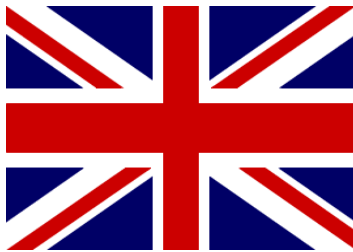


INDIA INSIGHT

An initiative by Osborne Clarke



presented by

Corporate Catalyst India www.cci.in

Doing Business with India

being better prepared

September 10, 2009

Ajay Sethi II Managing Director II

Sunil Arora II Director II



Corporate Catalyst India

PRESENTATION OUTLINE

Session 1- Ajay Sethi

- India tour & business set-up

Session 2 – Sunil Arora

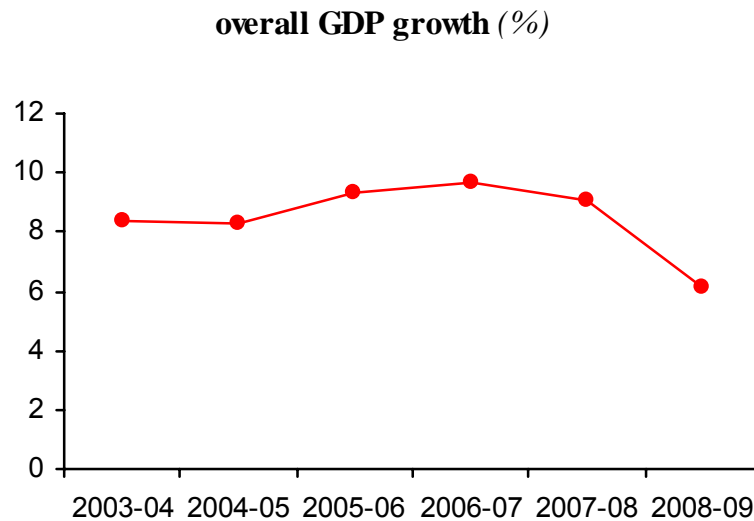
- Tax and regulatory matters

The Economy and the Tell Tale Signs

INDIA TOUR

- ❑ The 2nd **most attractive investment destination**
(source *UNCTAD World Investment Report 2008*)
- ❑ Advantage - **low cost of production, large size domestic market**
- ❑ Besides service industry, evolving into a **manufacturing hub**
- ❑ India figures in the **Research and Development** strategy of global corporate

Economic Indicators - GDP

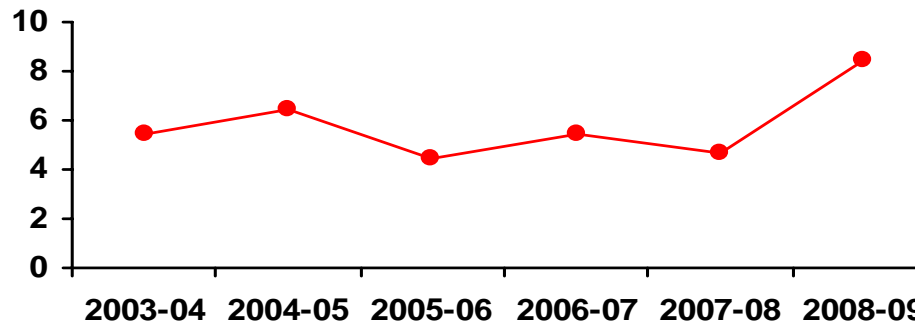


Source – indiabudget.nic.in

- 2007-08: Economy robust at 9 %
- 2008-09: Economy decelerated to 6.7%
- 2009 -10: GDP expected at 9 %

Economic Indicators - Inflation

inflation based on WPI index (%)



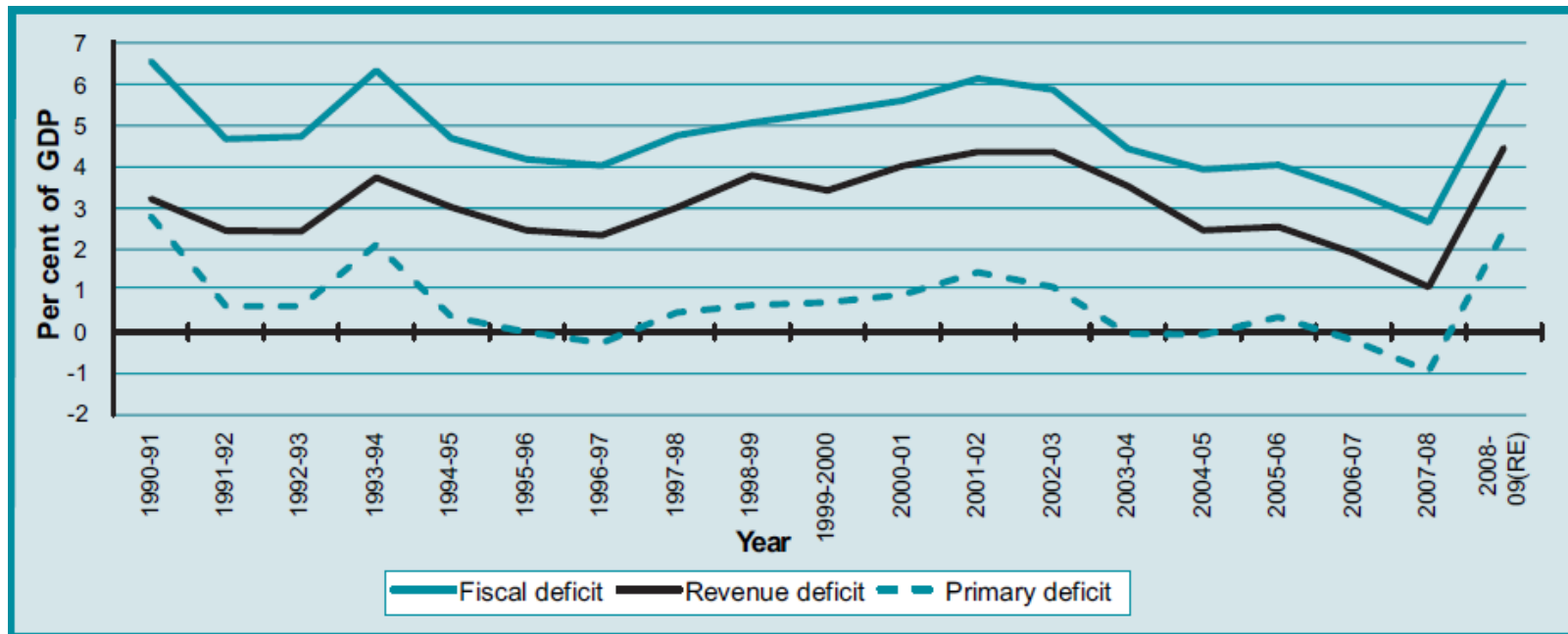
Source – indiabudget.nic.in

Inflation rose sharply in 2008-09 to 8.4% from 4.7% in 2007-08 followed by a dramatic reversal in past three months. In June 2009, negative inflation at (-) 1.3 %.

