



**DEZAN SHIRA & ASSOCIATES**

Your Partner for Growth in Asia

**An Introduction to**

# **Doing Business in India 2017**



**25** Years  
1992-2017



**VISIT US ON FACEBOOK**

<Dezan Shira & Associates>  
<India Briefing>



**VISIT US ON LINKEDIN**

<Dezan Shira & Associates>  
<India Briefing>



**FOLLOW US ON TWITTER**

@DezanShira  
@IndiaBriefing



This edition of Doing Business in India was produced by a team of professionals at Dezan Shira & Associates, with Koushan Das and Melissa Cyrill as Editors. Creative design of the guide was provided by Jessica Huan, Kking Lu and Belén Rodríguez.

© 2017 Dezan Shira & Associates

---

**Disclaimer**

The contents of this guide are for general information only. For advice on your specific business, please contact a qualified professional advisor. Copyright 2017, Asia Briefing Ltd. No reproduction, copying or translation of materials without prior permission of the publisher.



# DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia



## About Dezan Shira & Associates

At Dezan Shira & Associates, our mission is to guide foreign companies through Asia's complex regulatory environment and assist them with all aspects of establishing, maintaining and growing their business operations in the region. Since its establishment in 1992, Dezan Shira & Associates has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam, as well as liaison offices in Italy, Germany and the United States, and partner firms across the ASEAN region. With over 25 years of on-the-ground experience and a large team of professional advisers, we are your reliable partner in Asia

# Preface

India surged ahead of China in receiving foreign direct investment (FDI) in 2016. In the first six months of 2016, there was a 30 percent increase in FDI – equaling US\$21.6 billion as compared to US\$16.6 billion the previous year as per the Department of Industrial Promotion & Policy (DIPP). As the government pushes toward the ease of doing business, India is now perfectly positioned to compete with the world’s premier investment locations.

India can offer investors a unique array of advantages. Its skilled and low-cost labor force is one of the largest in the world, and it has a high level of English fluency relative to other countries in Asia. The reforms that have been implemented are numerous and include infrastructural improvements, the raising of FDI caps, and the simplification of visa obtainment procedures.

This publication, designed to introduce the fundamentals of investing in India, has been created using the most up-to-date information at the time. It was compiled by Dezan Shira & Associates, a specialist foreign direct investment practice that provides corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence and financial review services to multinationals investing in emerging Asia.



**ADAM LIVERMORE**

Partner  
Dezan Shira & Associates



## CONTACT

**Dezan Shira & Associates**

india@dezshira.com

www.dezshira.com



# Dezan Shira & Associates India



**ROHIT KAPUR**  
Country Manager  
Dezan Shira & Associates  
India Offices

Dezan Shira & Associates expanded into India in 2007, opening offices in Mumbai and later New Delhi in 2008. The launch of Dezan Shira's India offices was coupled with the launch of India Briefing, which is now a premier source of business and regulatory intelligence related to the Indian market.

Our services in India include corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence, and financial review. Dezan Shira & Associates' experienced business professionals in India are committed to improving your understanding of investing and operating in emerging Asian markets.

## DELHI OFFICE



Unit No. T-15, Third Floor, Rasvilas  
Saket District Centre  
New Delhi 110017, India

Tel: +91 9555440455  
Email: delhi@dezshira.com

## MUMBAI OFFICE



35, 3rd Floor Mittal Chambers.  
Nariman Point  
Mumbai 400021, India

Tel: +91 22 2204 6117  
Email: mumbai@dezshira.com



# Committed to Economic Reform and Digitalization: The Indian Economy in 2017

2016 ended on an epochal note for India's economy as the government implemented the demonetization of high-denomination currency notes (Rs 500 and Rs 1000) in an effort to combat counterfeit currency and formalize the parallel (black) economy to increase tax jurisdiction. Old currency was allowed to be exchanged till December 30, in tranches, and was monitored by tax authorities for discrepancies. Only in the case of non-resident Indians (NRIs), this exchange will be allowed until June 30, 2017; Indians who were abroad between November 9 and December 30, 2016 will be allowed a grace period till March 31, 2017.

In the initial weeks, demonetization led to cash shortages as the central bank imposed restrictions on withdrawals to manage the distribution of new and small denomination currency. Inevitably, this resulted in the slowdown of consumer spending and industrial growth, leading to a dip in the country's growth forecast at 6.6 percent.

Nevertheless, this slowdown is most likely to be temporary as India remains one of the fastest growing economies of the world. In the medium term, growth prospects look good precisely as the drive towards accelerating domestic manufacturing, infrastructure investments, support for startups, and the digitalization of the economy will continue undeterred.

Bolstering this overall positive outlook is the expected implementation of the Goods and Services Tax (GST) in the forthcoming financial year. Finally, the government is committed to various economic, legislative, and regulatory reforms that will ease the entry, investment, and expansion of business operations in India.

---

# Table of Contents

---

<b>Preface</b>	<b>04</b>
<b>Part 1   Establishing and Running a Business</b>	<b>09</b>
What are my options for investment?	10
Liaison office	10
Branch office	12
Project office	13
Setting up a wholly foreign-owned business in India	15
Establishing a wholly owned subsidiary	15
Navigating FDI caps and restrictions	18
FDI routes and forms	18
Changes to FDI caps and approval routes	18
Investing	21
<b>Part 2   Tax and Accounting in India</b>	<b>22</b>
Key taxes in India	23
Value Added Tax	23
Service Tax	27
Customs duty	29
India's Audit Process	38
Understanding annual audit: An overview	38
Types of audits	39
Ensuring a smooth audit: Key considerations	45
Miscellaneous	47
Summary	48

---

---

<b>Part 3   Human Resources and Payroll Considerations</b>	<b>51</b>
Key considerations when hiring staff	52
Visa application	52
Visa registration	53
Payroll and Social Insurance	60
Withholding tax returns filing	60
Individual Income Tax (IIT)	60
Income tax returns	61
India's Provident Fund scheme	63

---

<b>Part 4   Operational Issues</b>	<b>65</b>
Import and export procedures	66
Import procedures	66
Export procedures	67
Duties explained	69
An introduction to sourcing from India	72
India's sourcing edge	72

---

---

# Establishing and Running a Business

- ◆ **What are my options for investment?**
- ◆ **Setting up a wholly foreign-owned business in India**
- ◆ **Navigating FDI caps and restrictions**

# What are my options for investments?

A foreign investor may set up in India either as an 'unincorporated entity' or an 'incorporated entity'.

Unincorporated entities permit a foreign company to do business in India by establishing a liaison office, branch office, project office, or a trust. An incorporated entity in India has a more structured set up and is governed by the provisions of the Companies Act, 2013 / Limited Liability Partnership Act, 2008. We discuss the prominent unincorporated entity structures in India.

- Liaison office
- Branch office
- Project office

## Liaison office

Foreign companies can open a liaison office in India to facilitate and promote the parent company's business activities and act as a communications channel between the foreign parent company and Indian companies. Unable to engage in commercial, trading, or industrial activities, liaison offices must be sustained by private, inward remittances received from their foreign parent company.

A liaison office is permitted to engage in the following activities:

- Facilitate communication between the overseas head company and parties in India
- Promote imports/exports between countries
- Establish financial and technical cooperation between overseas and Indian companies
- Represent the overseas head company in India

The Foreign Exchange Management Act (FEMA), administered through the Reserve Bank of India (RBI), governs the application and approval process for the establishment of a liaison or branch office. Under the Act, foreign enterprises must receive specific approval from the RBI or through an 'authorized dealer' bank to operate a liaison office in the country. Applications are to be submitted through Form FNC (Application for Establishment of Branch/Liaison Office in India). The approval process generally takes 20 to 24 weeks and permission to operate a liaison office is granted for a three-year period, which can be extended at a later date.

Additionally, an enterprise must also meet the following conditions before qualifying for the establishment of a liaison office:

- Must have profitable operations during the immediately preceding three years in the home country
- Must have a minimum net worth of US\$50,000 verified by the most recent audited balance sheet or account statement



### CONTACT

**Dezan Shira & Associates**

india@dezshira.com

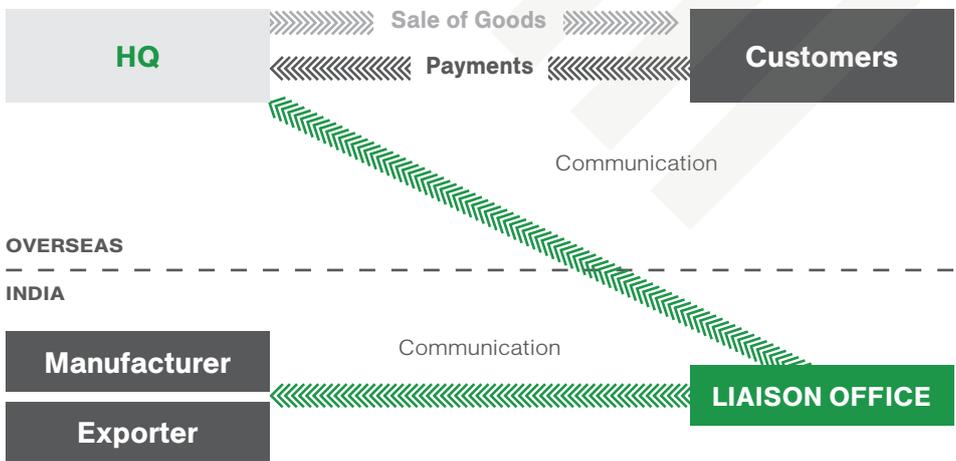
www.dezshira.com



If the company does not meet these requirements, but is a subsidiary of another company, that parent company may submit a Letter of Comfort on the subsidiary's behalf as long as it meets the conditions as mentioned above. A company must submit a Certificate of Incorporation or Memorandum and Articles of Association, and a copy of the parent company's latest audited balance sheet. The liaison office must also obtain a Permanent Account Number (PAN) from the income tax authorities.

