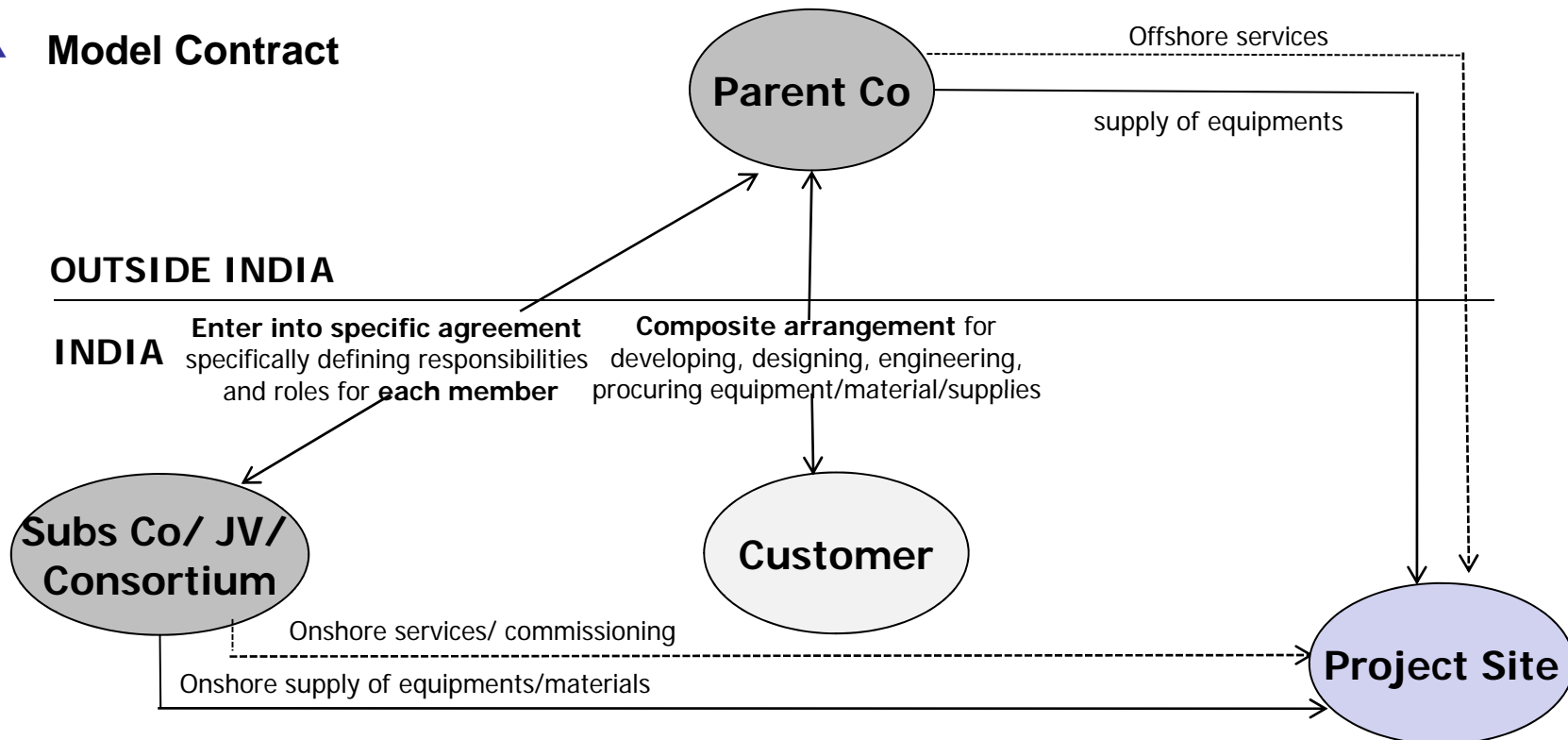
EPC CONTRACTS

▲ Structure

A contract involving Erection, Procurement & Commissioning (Turnkey Basis) (EPC) resulting in several distinctly identifiable streams of income primarily