In the present world scenario, not an immediate cause of concern.

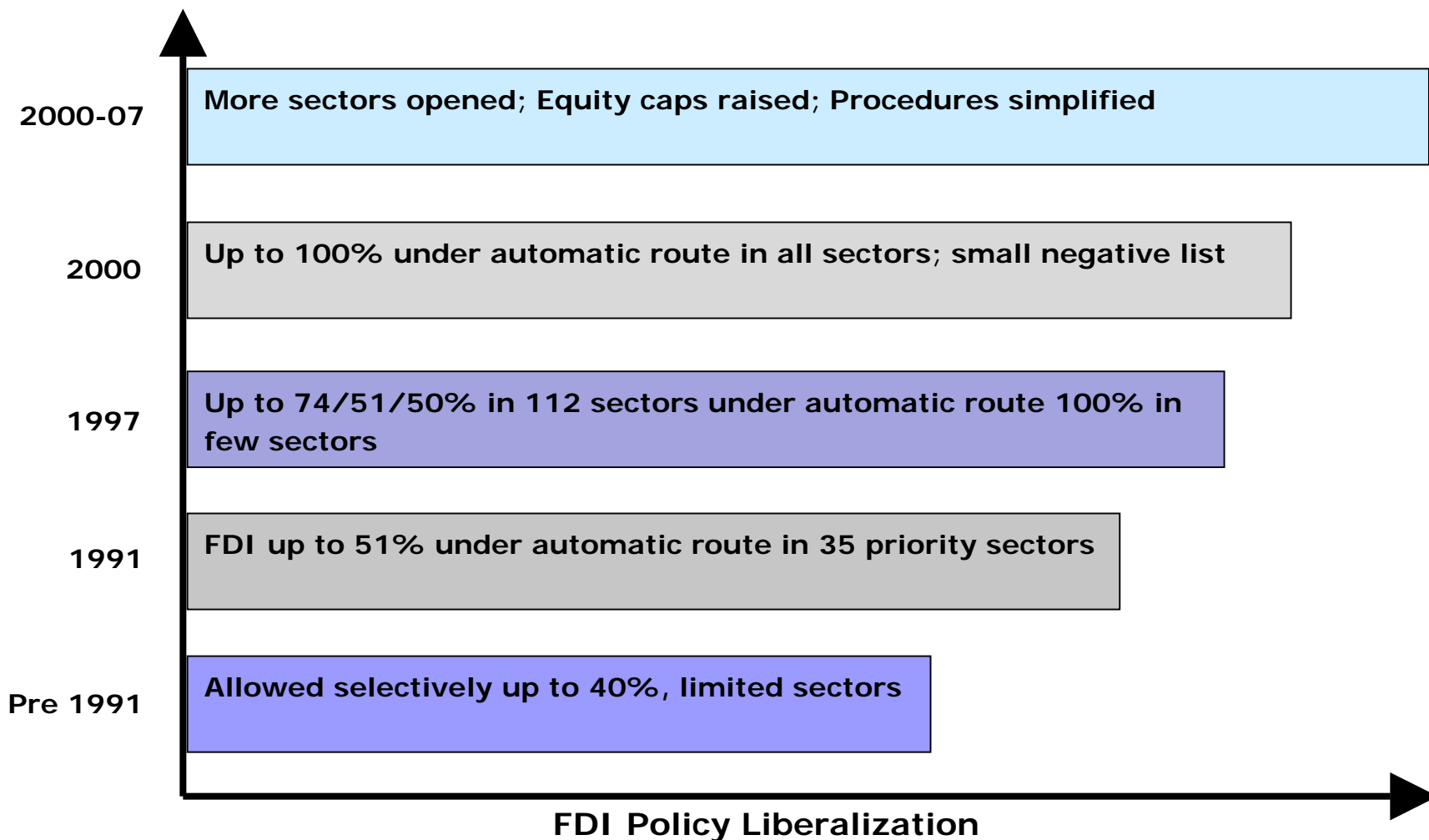
Economic Indicators - Fiscal Deficit

Trends in Deficit



Sharp deterioration in the fiscal position due to conscious measures to counteract effect of global shocks i.e. global commodity price rise and financial meltdown. **Fiscal deficit at 6.8 % - matter of key concern.**