Within 30 days of establishment, the liaison office must register with the Registrar of Companies (RoC) by filing Form FC-1 through the Ministry of Corporate Affairs' online portal. The following documents must also be provided:

- A copy of the liaison office charter or Memorandum and Articles of Association in English
- Full address for the enterprise's principal place of operation outside of India
- Name and address of the liaison office in India
- List of directors
- Name and address of the company's official representative based in India (e.g. the person authorized to accept delivery of notices and documents served to the company)



Each year, the liaison office must file an Annual Activity Certificate (AAC), prepared by a chartered accountant, to the RBI verifying the office's activities are within its charter. An AAC should also be filed with the Directorate General of Income Tax within 60 days of the close of the financial year. Only applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong, Kong, Macau and Pakistan have to register with the state police.

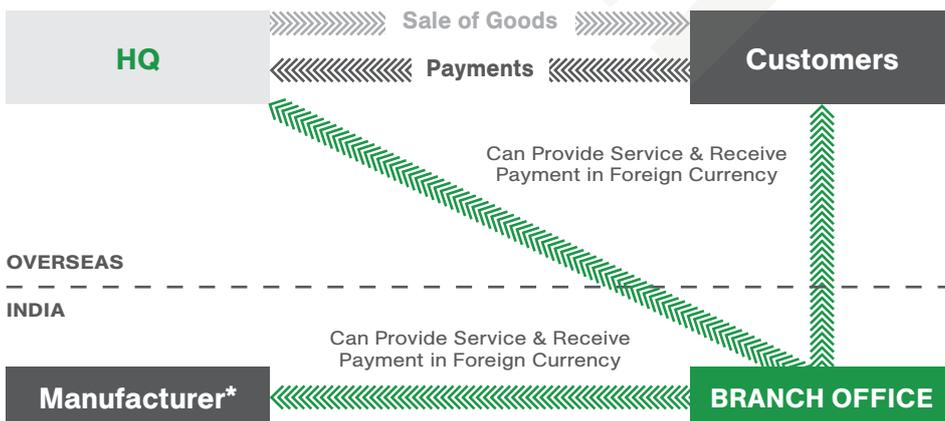
Copy of approval letter for citizens from these countries shall be marked by the AD Category I bank to the Ministry of Home Affairs, Internal Security Division – I, Government of India, New Delhi for necessary action and record. All other countries are exempt from registering with the state police.

## Branch office

Foreign companies, including those engaged in manufacturing and trading activities, are able to establish branch offices to carry out business activities substantially the same as those carried out by their parent company. Branches are permitted to carry out trading activities, but may not engage in manufacturing activities on their own—these may be subcontracted to Indian manufacturers. Branch offices operating in SEZs, however, are permitted to undertake manufacturing and service activities in sectors with 100 percent FDI approval.

Branch offices are permitted to engage in the following activities:

- Export/import of good
- Rendering professional or consultancy services, IT services, or technical product support
- Carrying out research work in which the parent company is engaged.
- Representing the parent company as a buying/selling agent or in order to establish technical or financial collaborations with Indian companies
- Operating as a foreign airline or shipping company
- Promoting technical or financial collaboration between Indian companies and parent or overseas group company
- Rendering technical support to the products supplied by parent/group companies



\* Can manufacture if in SEZ with 100 percent FDI



FEMA also governs the application and approval process for the establishment of a branch office, requiring that companies receive approval from the RBI. Permission to operate a branch office is granted for a three-year period, which can be extended at a later date. An enterprise must also meet the following conditions before qualifying for the establishment of a branch office:

- Must have profitable operations during the immediately preceding five years in the home country
- Must have a minimum net worth of US\$100,000 verified by the most recent audited balance sheet or account statement

If a company does not meet these requirements, but is a subsidiary of a company that does, the parent company may also submit a Letter of Comfort on the subsidiary's behalf during the application process. The process for establishing a branch office is identical to that required for a liaison office, and the same documents including Form FNC, the Certificate of Incorporation or Memorandum and Articles of Association, and an audited balance sheet must be submitted. A PAN must also be acquired, and the office must register with the Registrar of Companies through the Ministry of Corporate Affairs' online portal.

Each year, the branch office must file an AAC, prepared by a chartered accountant, to the RBI verifying the office's activities were within its charter. An AAC should also be filed with the Directorate General of Income Tax within 60 days from the end of the financial year. All profits earned by the branch office may be remitted from India, and will be subject to payment of all applicable taxes. Only applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong, Macau and Pakistan shall have to register with the state police.

Copy of approval letter for persons from these countries shall be marked by the AD Category I bank to the Ministry of Home Affairs, Internal Security Division – I, Government of India, New Delhi for necessary action and record. All other countries are exempted from registering with the state police.

## Project office

If a foreign company has secured a contract from an Indian company to execute a project in India and has attained the appropriate funding source or governmental clearance, a project office may be established.

One of the following criteria must be met in order to obtain permission to establish a project office:

- The project is funded directly by inward remittance from the overseas head company
- The project is funded by a bilateral or multilateral international financial agency such as the World Bank or IMF

- The project has received clearance by the relevant authorities within India
- The Indian company awarding the contract has been granted a term loan for the project

If none of the above criteria are met, an overseas company looking to establish a project office in India must make a specific request with the Central Office of the RBI for approval.

The project office should notify the relevant regional Director General of Police within five days of the office's establishment. Within two months the overseas company must also submit a report to the relevant regional office of the RBI through the authorized dealer branch bank (AD) that will be used by the foreign company. This report should include:

- Name and address of the overseas company
- Reference number and date of project contract
- Particulars of the authority awarding the project contract
- Total amount of the contract
- Brief details of both the project undertaken and authorized dealer branch bank
- Project details, including project office tenure and contact information

Each year, the project office will be required to submit a Project Status report compiled by a chartered accountant to the company's AD branch. This report ensures the activities undertaken by the project office conform with the activities permitted by the RBI. Only applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong, Kong, Macau and Pakistan shall have to register with the state police.

Copy of approval letter for persons from these countries shall be marked by the AD Category I bank to the Ministry of Home Affairs, Internal Security Division – I, Government of India, New Delhi for necessary action and record. All other countries are exempted from registering with the state police.

Project offices may open a non-interest bearing foreign currency banking account with an authorized dealer branch in India for project expenses and credits. The office may maintain both a foreign currency account and a rupee account while operating in India. Project offices are allowed occasional remittances to their parent companies and must provide a chartered accountant certificate verifying the offices can still meet their liabilities. Following project completion, the project office may repatriate any capital surplus once all tax liabilities have been paid, a final audit of the project accounts has been completed, and a document verifying the remittable surplus provided.



## RELATED NEWS

### **New Forms for Company Incorporation in India**

*India Briefing News  
November, 2016*

AVAILABLE HERE

# Setting up a wholly foreign-owned business in India

## Establishing a wholly owned subsidiary

Under Indian law, foreign investors are able to establish wholly owned subsidiary companies (WOS) in the form of private limited companies if they operate in sectors that permit 100 percent foreign direct investment (FDI). With India's recent loosening of FDI caps, companies are now also able to establish WOS in the telecom services and asset reconstruction sectors. Establishing a private limited company can be a lengthy and complicated process involving multiple steps.

First, a minimum of two directors (at least one must be a resident in India) must be appointed and registered through India's e-filing system for Director Identification Numbers (DIN). Minimum requirements for the establishment of a private limited company include the existence of two directors, two shareholders (who may be the same person as the directors), and a minimum share capital of US \$1,500 (INR 100,000 (1 lakh)).

Second, a suitable name must be selected that indicates the main objectives of the company, and submitted with the RoC along with a brief description of the business's proposed functions to verify both the name's appropriateness and availability. Upon successful name registration, the applicant company has 60 days to file its Memorandum of Association (MOA) and Articles of Association (AOA), and proceed with formal incorporation filings. Both the MOA and AOA must be stamped with the appropriate duty after the needed RoC fees and stamp duty have been paid, and both forms signed by at least two subscribers with a witness.

The following forms are required to be filed with the Ministry of Corporate Affairs for establishing a WOS.