- ▶ Offshore – Portion of the contract performs outside India
- ▶ Onshore - Portion of the contract performs inside India

▲ Model Contract



EPC CONTRACTS

▲ Summary of Income-tax Implications

Revenue Streams	No PE in India	PE in India
Offshore Supplies	Not Taxable	Taxable (2)
Offshore Services	Taxable (1)	Taxable (2)
Onshore Supplies	NA	Taxable (2)
Onshore Services	Taxable (1)	Taxable (2)

(1) generally taxable at 10% on **gross fee**

(2) contracts involving PE generally taxable at 42.23% on **net income**

▲ Do's & Dont's (for Sub Co's)

- ▶ To ensure **no participation** in the negotiations and making of offshore supply contract
- ▶ Offshore supply contract should be on FOB basis and **no involvement of subs co in delivery of materials/equipment in India**
- ▶ Subs co **not to involve in any warranty/after sales support** of such offshore materials
- ▶ Role of Subs Co should be **explicitly defined to the extent of the operations performed in India**
- ▶ Not to **sign contracts or bind P Co** in any manner.

SOCIAL SECURITY FOR EXPATRIATES

- ▲ India is presently in process of finalising Social Security Agreement (SSA) with a number of countries. A SSA typically aims for optimum contribution to social security funds and sets out clear parameters of reciprocity of retirement/withdrawal benefits
- ▲ Provident Fund contributions applicable to International Workers effective November 1, 2008
- ▲ Contribution equals 24% of base salary. No monetary ceiling on the amount of salary (even overseas salary considered)
- ▲ Amount in PF account was withdraw able on final departure from India. Interest paid between 8 - 9% by Government of India on outstanding balance in PF account
- ▲ **As per a recent notification (dated September 7, 2010), the amount accumulated in the PF account CANNOT be withdrawn unless**
 - ▶ **The employee attains the age of 58 years**
 - ▶ **Becomes physically or mentally incapable to perform official duties**
- ▲ The recent move by the PF authorities is aimed to further tighten its noose on international community to negotiate and finalise a SSA

KEY PROVISION OF DIRECT TAX CODE, 2010 (DTC)

TAX RATE - COMPARISON

Particulars	Income Tax Act, 1961	DTC
Domestic Company	33.22%	30%
Foreign Company	42.23%	30%
Branch Profit Tax (BPT)	Nil	15%
Minimum Alternate Tax (MAT)	19.93% on book profit	20% on book profit
Dividend Distribution Tax (DDT)	16.61%	15%

OTHER RELATED PROVISIONS - COMPARISON

Particulars	Income Tax Act, 1961	DTC
Residency Test	Foreign company is resident in India if controlled/managed wholly in India	Foreign company is resident in India if place of effective management is in India at any time
Controlled Foreign Corporation (CFC)	Not relevant	Introduced to tax the passive income of foreign company
DTAA and Act interplay	DTAA will override and Act will apply only to the extent it is beneficial	DTAA benefits are restricted where GAAR, BPT or CFC invoked
Due date for filing return	September 30	August 31

ABOUT US

Corporate Catalyst India

(in joint venture with SCS Global)

OUR STRENGTHS

- ❑ **CCI** – joint venture with **SCS Global**
- ❑ Approximately 70 per cent are **overseas clients**
- ❑ Offices across India and affiliations worldwide
- ❑ More than 20 years **work experience**
- ❑ Professional **staff strength** of over 160 in India & 1,500 through associate network

OUR SERVICES



Services

- ❑ **Business Advisory – Inbound investments**
- ❑ **Transaction Advisory – M&A, Restructuring**
- ❑ **Market Research/ Industrial Analysis**
- ❑ **Tax – Expatriates, Transfer Pricing**
- ❑ **Compliance – Bookkeeping, IFRS, SOX**
- ❑ **Audit – Statutory, Internal**

THANK YOU

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