The changing face of the FDI Policy



FDI Inflow - Top Investing Countries

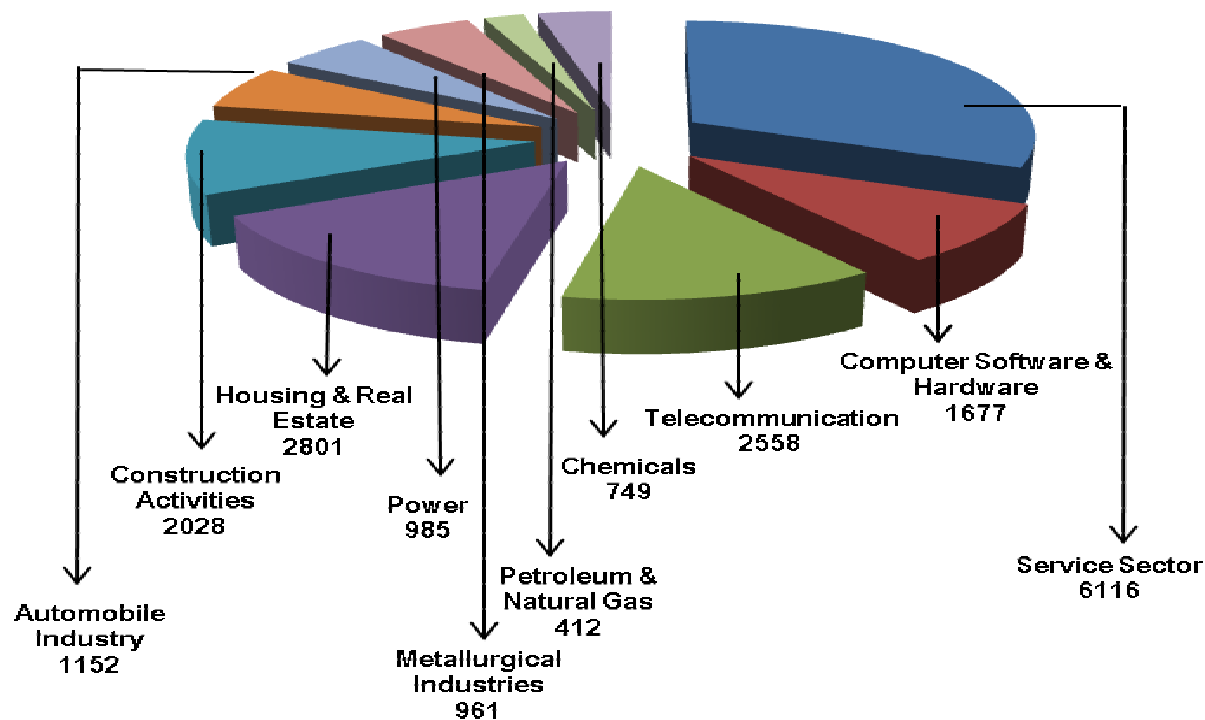
US\$ Million

Ranks	Country	2006-07	2007-08	2008-09	2009-10 (May 2009)	Cumulative
1	MAURITIUS	6,363	11,096	11,208	2,515	39,379
2	SINGAPORE	578	3,073	3,454	260	8,071
3	USA	856	1,089	1,802	173	6,508
4	UK	1,878	1,176	864	62	5,289
5	NETHERLANDS	644	695	883	110	3,701
6	JAPAN	85	815	405	303	2,834
7	GERMANY	120	514	629	205	2,378
8	CYPRUS	58	834	1,287	307	2,579
9	FRANCE	117	145	467	6	1,233
10	U.A.E.	260	258	257	75	995
	Total	15,726	24,579	27,309	4,434	94,274

Source – Department of Industrial Policy & Promotion

FDI - Sectoral Composition

Sectoral Composition of FDI 2008-09 (USD million)



Budget 2009 & beyond

Present Focus

- ❑ Recovery – focus on infrastructure
- ❑ Control fiscal deficit
- ❑ Ease-out defunct laws, rationalise taxes
- ❑ Spreading opportunities across the rural belt
- ❑ Encourage Foreign Direct Investment

Impetus on Infrastructure

- Push for long range projects viz. PPP
- SME encouragement
- Corporatize governmental enterprises providing commercial services
- Regulatory body for transport sector, covering highways, railways, ports and airports

Impetus on Infrastructure

Public Private Partnership (PPP)

- ❑ Earlier PPP model – viability gap, low government financial involvement, project developer usually unhappy with government over-interference
- ❑ Current PPP model – debt financing & newer methods to raise equity.
- ❑ New equity tools being planned viz golden share
- ❑ Established stable & efficient, regulatory & dispute resolution mechanisms

Fiscal Deficit

- Divestment - selling of 5-10 per cent equity in previously identified profit making Public Sector Enterprises ('PSUs'), unlisted PSUs, auction all loss making PSUs
- Other possibilities – amnesty schemes, NRI deposits

Promising Sectors

- ❑ **Retail**
- ❑ **Healthcare**
- ❑ **Logistics**
- ❑ Power
- ❑ Transport
- ❑ Banking
- ❑ Telecom