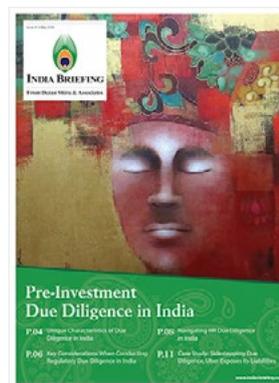
- Form INC-1; Name approval form
- Form INC-7 or INC-2: Form INC-7 for Application for incorporation of a company (Other than One Person Company) or Form INC-2 for Application for Incorporation of OPC.
- Form INC-22: Notice of situation or change of situation of registered office based on the option chosen in Form INC-7.
- Form DIR-12: Particulars of appointment of directors and the key managerial personnel and the changes among them.

Upon successful submission of the above documents, the RoC will issue a Certificate of Incorporation and a Corporate Identification Number (Corporate Identity). The process generally takes seven to eight weeks to complete, and private limited companies are permitted to commence business immediately following their successful incorporation.

Ministry of Corporate Affairs has introduced SPICe Form INC-32 which is Simplified Proforma for Incorporating Companies Electronically. SPICe or Form INC-32 can help incorporate a company with a single application for reservation of name, incorporation of new company and/or application for allotment of Director Identity Number (DIN).



### RELATED READING



#### **Pre-Investment Due Diligence in India** May, 2016

We examine issues related to pre-investment due diligence in India. We highlight the different regulatory, tax, and socio-economic issues that a company should be aware of before entering the Indian market. We also detail some of the topics related to entry structures while investing in the Indian market, as well as cultural and HR due diligence, which may differ from state to state.

AVAILABLE HERE

## Applicable taxes

While India has been liberalizing its governing policies since 1991, the country's tax structure remains among the most complex and difficult to navigate in the world. Understanding the wide variety of laws, regulations and procedures can be confusing for even the savviest of business operators. Foreign companies that do not seek specialized advice often end up overpaying on taxes or on the associated penalties and interest that go along with them. What follows is a brief description of the various taxes which should be taken into consideration when incorporating a private limited WOS company in India.

### Tax Rates for Foreign Companies

Particulars	Taxable income is < US\$150,000	Taxable income > US\$150,000 < US\$1.4 million	Taxable income > US\$1.4 million
Basic rate	40.00%	40.00%	40.00%
Surcharge	0	2.00%	5.00%
Basic rate + surcharge	40.00%	40.80%	42.00%
Edu. cess@ 3%	3%	3%	3%
Effective tax rate	41.20%	42.02%	43.26%

### Domestic Companies with Turnover/Gross Receipts of Less Than US\$750,000

Particulars	Taxable income < US\$150,000	Taxable income > US\$150,000 < US\$750,000
Basic rate	29.00%	29.00%
Surcharge	0	2.00%
Basic rate + surcharge	29.00%	29.58%
Edu. cess@ 3%	3%	3%
Effective tax rate	29.87%	30.46%

### Domestic Companies with Turnover/Gross Receipts of More Than US\$750,000

Particulars	Taxable income is < US\$150,000	Taxable income > US\$150,000 < US\$1.4 million	Taxable income > US\$1.4 million
Basic rate	30.00%	30.00%	30.00%
Surcharge	0	7.00%	12.00%
Basic rate + surcharge	30.00%	32.10%	33.60%
Edu. cess@ 3%	3%	3%	3%
Effective tax rate	30.90%	33.06%	34.61%

## Tax on the distribution of dividends

Corporate entities are subject to a tax on the distribution of dividends. However, in the case of shareholder dividends, the associated income is exempt from tax. The current effective rate of the Dividend Distribution Tax is 20.358 percent (15 percent plus a 12 percent surcharge and an education cess of 3 percent grossed up to the amount distributed.). No exemption from payment of the DDT is granted for the profits relating to SEZ developers. In addition, individuals, firms and HUF residents in India receiving dividend income in excess of US\$150,000 (INR 10 lakhs) shall be charged additional tax at 10 percent plus surcharges and cess (may be applicable) on a gross basis.

To avoid a situation of double taxation being created by the DDT, it is permitted that, for the purpose of computing the tax, any dividend received by a domestic company during any financial year from its subsidiary shall be allowed to be deducted from the dividend to be distributed. This is provided the dividend received by the domestic company has been subject to DDT and the domestic company is not the subsidiary of any other company.

## Minimum alternate tax

All companies declaring low or zero taxable income are subject to the Minimum Alternate Tax (MAT). Presently, MAT is levied at 18.5 percent of book profits plus the applicable surcharges and education cess. The MAT is levied on companies whose tax payable under normal income tax provisions is less than 18.5 percent of book profits. Additionally, MAT is applicable to SEZ developers/units for income arising on or after April 1, 2012.

## Taxation of royalties/technical fees

Under domestic tax law, the royalties/technical fees that are payable to non-residents with a permanent establishment in India are taxed on a different basis compared to non-residents without permanent establishment in India. Concessional tax rates apply if the agreement relates to a matter that has been approved by the government of India. The payments made are subject to tax avoidance agreements entered into by the non-resident's country.

## Wealth tax

As of April 1 2016, Wealth Tax has been abolished. For information on the indirect taxes that a company will encounter in India, see our Tax and Accounting in India section.



VISIT US ON FACEBOOK  
@IndiaBriefing

# Navigating FDI caps and restrictions

Amendments in Indian FDI policy has opened a number of key business sectors to increased foreign investment and, in several instances, eliminated the need for foreign investors to obtain approval from the Indian government before investing. These amendments have been further augmented, with several sectors significantly increasing the amount of foreign investment permitted.

## FDI routes and forms

Foreign investment into India falls under one of two FDI routes:

- Government Route: For investment in business sectors requiring prior approval from the Foreign Investment Promotion Board (FIPB).
- Automatic Route: For investment in business sectors that do not require prior approval from the government, but the filing of a notification after the incorporation of the company and issue of initial shares.

Foreign investment takes one of two principal forms:

- Foreign Direct Investment (FDI): The acquisition of shares or other securities in an Indian company.
- Foreign Institutional Investment (FII): Investment by foreign institutional investors (such as hedge funds, insurance companies, or mutual funds) registered with the Securities and Exchange Board of India (SEBI).

These distinctions are important when interpreting recent changes in foreign investment policy, as FDI caps and approval routes often vary by both industry and investor.

## Changes to FDI caps and approval routes

FDI amendments are now being further augmented under the Narendra Modi administration, with several sectors significantly increasing the amount of foreign investment permitted. Of particular interest are the hikes that will be seen in the private sector banking and railway sectors; the former rising from 74 percent to 100 percent, and the later from 0 percent to a massive 100 percent.

India's current FDI caps look like this:

India's current FDI caps				
Sector/Industry	Previous Policy		2017 Policy	
	Investment Cap	Approval Route	Investment Cap	Approval Route
Commodity exchanges	49% ( FDI + FII )	Government	49%	Automatic
Power exchanges	49% ( FDI + FII )	Government	49%	Automatic
Asset reconstruction	74% ( FDI + FII )	Government	100%	Automatic
Insurance	26% ( FDI )	Automatic	49% ( FDI + FII )	Automatic
Telecom services	Up to 49%	Automatic	Up to 49%	Automatic
	Above 49% and up to 74%	Government	Above 49% and up to 100%	Government
Courier services	100%	Government	100%	Automatic
Test marketing	100%	Government	100%	Automatic
Petroleum refining by public sector undertakings	49%	Government	49%	Automatic
Defense production	26% ( FDI )	Government	49% Above 49%	Automatic Government
Railway infrastructure	N/A		100%	Automatic
Print media	26%	Government	26%	Government
Brownfield pharmaceuticals	100%	Government	100%	Government
			74%	Automatic
Multi-brand retail	51%	Government	51%	Government
E-commerce (B2B only)	100%	Automatic	100%	Automatic
Civil aviation	100% except in		100% except in	
• Scheduled air transport service / domestic scheduled passenger airline	49%	Automatic	49%	Automatic
			100%	Government
• Regional air transport service			100%	Automatic for Non-Resident Indians

## Single and multi-brand retail trading

While previous FDI policy only permitted one non-resident entity with ownership of a brand (or rights to a brand) to invest in Indian companies engaged in the retail trading of that brand, policy changes now allow multiple non-resident entities to invest in Indian entities engaged in single-brand retail trading of that brand (as long as each own or have rights to the brand via a legally binding agreement).

<b>Single-Brand Retail Trading</b>		
	<b>Cap</b>	<b>Route</b>
<b>Former position</b>	100%	Government
<b>Revised position</b>	Up to 49%	Automatic
	Above 49% and up to 100%	Government

In respect to multi-brand retail trading, changes made in 2012 permitted up to 51 percent FDI with prior government approval. Conditions for investment, however, required companies to invest at least 50 percent of the total FDI proceeds into 'back-end infrastructure' such as manufacturing, processing, packaging and distribution. Changes made in 2013 now clarify that at least 50 percent of the first US\$100 million invested must be in 'back end infrastructure' within three years.

Furthermore, the previous requirement for multi-brand retail trading companies (MBRTCs) regarding manufacturing and processing 30 percent of products in 'small industries' has been discontinued, and companies are now permitted to source their products from any manufacturing or processing entity so long as investment in plant and machinery is below US\$2 million at the first engagement. MBRTCs are now also allowed to establish outlets in a wider range of locations, as the previous restriction to cities with populations of at least 1 million has been scaled back. State governments now possess the authority to permit MBRTCs to operate in their region.

## Investing

The issuance of shares by Indian companies falls under the compliance guidelines outlined in the Foreign Exchange Management Act (FEMA). Companies seeking capital through the public route should base the issuance price on SEBI guidelines. Unlisted companies seeking capital may not issue private shares at a price less than fair value determined according to internationally accepted pricing methods or arm's length basis. The price will be determined by a SEBI registered banker or a chartered accountant. The acquisition of unlisted shares by a non-resident from an Indian resident must be exchanged at fair value based on the SEBI guidelines.

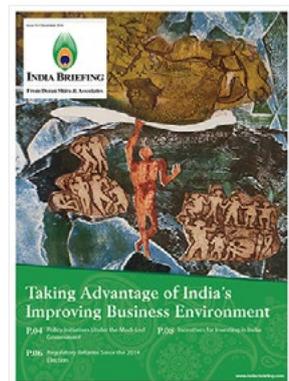
Units operating in SEZs may issue shares at a price based on the valuation against the import of capital goods. This valuation must receive approval from a Development Commissioner Committee and the appropriate customs officials. Shares must be officially issued within 180 days of receipt of invested capital, or the funds must be refunded to investors.

Upon the issuance of shares to foreign investors, the issuing company has 30 days to file Form FC GPR, which outlines the company's activities and relevant details, through the regional office of the RBI. A certificate declaring compliance with the Companies Act 2013, should be submitted at the same time. The issuing company should also obtain a certificate confirming that the price of issue is in line with the prescribed guidelines.

Foreign investors should be familiar with Indian investment regulations and compliance requirements before moving to invest in regulated sectors. Despite India's liberalized investment and an improvement in the ease of doing business rankings environment, the nation still ranks among the most difficult countries in which to start and conduct business according to the World Bank. As such, firms and individuals considering investment in the country should strongly consider consulting a professional services firm before attempting to navigate India's foreign investment environment.



### RELATED READING



#### **Taking Advantage of India's Improving Business Environment**

*December, 2016*

We look at the important regulatory reforms, policy initiatives, and increased incentives for investing in the Indian market that have emerged since Prime Minister Narendra Modi took office in 2014. Foreign companies should take note of the pro-business agenda of the current government and stay updated with the new reforms and sectoral policies that might ease their entry, investment, and expansion of business operations in India.

[AVAILABLE HERE](#)

---

# Tax and Accounting in India

- ◆ Key taxes in India
- ◆ India's audit process

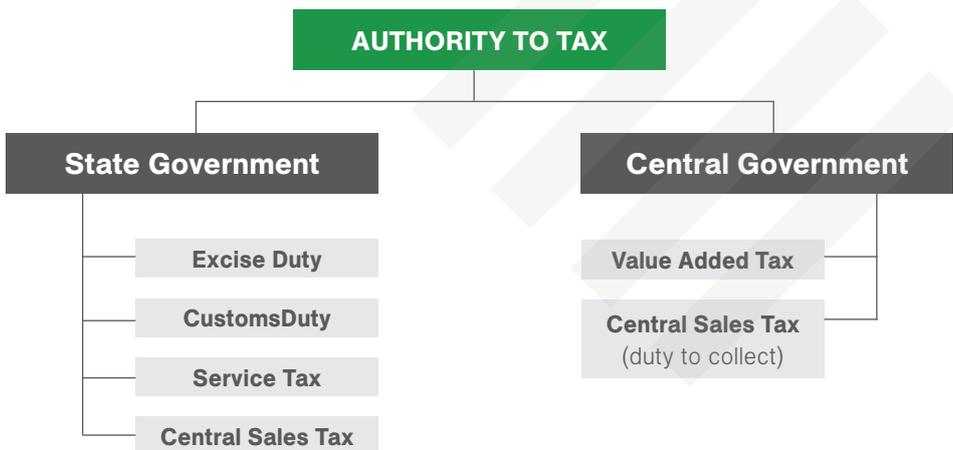
# Key taxes in India

## Value Added Tax

India has a Federal structure of taxation. The graphic below provides a description of the existing administration.

The Central Sales Tax imposes a tax on manufacturing, and the state government imposes a tax on the selling and distribution of goods. Hence, the manufacturer and service provider pay excise duty and service tax and claim credit for the same at the time the goods are sold to manufacturers under the nomenclature of CENVAT Credit (i.e. Centralized Value Added Tax), and the dealer pays VAT and claims VAT credit.

### Federal Structure of Taxation



Value Added Tax (VAT) is a tax on the final consumption of goods or services, and is ultimately borne by the consumer. It is a multi-stage tax with the provision to allow Input Tax Credit (ITC) on tax at an earlier stage, which can be appropriated against the VAT liability on subsequent sale. This credit means setting off the amount of input tax by a registered dealer against the amount of output tax. It is given for all manufacturers and traders for the purchase of inputs/supplies meant for sale, irrespective of when these will be utilized/sold. The VAT liability is calculated by deducting input tax credit from tax collected on sales during the month. If the tax credit exceeds the tax payable on sales in a month, the excess can be carried over to the end of the next financial year. If there is any balance excess or unadjusted input tax credit at the end of second year, then the same shall be eligible for refund.

VAT is managed exclusively by respective states. The state governments, through taxation departments, carry out the responsibility of levying and collecting VAT. The central government plays the role of facilitator for the successful implementation of VAT.



#### RELATED SERVICES

Dezan Shira & Associates provides tax consulting for foreign companies in India. For more information, please contact us at [tax@dezshira.com](mailto:tax@dezshira.com)



Every dealer of goods and commodities is required to register under the relevant state act as applicable according to their area of operation. The limit for the threshold is set by the states which may vary between US\$7,700 (INR 5 lakhs) to US\$30,700 (INR 2 lakhs). Further, the premise of availing the tax credit for any amount of VAT paid is based on the issue of an invoice. An invoice plays a pertinent role in the functioning of the VAT system as it aids in substantiating the VAT claim during subsequent sales. The entire system of claiming input tax credit is crucially based on the documentation of a tax invoice or bill. Mandatory to follow, this tax invoice is to be signed and dated by the dealer, showing the requisite particulars.

For identification/ registration of dealers under VAT, the tax payer's Tax Identification Number (TIN) is used. TIN consists of 11 digits with its first two characters representing the state code and the set-up of the next nine characters varying by state.

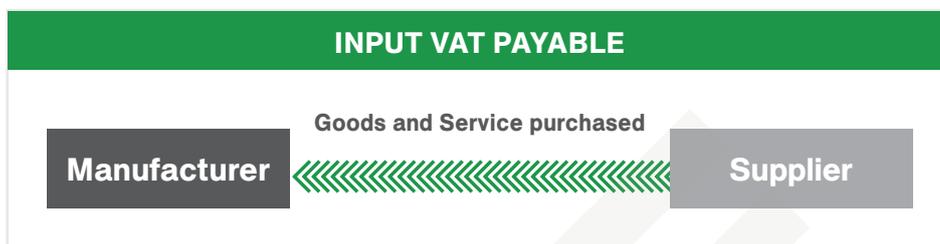
Presently, there are three basic rates of VAT (4, 5, and 12.5 percent). There is also an exempt category and a special rate of 1 percent for a few select items. Gold, silver, and precious stones, for example, have been put in the 1 percent schedule. VAT paid on items such as motor spirit (petrol, diesel and aviation turbine fuel), liquor, etc. are not eligible for offsetting VAT payment.

Some of the other VAT features at the state level are:

- State taxes on the purchase or sale of goods subsumed in VAT, not excluding Entry Tax.
- A provision for allowing Input Tax Credit (ITC) which is the basic feature of VAT.
- An intra-state transaction does not cover inter-state sales transactions (i.e. credit for VAT paid within the state shall not be allowed on inter-state purchases).
- Items destined for export have been made zero-rated by giving credit for all taxes on inputs/ purchases related to such exports.
- The procedure for the VAT system is favorable for businesses as it provides for self-assessment by dealers. Further, there is a provision for introducing a threshold limit for the registration of dealers when annual turnover is US\$15,000 (INR 10 lakhs) and a provision for the composition of tax liability up to an annual turnover limit of US\$75,700 (INR 50 lakhs). It should also be noted that no credit is available on the basis of invoices provided by unregistered dealers or to those opting for the composition scheme.