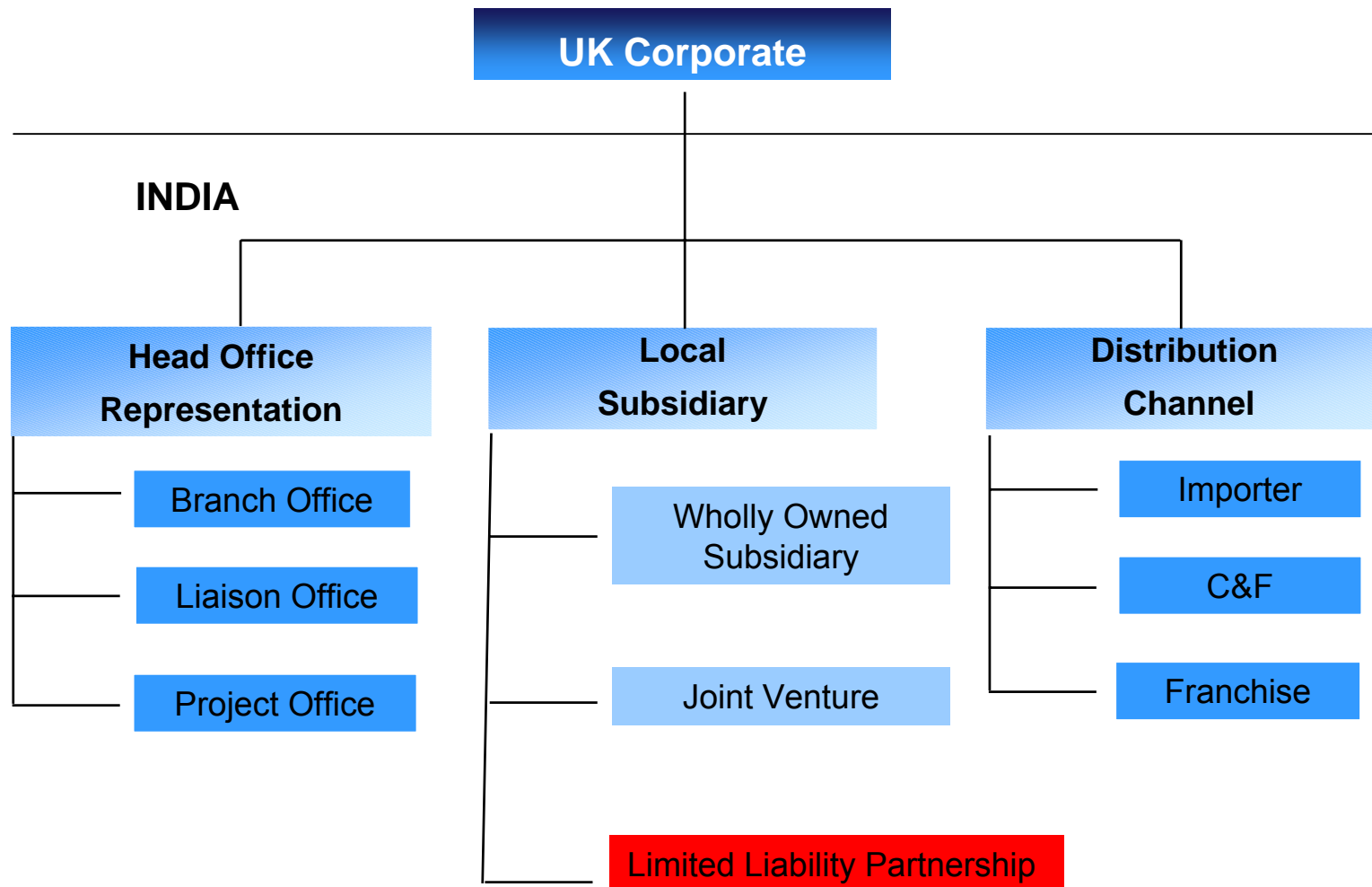
Policy Framework – In the horizon

- ❑ Goods & Services Tax
- ❑ Companies Law Amendment Bill
- ❑ New Direct Tax Code
- ❑ Insurance Laws (Amendment) Bill
- ❑ Banking Regulations (Amendment) Bill
- ❑ Phased Increase In FDI Limits
- ❑ National ID card based on unique identification number

INDIA ENTRY

Mode of Investment

INDIA ENTRY - Mode of Investment



INDIA ENTRY - Alternate Entity Comparison

	Corporate [CO]	Liaison Office [LO]	Project Office [PO]	Branch Office [BO]
Characteristics	Share capital owned by parent company	No commercial activities allowed	Temporary site office, specific projects	Commercial activities allowed
Status	Shareholders	Foreign Company	Foreign Company	Foreign Company
Tax Rate	30% +	Non Taxable	40% +	40% +
Control	Board of Directors	Parent Company	Parent Company	Parent Company
Set-up	FIPB Approval / Automatic Route (4-6 weeks)	RBI approval (4 weeks)	RBI approval (4 weeks)	RBI approval (4 weeks)
Closure	ROC (6-9 months)	RBI (3 months)	RBI (3 months)	RBI (3 months)

RBI – Reserve Bank of India
 FIPB – Foreign Investment Promotion Board
 ROC – Registrar of Companies

INVESTMENT STRATEGY – Corporate

- ❑ Green field project (*Wholly Owned Subsidiary*)
- ❑ Joint Venture
- ❑ Brown field project (*Acquisition*)

INVESTMENT STRATEGY - Greenfield Project

Wholly Owned Subsidiary

```
graph TD; A[Wholly Owned Subsidiary] --> B[Automatic Route]; A --> C[Approval Route]; B --> D[No Prior Government Approval Required]; C --> E["▶ Prior approval required from Foreign Investment Promotion Board ('FIPB') if Foreign investment exceeds specified sectoral caps"]; C --> F["▶ Applicability of Press Note 1"];
```

Automatic Route

No Prior Government
Approval Required

Approval Route

- ▶ Prior approval required from Foreign Investment Promotion Board ('FIPB') if Foreign investment exceeds specified sectoral caps
- ▶ Applicability of Press Note 1

Joint Venture Project vs Wholly Owned Subsidiary

- ❑ Value added by Indian Partner
 - Operating Infrastructure
 - Market Access
 - Government Dealing
 - Labour Management
- ❑ Management and Control
- ❑ Dilution of Profits
- ❑ Protection of Technology, Trademarks and Trade Names

INVESTMENT STRATEGY - Policy Matters

- ❑ Analysis of **Sectoral Caps** - Investment Allowed Under Automatic or Approval Route
- ❑ **Negative List** - Gambling & Betting, Lottery business, Atomic Energy, Retail trading (except 'Single Brand' product retailing)
- ❑ **Press Note 1 of 2005** - Special Approval on Investment in Existing Industries



Examine the Negative List, Sectoral caps and SSI reservations while conceptualizing investment into India

INVESTMENT STRATEGY

Existing Collaboration(s) in India can restrict your entry plans

- Do you have an **existing joint venture** with an Indian partner for the very field in which you now intend to set-up business in India?
- Do you have an **existing technology collaboration** with an Indian partner for the same field in which you intend to do business in India?

Press Note 1 (2005 Series)

If yes, a 'No Objection Certificate' is mandatory from the existing Indian Partner and prior approval is required from the Foreign Investment Promotion Board of India

INVESTMENT STRATEGY

Term Sheet and Shareholder's Agreement

Management control issues viz.

- appointment to the board of directors and chairman of the board
- appointment of CEO, MD, CFO
- issues arising from future change of control, non-compete, etc.
- implications of 26, 51 and 75 percent shareholding

Operational issues viz.

- Labour handling
- Government Liaisoning
- Appointing head of sales, manufacturing, etc

INVESTMENT STRATEGY - 'Single Brand' Retailing

Though retailing is not allowed, 'Single Brand' retail can be done through a 51:49 joint venture with an Indian Partner

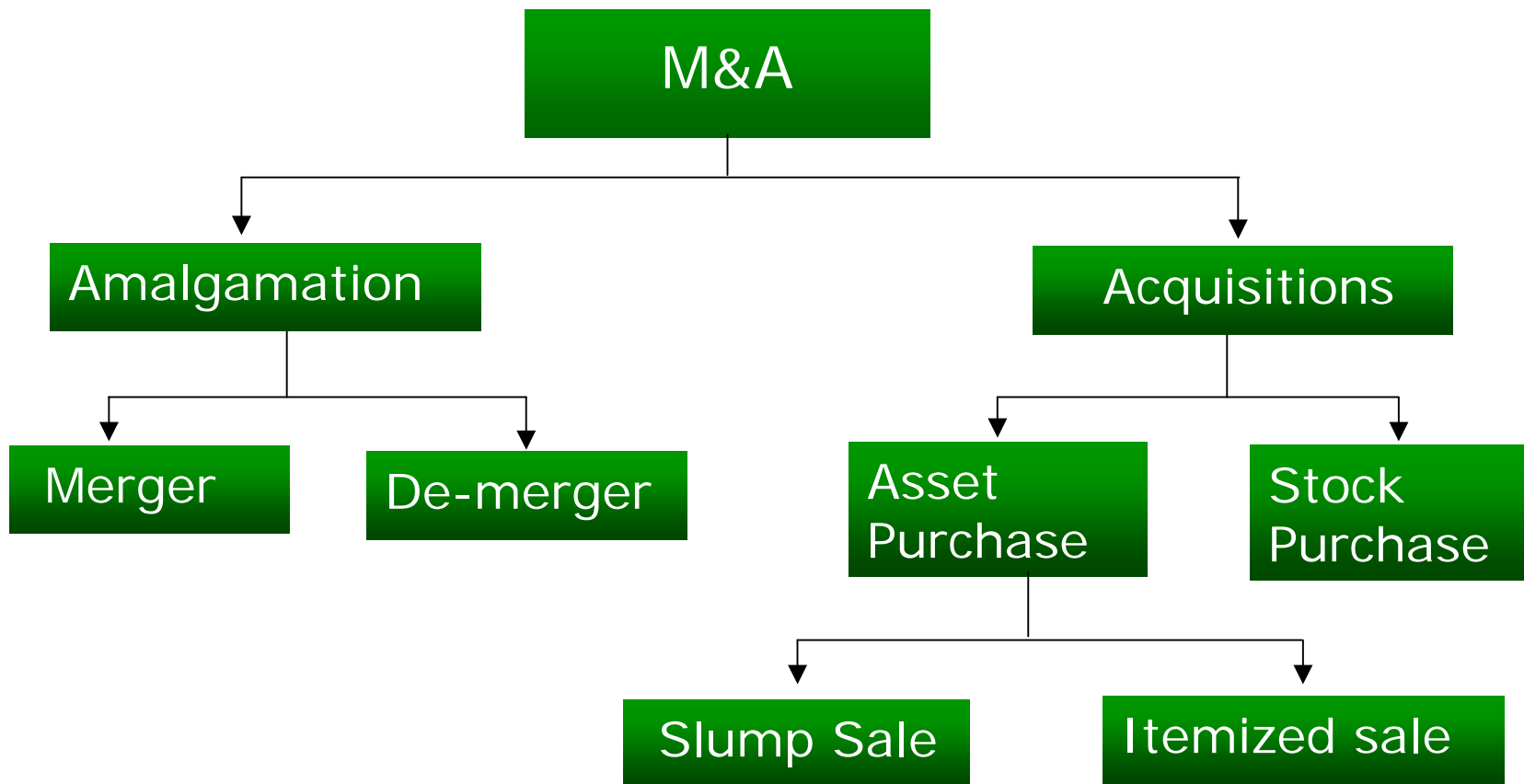
Single Brand Retailing means

- You retail goods under one single brand, and
- The brand is well recognised, and
- It covers only products branded during manufacturing

Press Note 3 (2006 Series)

Applications for single brand retailing are processed by the Department of Industrial Policy & Promotion (DIPP) and is presently somewhat restrictive

INVESTMENT STRATEGY - Brownfield Project



M&A – key tax issues

Factors

- ❑ Separation tax cost (viz. capital gains, stamp duty, VAT etc.) directly hits the seller's consideration. Therefore the need to select the **most optimum mode** of sell-out
- ❑ Future tax planning greatly impacts the financial feasibility for buyer. Therefore, the need to be aware of eligible tax holidays, unabsorbed losses, VAT credits etc to assess the real benefit.
- ❑ Procedural compliances and time-lines related to transfer of tax benefits has a bearing on the timeline to transaction closure

M&A – Modes of Carve Out

- **Demerger** : Vertical split of business unit into a new/existing entity. Generally tax neutral and allows carry forward of all benefits/losses; No VAT/ Sales tax on transfer of assets; time consuming

- **Slump Sale** : Sale of business unit as a whole on a going concern basis; may be tax efficient; widely used to dispose loss making business units; less time consuming; No VAT/ sales tax on transfer of assets; continuation of tax holidays can also be argued

- **Itemized Sale** : Sale of identified assets & liabilities; allows flexibility to sell; less time consuming; exposed to VAT/ sales tax on transfer of assets; tax holidays cannot be continued;

- **Equity Carve-Out** : Sale of shares in wholly owned subsidiary; restriction on carry forward of unabsorbed business loss, time efficient; tax holidays can be continued

M&A – Modes of Carve Out

Facts, Objectives and transaction timeline determines the optimum mode of carve – out

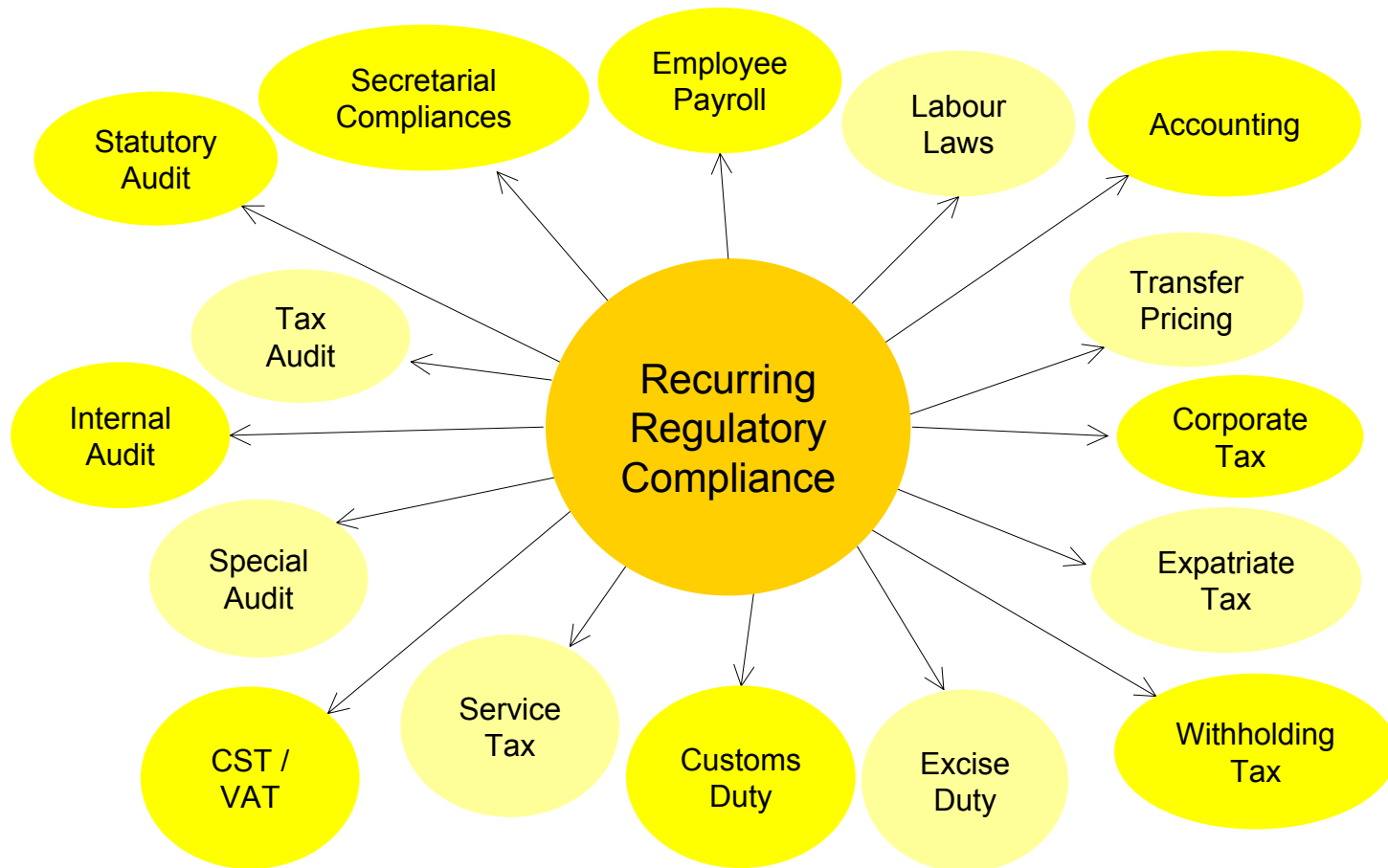
- Buyer's intention to integrate the unit with its existing operations
- Seller's need to use profits from carve-out for its core operations
- Nature of assets and liabilities constituting a business unit
- Listed Vs Unlisted entities