## VAT procedure

- Input VAT - Payable on goods purchased from another dealer.
- Output VAT - Payable on goods rendered.



$$\text{VAT PAYABLE} = \text{OUTPUT VAT} - \text{INPUT VAT}$$



### RELATED READING



**Tax, Accounting and Audit in India 2016-2017**  
*August, 2016*

Tax, Accounting, and Audit in India 2016 is designed to introduce the fundamentals of the tax regime as well as the critical accounting and auditing practices in India. As such, this comprehensive guide is ideal for not only businesses looking to enter the Indian market, but also for companies who already have a presence here and want to stay up-to-date with the most recent and relevant policy changes.

[AVAILABLE HERE](#)

**A registered dealer under VAT affects purchases and sales, both locally, in a year**

Input		Output	
Exempted goods	200,000	Exempted goods	150,000
Goods taxable at 4%	300,000	Goods taxable at 4%	180,000
Goods taxable at 12.5%	800,000	Goods taxable at 12.5%	670,000
<b>TOTAL</b>	<b>13,00,000</b>	<b>TOTAL</b>	<b>10,00,000</b>
Input tax credit		Output tax credit	
Exempted goods	0	Exempted goods	0
Goods taxable at 4%	12,000	Goods taxable at 4%	7,200
Goods taxable at 12.5%	100,000	Goods taxable at 12.5%	83,750
<b>TOTAL</b>	<b>1,12,000</b>	<b>TOTAL</b>	<b>90,950</b>
VAT payable			
Output VAT payable			90,950
Input VAT available			112,000
VAT payable			NIL
VAT credit carried forward			21,050

**A registered dealer under VAT affects purchases and sales, both locally and inter-state, in a year**

Input		Output	
Exempted goods	200,000	Exempted goods	150,000
Goods taxable at 4%	200,000	Goods taxable at 4%	180,000
<b>TOTAL</b>	<b>400,000</b>	<b>TOTAL</b>	<b>330,000</b>
		VAT payable	NIL
		No liability under VAT Act, since total turnover under VAT Act is less than US\$7,500 (INR 5 lakhs)	
		<b>OUTPUT(CST)</b>	
		Goods taxable at 4% -150,000 (with Form C)	

The dealer is liable under the CST Act irrespective of total turnover under the VAT Act. There is no liability under the VAT Act, but the dealer can avail input tax credit for liability under the CST Act.

Input tax credit (under VAT)		Output tax credit (Central Sales Tax)	
Exempted goods	0	Exempted goods	0
Goods taxable at 4%	8,000	CST due	6,000
Goods taxable at 12.5%	100,000	Adjustment from Input Tax credit	6,000
		CST payable	NIL
<b>Input Tax Credit (to be carried over to next month)</b>			<b>2000</b>

## Service Tax

A tax on services was put into effect in India for the first time in 1994. With the initial imposition of only three services, over the years various other services have been added raising the count to 119 in the year 2011. The basic premise of imposing a service tax is that the manufacturing sector can only be taxed to a certain extent on specified activities while fostering healthy competition. Presently, services form more than 52 percent of India's GDP, and are expected to reach around 70 percent. This tax will be subsumed into the Goods and Services Tax (GST), which is expected to be in place in the near future. The regulatory provisions pertaining to service tax are given in Chapter V and V(A) of the Finance Act 1994. The levy of the service tax extends to the whole of India except that it does not extend to a service provider offering taxable services from the state of Jammu and Kashmir by virtue of section 64, Chapter V, of the Finance Act.

A new service tax regime was introduced in India's 2012 budget, under which all services are taxed, with services specified under the negative list entry otherwise exempted. The CBEC also issued a notification in June 2012, commonly referred to as the 'Mega Exemption Notification' enumerating the services which shall be exempt from the payment of service tax with effect from July 2012. Earlier there were numerous notifications and litigations challenging the service tax. The present rate of service tax is 15 percent, inclusive of 0.5 percent swach bharat cess and 0.5 percent krishi kalyan cess. The negative list of services signifies that all services, excluding those specified by the negative list, will be subject to service tax. Additionally, there will be exemptions, abatements, and composition schemes as issued by the CBEC from time to time.

### WFOE Setup Procedure



The Mega Exemption Notification mentions 38 services on which service tax can be exempted, thereby including all other services. A simplistic approach has been laid out that services which are not mentioned in the negative list will attract service tax liability. Services covered in the negative list category are as follows on next page.

### Mega exemption negative list

<b>1</b>	1. Health care services by a clinical establishment, an authorized medical practitioner or paramedics; - 2. Services provided by way of transportation of a patient in an ambulance, other than those specified in (i) above
<b>2</b>	Services by an entity registered under section 12AA of the Income tax Act, 1961 (43 of 1961) by way of charitable activities
<b>3</b>	Services by a person by way of- a. renting of precincts of a religious place meant for general public; or b. conduct of any religious ceremony
<b>4</b>	Services provided by - a. an arbitral tribunal to - 1. any person other than a business entity; or 2. a business entity with a turnover up to rupees ten lakh in the preceding financial year; or b. an individual as an advocate or a partnership firm of advocates by way of legal services to,- 1. an advocate or partnership firm of advocates providing legal services; 2. any person other than a business entity; or 3. a business entity with a turnover up to rupees ten lakh in the preceding financial year; or c. a person represented on an arbitral tribunal to an arbitral tribunal  This does not include services provided by senior advocate. However, services by a senior advocate would be exempt when the service is provided to a person other than
<b>5</b>	Services by way of training or coaching in recreational activities relating to arts, culture, or sports
<b>6</b>	Services provided,- a. by an educational institution to its students, faculty and staff; b. to an educational institution, by way of,- 1. transportation of students, faculty and staff; 2. catering, including any mid-day meals scheme sponsored by the Government; 3. security or cleaning or house-keeping services performed in such educational institution; 4. services relating to admission to, or conduct of examination by, such institution;
<b>7</b>	Services provided to a recognized sports body by- a. an individual as a player, referee, umpire, coach or team manager for participation in a sporting event organized by a recognized sports body; b. another recognized sports body.
<b>8</b>	Services provided in relation to serving of food or beverages by a restaurant, eating joint, or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year;
<b>8A</b>	Services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948 (63 of 1948), having the facility of air-conditioning or central air-heating at any time during the year.
<b>9</b>	Transport of passengers, with or without accompanied belongings, by non air-conditioned contract carriage other than radio taxi, for transportation of passengers, excluding tourism, conducted tour, charter or hire.

*Note: The above table is an essential illustrative. The exhaustive list including the act, circulars, and notifications issued by the government authority should be analyzed to see which services are covered under the exemption category.*

The payment of service tax must be completed on a monthly basis. The due date is the 7th of the month following the month to which the amount of tax pertains. Additionally, a service tax return must be filed on a half yearly basis. The due date for filing the return falls on the 25th of the month following the period ending in September and March.

## Customs duty

Customs duty is levied by the central government on the import and export of goods from India. The rate of customs duty applied to imported and exported products depends on its classification under the Customs Tariff Act (CTA). In the case of exports from India, duty is levied only on a very limited list of goods. The Customs Tariff is aligned with the internationally recognized Harmonized Commodity Description and Coding System of Tariff Nomenclature promulgated by the World Customs Organization. The Indian central government has the power to exempt any specified goods from the whole or part of the customs duties.

In addition, preferential/concessional rates of customs duty are available under the various bilateral and multilateral trade agreements entered into by India. Customs duty is levied on the transaction value of the imported or exported goods. Under the Customs Act, 1962, transaction value is the sole basis of valuation for the purposes of import and export. Although India has adopted general principles of valuation for goods that are in accordance with the World Trade Organization's agreement on customs valuation, the central government has established independent Customs Valuation Rules applicable to the import and export of goods. India has no uniform rate of customs duty, thus duty applicable to any product is based on a number of components. The types of customs duties are as follows:

- **Basic Customs Duty (BCD)** - BCD is the basic component of customs duty levied at the effective rate stipulated in the First Schedule to the Customs Tariff Act, 1975 (CTA) and applied to the landed value of the goods.
- **Countervailing Duty (CVD)** - CVD is equivalent to, and is charged to counter the effect of, the excise duty applicable on goods manufactured in India. CVD is calculated on the landed value of the goods and the applicable BCD.
- **Educational Cess (EC)** - EC at 2 percent and Secondary & Higher Education Cess (SHEC) at 1 percent are also levied on the CVD. Further, EC at 2 percent and SHEC at 1 percent are also levied on the aggregate customs duties. An Additional Duty of Customs (ADC) at 4 percent is also charged.

## Duties of excise

Central Value Added Tax (CENVAT) is a tax levied by the central government on the manufacture or production of movable and marketable goods in India. 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 eight digit Harmonized System Code. The excise duty on most consumer goods is charged based on the MRP printed on the good's packaging.

Abatements are admissible at rates ranging from 20 percent to 50 percent of the MSRP for the purposes of charging Basic Excise Duty (BED). Goods other than those covered by an MSRP assessment are generally charged based on the "transaction value" of the goods sold to an independent buyer.

In addition, the central government has the power to fix tariff values in order to charge ad valorem ("according to value") duties on specific goods. Occasionally, notifications granting partial or complete exemption to specified goods from payment of excise duties are also issued. EC at 2 percent and SHEC at 1 percent are applicable on the aggregate excise duties.

The central excise duty is a modified form of Value Added Tax (VAT) where a manufacturer is allowed credit on the excise duty paid on locally sourced goods as well as on the CVD paid on imported goods. The CENVAT credit can be utilized for payment of excise duty on the clearance of dutiable final products manufactured in India. In light of the integration of the goods and services tax initiated in 2004, manufacturers of dutiable final products are eligible to apply CENVAT credit to the service taxes paid on input services used in or in relation to the manufacture of final products as well as on clearances of final products up until the point of removal. In addition, CENVAT credit is allowed on the following input services:

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

A manufacturer of dutiable and exempt goods, using common inputs or input services and opting not to maintain separate accounts, may choose between reversing the credit attributable to the inputs and input services used for manufacture of the exempted goods, to be worked out in a manner prescribed in the rules, or paying a percentage of the value of the exempted goods.

## Goods and Services Tax

The Government of India is committed to replace all the indirect taxes levied on goods and services by the Centre and States and implement Goods and Services Tax (GST) by July 2017. With GST, it is anticipated that the tax base will be comprehensive, as virtually all goods and services will be taxable, with minimum exemptions. GST will create a common Indian market



**SAHIL AGGARWAL**

Manager  
International Business Advisory  
India Offices

*“ The Goods and Services Tax will create a common Indian market and reduce the cascading effect of tax on the cost of goods and services. ”*

and reduce the cascading effect of tax on the cost of goods and services. It will impact the tax structure, tax incidence, tax computation, tax payment, compliance, credit utilization and reporting, leading to a complete overhaul of the current indirect tax system.

GST is a value-added tax levied at all points in the supply chain with credit allowed for any tax paid on input acquired for use in making the supply. It would apply to both goods and services, with exemptions restricted to a minimum. In keeping with the federal structure of India, GST will be levied concurrently by the Centre (CGST) and the States (SGST). Both CGST and SGST would be levied on the basis of the destination principle. Thus, exports would be zero-rated, and imports would attract tax in the same manner as domestic goods and services. Inter-state supplies within India would attract an Integrated GST (aggregate of CGST and the SGST of the destination State). In addition to the IGST, in respect of supply of goods, an additional tax of up to 1 percent has been proposed to be levied by the government. Revenue from this tax is to be assigned to origin states. This tax is proposed to be levied for the first two years or a longer period, as recommended by the GST Council.

• **The advantages of GST are:**

- » Seamless availability of credit across goods & services
- » Integration of prevailing indirect taxes to ensure uniformity
- » Preventing cascading of taxes
- » Simplified compliances
- » Availability of credit even for inter-state procurements
- » Harmonization of Centre and State taxes to achieve common market
- » Wider tax base, necessary for lowering tax rates and eliminating classification disputes

• **Taxes to be subsumed:**

GST would replace most indirect taxes currently in place such as:

Central Taxes	State Taxes
<ul style="list-style-type: none"> <li>• Central Excise Duty [including additional excise duties, excise duty under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955]</li> <li>• Service tax</li> <li>• Additional Customs Duty (CVD)</li> <li>• Special Additional Duty of Customs (SAD)</li> <li>• Central Sales Tax (levied by the Centre and collected by the States)</li> <li>• Central surcharges and cesses (relating to supply of goods and services)</li> </ul>	<ul style="list-style-type: none"> <li>• Value-added tax</li> <li>• Octroi and Entry tax</li> <li>• Purchase tax</li> <li>• Luxury tax</li> <li>• Taxes on lottery, betting and gambling</li> <li>• State cesses and surcharges</li> <li>• Entertainment tax (other than the tax levied by the local bodies)</li> <li>• Central Sales tax (levied by the Centre and collected by states)</li> </ul>



## Navigating India's bilateral & multilateral free trade agreements

Free trade agreements (FTAs) are normally made between two countries, or a larger nation and a regional trading bloc. Many governments, including India, have either signed FTAs or are in the process of negotiating new bilateral free trade and investment contracts.

There are typically two types of FTAs: bilateral and multilateral, although India categorizes these in a somewhat different manner than most other nations.

Every customs union, trade common market, economic union, customs and monetary union has also negotiated free trade areas. India looks at these more regional trading arrangements (RTAs) as building blocks towards the overall objective of trade liberalization and future "Free Trade" status. Therefore, it is participating in a number of RTAs that include structures such as FTAs, Preferential Trade Agreements (PTAs), and Comprehensive Economic Cooperation Agreements (CECAs). In this article we will discuss each of these structures and identify their participating partner nations.

### Free Trade Agreements

An FTA between two countries or group of countries agrees to abolish tariffs, quotas and preferences on most, if not all, of goods traded. Countries often agree to FTAs if their economic structures are complementary, not competitive. India enjoys FTAs, to date, with the following two countries: Sri Lanka (December 28, 1998) and Thailand (October 9, 2003). However, it has also negotiated far-reaching FTAs with a number of trade blocs.

### Early Harvest Scheme

An "Early Harvest Scheme" (EHS) is a precursor to an FTA between two trading partners. This is to help the two trading countries identify certain products for tariff liberalization pending the conclusion of actual FTA negotiations. A good example of an EHS is that between India and Thailand signed in October 2003, wherein the duties on 83 products were identified to be reduced to zero in a phased manner. The EHS has been used as a mechanism to build greater confidence between trading partners in order to prepare them for even bigger economic engagement. India has been keen on these schemes and has numerous EHS agreements in place; some within existing treaties.

### Trade agreements

These are bilateral or multilateral treaties, or any other enforceable compact, that commit two or more nations to specified terms of commerce. They mostly involve mutually beneficial concessions.

## Framework agreements

These set the period for future substantive liberalization by defining the scope and provisions of orientation for some new area of discussions.

## Preferential Trade Agreements (PTAs)

This type of agreement gives preferential right of entry to certain products. This is done by reducing tariffs, but does not abolish them completely. A PTA is established through a trade pact and is a stepping stone towards better economic relations with the concerned country. India enjoys PTAs with Afghanistan and Chile.

## India's multilateral & trade bloc FTAs



The Association of Southeast Asian Nations (ASEAN) was founded on August 8, 1967, and now consists of Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. India is one of the four "Summit level Dialogue Partners" of ASEAN.

ASEAN's economic, political and strategic significance in the larger Asia-Pacific region is the primary mover behind India's relationship with the organization. It also provides a link for India to bond with the Asia-Pacific-centered economic policies that are shaping the 21st century marketplace. Conversely, ASEAN seeks admission to India's professional and technical strengths.

A Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India was signed on October 8, 2003, in Bali (Indonesia). The agreement encompassed areas of economic cooperation and provided for an Early Harvest Programme (EHP), which covers areas of economic cooperation and a common list of items for exchange as an assurance building measure.

India further signed an FTA in services and investments with ASEAN in September, 2014, which is due to be ratified. Trade between India and ASEAN stood at US\$65.04 billion in 2015-16 and comprises 10.12 percent of India's total trade with the world.

 **MERCOSUR**

Formed in 1991, MERCOSUR is a trading community in Latin America comprising Argentina, Brazil, Paraguay and Uruguay. It has Chile and Bolivia as its associate members.

A framework agreement was signed between India and MERCOSUR on June 17, 2003. The plan of this framework agreement is to:

- Generate circumstances and mechanisms for discussions;
- Grant mutual tariff preferences;
- Bargain a free trade area between the two parties in line with the rules of the World Trade Organization.

 **BIMSTEC**

The Bay of Bengal Initiative for Multi Sectoral Technical and Economic Cooperation (BIMSTEC) is a Technical and Economic Cooperation forum formed in 1997 and includes Bangladesh, India, Myanmar, Sri Lanka and Thailand. Bhutan and Nepal joined the group in February, 2004. Because it includes five members of SAARC (India, Bangladesh, Bhutan, Nepal & Sri Lanka) and two members of ASEAN (Thailand, Myanmar), it is seen as a bridge between these two major regional organizations.

Cooperation is proposed in 13 sectors and each sector is led by one member country.

 **SAARC**

The South Asian Association for Regional Cooperation (SAARC) is a regional body that promotes cooperation and investment in South Asia. Recognized in Dhaka in December, 1985, its members include Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, who collectively have the world's third largest GDP (PPP).

## SAFTA (South Asian Free Trade Agreement)

South Asia's FTA was approved by all the member states of SAARC during the twelfth "SAARC Summit" held in Islamabad between January 4-6, 2004. SAFTA came into force from January 1, 2006.

The purpose of SAFTA is to endorse and improve mutual trade and economic cooperation among the "Contracting States" by:

- Eliminating blockades to trade in, and facilitating the cross-border movement of goods between, the territories of the Contracting States;
- Promoting conditions of fair competition in the free trade area, and ensuring equitable benefits to all Contracting States, taking into account their respective levels and patterns of economic development;
- Creating an effect mechanism for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and,
- Establishing a framework for further regional cooperation to expand and enhance the mutual benefits of this Agreement.