RECURRING REGULATORY COMPLIANCES

Understanding Regulatory Environment

- ❑ Most laws originate from British Laws
- ❑ Procedure Driven
- ❑ Failures to comply usually leads to penalty and sometimes prosecution
- ❑ Stacked in favor of labour (*blue collar staff*)
- ❑ Fine reading and interpretation is the norm

COMPLIANCES - Overview



TRANSFER PRICING

- **Arm's Length price ('ALP')**

Any income arising from an international transaction between associated parties to be computed having regard to ALP

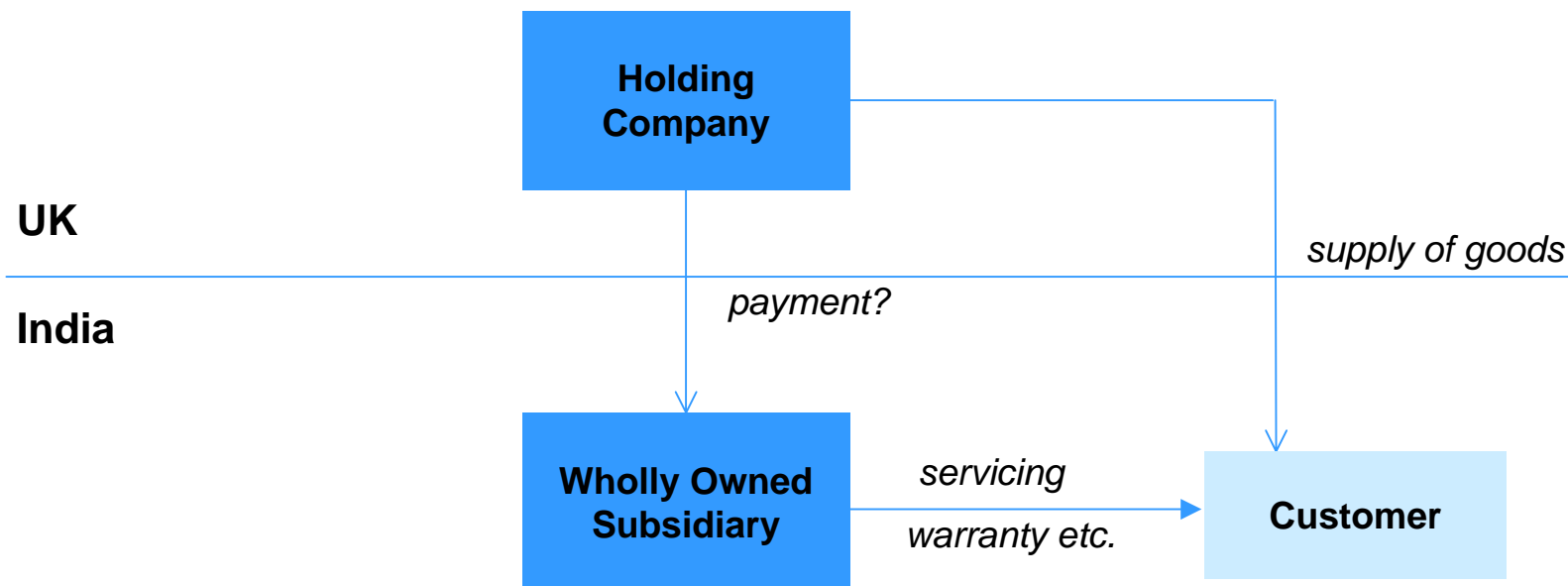
ALP means a price which is applied in a transaction between persons other than associated enterprises

- **Associated Enterprise ('AE')**

Participation in management or control or capital of other enterprise
Directly through intermediaries

TRANSFER PRICING

Determining the appropriate pricing for intra - group transactions



Transfer Pricing Issue –
what should be the profit
margin of the Wholly
Owned Subsidiary?

PERMANENT ESTABLISHMENT (PE) - Risk of

- Foreign company operating through an agent, branch etc regarded as having a PE in India
- In certain cases, an Indian subsidiary can be classified as a PE

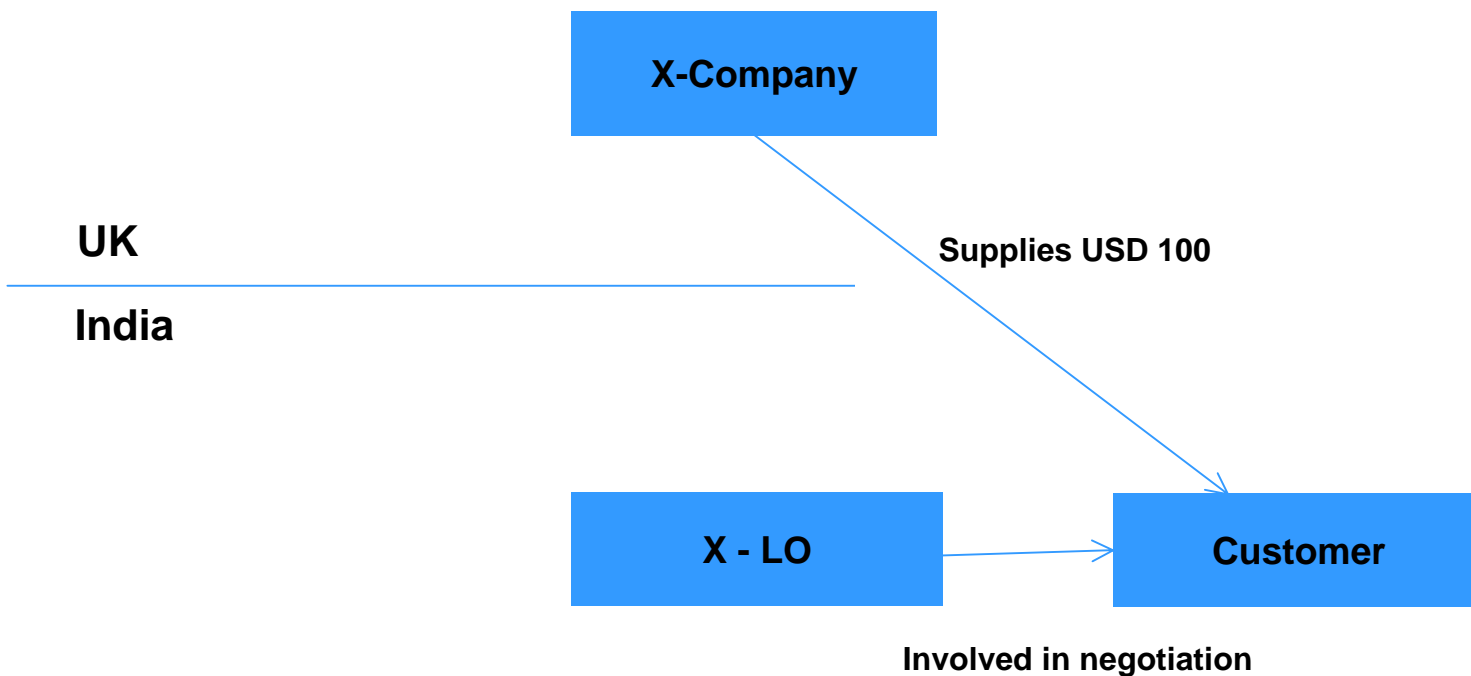
Where work linked to India, India tax office can prove existence of PE, part or entire portion of India linked transactions can be brought to tax in India

LIAISON OFFICE - The PE Trap

- Does the India Liaison Office ('LO') sign direct contracts in India ?
- Is the LO deeply involved in price negotiations?
- Are the employees of the LO paid incentives on sales ?
- Does the LO raise Purchase Orders on the Head Office ?

An affirmation to any of the above – LO regarded as a Permanent Establishment of the parent company in India. This is a high risk of exposure to taxation