## How to evaluate India's FTAs for your business

FTAs are, by nature, complicated documents. To establish whether the contents are applicable to your business, the following questions need to be addressed:

- Is your product or service included within the FTA's remit?
- If so, what are the dutiable advantages?
- What are the implementing rules and documentary requirements on claiming lower duties?
- Are there any tax advantages that may apply to my business operations?
- How can I implement and claim these?

Such advice typically needs to be handled by a professional firm that is familiar with India's FTA agreements and can assist with on-the-ground administration in order to ensure benefits can be obtained.

India has tended to be somewhat long-winded and bureaucratic about some of its trade agreements. Despite this, certain FTAs, such as those with ASEAN and the GCC, have provided and will continue to provide significant reductions on dutiable trade. This is evidenced in India's annual bilateral trade with ASEAN doubling to US\$80 billion in the four years since the FTA came into effect. To compare, India-U.S. trade per annum currently stands at some US\$64 billion.

While navigating India's FTAs can be a protracted process, their benefits cannot be overstated and should always form part of your overall business strategy for investing in India.

## Using India's double tax agreements

India has taken a positive view when it comes to entering into Double Tax Agreements (DTA) with other nations – it now has over 90 such treaties, many of them recent.

DTAs are useful as they enshrine within a bilateral agreement the treatment of many forms of tax – including corporate income tax, individual income tax, withholding tax and dividends tax, amongst others. They are useful not just for companies that have a presence in both nations, but also for trading companies that do not have a permanent presence in India but services to an India-based entity. Such services are typically subject to withholding tax, but effective use of the applicable DTA can halve this burden.

The legal and tax professions are effectively split in India, with a third profession – the Corporate Secretarial position – also prominent when it comes to Indian tax administration. Ignoring DTAs when structuring foreign investments into India can be problematic; these investments should be negotiated up front with the relevant tax officials in India. Failure to do so can result in tax overheads that are far more expensive than necessary.

That said, this problem can be resolved – but only through a firm both qualified to do so and with an understanding of India's regulations, from both the legal and the tax perspective. India has always been a tax structural play for foreign investors at the start-up stage. Companies should ensure that they do not miss out on the benefits of bilateral agreements.

## Typical DTA benefits

Apart from the principal of an individual or corporation not being subject to “double taxation” – being taxed both in one country and then back home – most DTAs also include “tax sweeteners” that international businesses can take advantage of. These include, but are not limited to, the following reductions.

## Dividends distribution tax

In addition to a 40 percent corporate income tax (CIT) for foreign investors, India charges a 15 percent dividends distribution tax (DDT) upon profit repatriation overseas. Many DTAs provide for a clause that reduces the dividends tax portion by 50 percent.



### RELATED NEWS

#### **Singapore and India to Include Limitation of Benefits in DTAA Amendment**

*India Briefing News  
January, 2017*

AVAILABLE HERE

---

## Withholding tax

Withholding Tax (WT) is charged on an array of service fees billed by a firm's HQ to a company (which could be either a client or a subsidiary) in India for a service provided by the former to the latter. As profits tax cannot be charged to a company that is non-resident, WT takes its place. The amount of WT varies considerably depending upon the service provided.

Interested businesses should check the applicable rate per service. However, as a general rule of thumb, withholding tax in India is 20 percent of the total invoice value. DTAs can in many cases halve this amount. Services charged by the parent for use of royalties for trademarks by its own subsidiary, for example, may be remitted to the parent at a 10 percent rate – far more preferable to the combined CIT and DDT rate of 55 percent if the money is left in India.

While India-based foreign-invested entities can sign a variety of service agreements with foreign companies, including with their HQ, these agreements can sometimes be looked upon with suspicion as “constructed channels” for sending money between the HQ and its subsidiary. It is up to firms themselves to inform the local tax office in India of their intention to use the DTA - the application for which requires copies of the DTA, Articles of Association, and business license of the company. Permission is required from tax officials in India to reduce the amount of taxes due from a company, as they need to provide an explanation for doing so to their own superiors. Accordingly, a well presented case needs to be made. It is advisable that this involve assistance from a professional firm in India qualified to do so. The tax savings obtained typically outweigh the fees charged for such services.



**VISIT US ON LINKEDIN**  
<Dezan Shira & Associates>

# India's Audit Process

## Understanding annual audit: An overview

Audit season in India can be a hectic and confusing time for foreign invested enterprises (FIEs) operating in the country. While most foreign executives in India leave auditing to chartered accountants and professional services firms, it is important to maintain at least a basic understanding of the audit process, how to prepare an FIE for audit, and key considerations that should be taken into account.

There are two primary objectives associated with annual audit in India. The first objective is for auditors to report to shareholders and the government whether or not the company's balance sheet provides a true and fair reflection of its state of affairs and any profit or loss derived during the financial year. The second, an incidental objective, concerns the detection and prevention of fraud and error. Hiring an experienced firm to complete annual audit in a timely and accurate manner is critical to achieving both of these objectives.

### The basics

Audits of company accounts have been compulsory in India since the passing of the first Companies Act in 1913. Since then, the Institute of Chartered Accountants of India (ICAI), a statutory body established under the Chartered Accountants Act, 1949, has regulated the profession of chartered accountants in India and ensured the maintenance of India's accounting standards. All chartered accountants are members of the ICAI, and must comply with the standards stipulated by the ICAI and the Audit and Assurance Standards Board (AASB).

Essentially, an audit is the inspection of an individual, business or organization's accounts, and is traditionally completed by an independent individual or firm with specialized skills and knowledge of auditing procedures in the country in question. In other words, accountants verify that a company's business transactions were recorded accurately, and provide a true and fair reflection of that company's financial situation.

The importance of the audit process cannot be understated, as the results can be used for the following purposes:

- Helping investors know the financial health of the company
- Assuring the government that the company is properly discharging its legal duties
- Helping lenders evaluate the credibility of the company
- Drawing management's attention to any shortcomings in the company's business operations
- Helping management improve business efficiency

## Auditing objectives

As mentioned earlier, there are two key objectives associated with annual audit in India: expressing to shareholders and the Indian government a true and fair view of the company's financial statements, and detecting and preventing instances of fraud and error.

Ensuring a company's balance sheet provides a true and fair reflection of its current state of affairs requires an auditor who, after completing the audit process, will express their opinion of the company's financial statements via an auditor's report. These financial statements should include Balance Sheet, Profit & Loss Account, Cash Flow Statement and Notes to Accounts.

A "true and fair view" can only be satisfied if the financial statements are accurate and not misleading. A company can expect the auditor to feel they have provided a true and fair assessment if the following criteria are satisfied:

- The accounts are prepared with reference to the entries in the account books
- Entries are supported by proper vouchers, documents, or other evidence
- No entry in the account book is omitted while preparing the financial statements, and nothing is included in the financial statements that were not in the account books
- The financial statements are prepared in accordance with the relevant accounting standards

An incidental objective associated with annual audit in India is the detection of errors or fraud in a company's financial statements. If an irregularity is detected, the auditor has a duty to report the details to management, who is then expected to remedy such an error.

## Types of audits

Basic audits in India are generally classified into two main types:

1. Statutory Audits
2. Internal Audits

**Statutory audits** are conducted to report the current state of a company's finances and accounts to the Indian government and shareholders. Such audits are performed by qualified auditors working as external and independent parties. The audit report of a statutory audit is made in the form prescribed by the government agency.

**Internal audits** are conducted at the behest of internal management in order to check the health of a company's finances, and analyze the organization's operational efficiency. Internal audits may be performed by an independent party or by the company's own internal staff

In India, every company whose shares are registered on the stock exchange must have an internal auditing system in place. This includes:

- Every unlisted public company having:
  - a. Paid up share capital of US\$7 million (INR 50 crore) or more during the preceding financial year; or
  - b. Turnover(income) of US\$29 million (INR 200 crore) or more during the preceding financial year; or
  - c. Outstanding loans or borrowings from banks or public financial institutions exceeding US\$14 million (INR 100 crore) or more at any point of time during the preceding financial year; or
  - d. Outstanding deposits of US\$3 million (INR 25 crore) or more at any point of time during the preceding financial year; and,
- Every private company having:
  - a. Turnover of US\$29 million (INR 200 crore) or more during the preceding financial year; or
  - b. Outstanding loans or borrowings from banks or public financial institutions exceeding US\$14 million (INR 100 crore) or more at any point of time during the preceding financial year

## Statutory audits

In India, statutory audits are conducted for each fiscal year (April 1 to March 31) and not the calendar year. The two most common types of statutory audits in India are:

1. Tax Audits
2. Company Audits

### Tax audits

Tax audits are required under Section 44AB of India's Income Tax Act 1961. This section mandates that those whose business turnover exceeds US\$149,200 (INR 1 crore), and those working in a profession with gross receipts exceeding US\$75,000 (INR 50 lakhs), must have their accounts audited by an independent chartered accountant. The audit report is made using Form 3CD along with either Form 3CA (for companies) or Form 3CB (for entities not included under Form 3CA). The provision of tax audits are applicable to everyone, be it an individual, a partnership firm, a company, or any other entity. The tax audit report is to be completed by November 30 after the end of the previous fiscal year. Non-compliance with the tax audit provisions may attract a penalty of 0.5 percent of turnover or US\$1,500 (INR 100,000) whichever is lower. There are no specific rules regarding the appointment or removal of a tax auditor. audit evidence and is, therefore, unable to express an opinion on the financial statements.