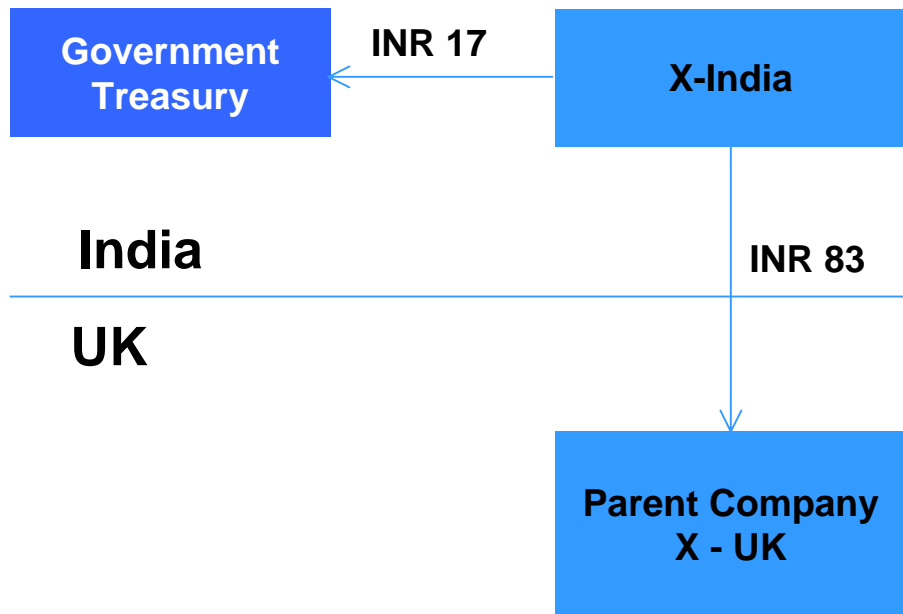
LIAISON OFFICE - The PE Trap



Effect: Part or whole of USD 100 can be taxed to India

REPATRIATING PROFITS

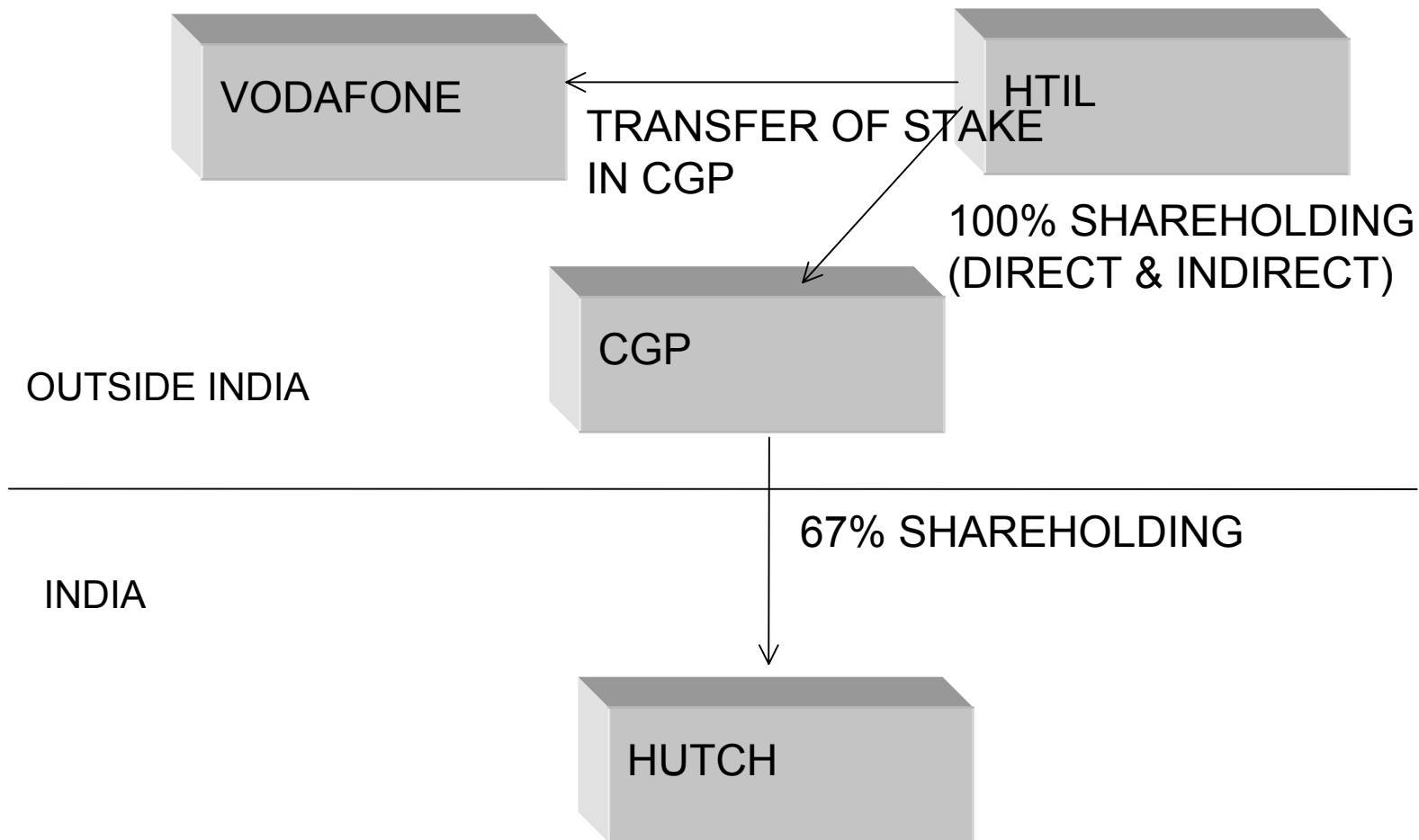
The menace of Dividend Distribution Tax



Amount in INR	
Net Profit	133
Tax on Profit	33
Distributable Profit	100

Whether the credit in respect of Dividend Distribution Tax (DDT) of INR 17 is available in the Parent Country?

INBOUND INVESTMENT – use of tax treaties



INBOUND INVESTMENT – use of tax treaties

- Contentions of Revenue Authorities
 - Such transfer of shares represents transfer of business assets in India and therefore was liable to tax in India

- A writ petition was filed by Vodafone before the Bombay High Court on the following grounds
 - That the transaction was not taxable in India (as per tax treaty)
 - Show-cause notice is without jurisdiction and Vodafone is not as assessee in default.

- The Court held that “shares in themselves which may be an asset but in some cases like the present one, shares may be merely a mode or a vehicle to transfer some other asset(s). In the instant case, the subject matter of transfer as contracted between the parties is not actually the shares of a Cayman Island company, but the assets situated in India” . Hence, the transaction is prima facie taxable in India

- Vodafone appealed before the Supreme Court, which also decided in favor of the Revenue authorities

ON THE ANVIL

Major Regulatory Changes

LIMITED LIABILITY PARTNERSHIP (LLP)

- ❑ LLP - alternate corporate business entity
- ❑ Like a private limited company, is a body corporate having a distinct legal entity separate from its partners
- ❑ Benefit of limited liability, at the same time allowing members a flexible internal structure akin to partnership
- ❑ LLP introduced, appropriate changes awaited in the exchange control regulations and tax laws

NEW COMPANIES BILL 2008

- ❑ Introduction of One Person Company (OPC)
OPC can be formed for charitable purpose as well
- ❑ Companies can be struck off if business not commenced within 180 days of incorporation
- ❑ One Resident Director mandatory for all companies
- ❑ Director can himself file details of his resignation to ROC
- ❑ A Whole-Time Director not to hold office in more than one company unless permitted by the company

International Financial Reporting Standards (IFRS)

- India to fully converge with IFRS by April 1, 2011

- Will apply to all public listed companies and those with turnover exceeding USD 25 million

- Paradigm shift in the basis of recording transactions
 - Impresses substance over form
 - adequacy of disclosures

DIRECT TAX CODE (DTC)

- ❑ Business related loss can be carried forward for an indefinite period
- ❑ Tax rate on royalties and fee for technical services payable to non-residents enhanced to 20 per cent on gross payment
- ❑ Head office expenses, earlier based on 5 per cent of net profits of non-resident Permanent Establishment ('PE'), will now be computed at 0.5 per cent of net sales
- ❑ Introduction of General Anti Avoidance Rule ('GAAR') wherein commercial expediency of international transactions can be challenged by the authorities; primarily to check contentious issues viz. check round trip financing, lifting of corporate veil etc
- ❑ Provisions of DTC to have an overriding effect over all past tax treaties signed by India

DIRECT TAX CODE (DTC)

- ❑ Tax rates rationalized for both corporate and non-corporate tax payers. All corporates to now pay a reduced tax of 25 per cent
- ❑ Domestic companies to still pay a 'dividend distribution tax' at 15 per cent
- ❑ Foreign companies to pay an additional 'branch profits tax' at 15 per cent of post tax profits
- ❑ Export based incentives (viz. STPI, EOU etc) discontinued; though the existing schemes of deductions/exemptions will be grandfathered
- ❑ Fresh tax exemptions to be 'investment linked' rather than 'profit linked'
- ❑ Payment of Minimum Alternate Tax (MAT) now based on 'value of gross assets' and not 'book profits'. Rate revised to 2 per cent from 15 per cent. No credit allowed of taxes paid under MAT

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