## Company audits

The provisions for company audits are contained in the Companies Act, 2013 as applicable. Every company, irrespective of its nature of business or turnover, must have its annual accounts audited each financial year.

For this purpose, the company and its directors must first appoint an auditor at the outset. Thereafter, at each annual general meeting (AGM), an auditor is appointed by the shareholders of the company who will hold the position from one AGM to the conclusion of the next AGM. Listed companies and companies belonging to prescribed class of companies will not appoint or re-appoint the auditor for:

- More than two terms of five consecutive years, if the auditor is an audit firm;
- More than one term of five consecutive years, if the auditor is an individual.

Only an independent chartered accountant or a partnership firm of chartered accountants can be appointed as the auditor of a company. The following persons are specifically disqualified from becoming an auditor per the Companies Act:

- A body corporate;
- An officer or employee of the company;
- A person who is partnered with an employee of the company, or employee of an employee of the company;
- Any person who is indebted to a company for a sum exceeding US\$15 (INR 1,000) or who has guaranteed to the company on behalf of another person a sum exceeding US\$15 (INR 1,000);
- A person who has held any securities in the company after one year from the date of commencement of the Companies (Amendment) Act, 2000;
- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

The auditor is required to prepare the audit report in accordance with the Company Auditor's Report Order (CARO) 2016. CARO requires an auditor to report on various aspects of the company, such as fixed assets, inventories, internal audit systems, internal controls, and statutory duties, among others. The audit report must be obtained before holding the AGM, which itself should be held within six months from the end of the financial year.

According to the ICAI, audit can be defined as follows:

*Auditing is defined as a systematic and independent examination of data, statements, records, operations and performance (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the proposition before him for examination, collects evidence, evaluates the same and on this basis formulates a judgment which is communicated through an audit report. An audit is an independent examination of financial information of an entity, irrespective of its size and form, when such examination is conducted with a view of expressing an opinion thereon.*

## Audit reporting

As discussed earlier, audits are conducted to ensure a company's financial statements present a true and fair view of its financial affairs. Therefore, the auditor's opinion expressed in the ultimate report is based on the information gathered during the audit and the verification of financial statements. Upon completing the report, the auditor may express one of the following four opinions:

1. Unqualified opinion
2. Qualified opinion
3. Disclaimer of opinion
4. Adverse opinion

### **Unqualified opinion**

An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements. It confirms that:

- Generally accepted accounting principles are consistently applied in the preparation of financial statements
- Financial statements comply with the relevant statutory requirements and regulations
- There is adequate disclosure of all material matters relevant to the proper presentation of financial information (subject to statutory requirements)

## Qualified opinion

A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed, but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or the limitation of scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being “subject to” or “except for” the effects of the matter to which the qualification relates.

## Disclaimer of opinion

A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient and appropriate audit evidence and is, therefore, unable to express an opinion on the financial statements.

## Adverse opinion

An adverse opinion is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to indicate the misleading or incomplete nature of the financial statements.

## IFRS/IAS convergence

While accounting standards in India differ slightly from the International Financial Reporting Standards (IFRS), Indian Accounting Standards (AS) are likely to converge with the IFRS in the foreseeable future. The MCA through a notification on February 16, 2015 issued the Companies (Indian Accounting Standards) Rules, 2015 (Rules) which lay down a roadmap for implementation of Ind AS converged with IFRS through i) voluntary adoption and ii) Mandatory applicability. This applies to companies other than insurance, banking and non-banking finance companies (NBFC).

India’s eventual “convergence” with the IFRS will differ from “adoption” in that AS will be altered to conform with the IFRS rather than requiring full-fledged adoption of the standards outlined by the

International Accounting Standards Board (IASB). This will preserve differing terminologies between the IFRS and AS while adding some new concepts and models such as the Acquisition Method in lieu of the Purchase Method.

The chart in the next page highlights key differences between the IFRS/IAS and current AS.

## Key Differences between the IFRS/IAS and Current Indian Accounting Standards

Topic	IFRS/IAS	Current Indian Accounting Standards
Disclosure of accounting policies	<ul style="list-style-type: none"> <li>Deals with overall considerations, including presentation, off-setting, comparative information, and format</li> <li>Provides for preparing statement of change in equity</li> </ul>	<ul style="list-style-type: none"> <li>Does not deal with these aspects. Refers to Schedule VI of Companies Act 1956 for these aspects</li> <li>No such account prescribed</li> </ul>
Valuation of inventories	<ul style="list-style-type: none"> <li>Prescribes same cost formula for all inventories having a similar nature</li> <li>When inventory is purchased on deferred terms, excess over normal price is treated as interest over the period of financing</li> </ul>	<ul style="list-style-type: none"> <li>There is no stipulation for use of same cost formula</li> <li>No such provision in AS</li> </ul>
Cash flow statement	<ul style="list-style-type: none"> <li>Bank overdraft is treated as a component of cash</li> <li>Provides option to classify interest and dividends either under operating activities or financing activities</li> </ul>	<ul style="list-style-type: none"> <li>Bank overdraft is not treated as a component of cash</li> <li>No such option available</li> </ul>
Contingencies and events occurring after the balance sheet date	<ul style="list-style-type: none"> <li>States that proposed dividends should not be shown as liabilities</li> </ul>	<ul style="list-style-type: none"> <li>Specifically requires proposed dividends to be shown as liabilities</li> </ul>
Changes in accounting policies	<ul style="list-style-type: none"> <li>Requires retrospective effect to be given by adjusting opening retained earnings in case of change in accounting policy</li> </ul>	<ul style="list-style-type: none"> <li>Requires only prospective effect in case of change in accounting policy</li> </ul>
Depreciation	<ul style="list-style-type: none"> <li>Change in method of depreciation to have prospective effect, and treated as change in accounting estimate</li> </ul>	<ul style="list-style-type: none"> <li>Requires retrospective re-computation of depreciation where there is change in depreciation method, and treated as change in accounting policy</li> </ul>
Construction contract	<ul style="list-style-type: none"> <li>Contract revenue is measured at the fair value of the consideration received or receivable</li> </ul>	<ul style="list-style-type: none"> <li>Contract revenue is measured as the consideration received or receivable</li> </ul>
Revenue recognition	<ul style="list-style-type: none"> <li>Allows only percentage of completion method for services rendered</li> <li>Interest income is recognised on an effective interest rate basis</li> </ul>	<ul style="list-style-type: none"> <li>Allows option of completed service contract method or proportionate completion method</li> <li>Interest income is recognised on a time proportion basis</li> </ul>
Fixed assets	<ul style="list-style-type: none"> <li>Subsequent costs incurred for replacement of a part of a fixed assets are required to be capitalized and, simultaneously, the replaced part has to be de-capitalized</li> </ul>	<ul style="list-style-type: none"> <li>Only expenditures that increase the capacity of an asset have to be capitalized</li> </ul>



**ROHIT KAPUR**

Country Manager  
Dezan Shira & Associates  
India Offices

*“ Investors will find that India’s legal and financial operational procedures are not as complex as they may have initially thought. ”*

## Ensuring a smooth audit: Key considerations

Many investors are concerned about India’s reputation for having notoriously unclear rules and procedures, and approach the audit season with no small degree of trepidation. With proper advice and some relevant knowledge of the local operating environment, however, investors will find that India’s legal and financial operational procedures are not as complex as they may have initially thought.

An audit does not need to be a costly and disruptive exercise for businesses, and an audit report can be invaluable in helping companies manage their business better and address problems or loopholes going forward by identifying irregularities and errors. This article explains the processes a foreign-invested enterprise (FIE) in India can expect to undergo during statutory audit, and what companies need to know and prepare to make the audit process go smoothly.

### Initial brief

Auditors should be provided with an overview of a company’s business activities and structure so as to enable them to provide the most thorough and accurate feedback possible. While most auditors have some general industry knowledge, briefing auditors on the specific activities a business conducts, its supply chain and procurement procedures, and existing internal controls can allow the audit process to proceed smoothly. While auditors are expected to perform checks on internal controls independently, it can be beneficial to first explain how these internal controls function.

### Purchasing and procurement procedures

Auditors will closely examine purchasing and procurement procedures, and will likely request a flow chart during audit proceedings that outlines the specifics of this process. Preparing this flow chart beforehand can save valuable time during the audit process, and providing this to auditors even if they do not request it can enable the provision of thorough feedback that will allow businesses to better understand the efficiencies and deficiencies of their operations.

Businesses can also expect auditors to examine major purchases to ensure the company is not being overcharged for the purchase of raw materials and other supplies. It is not atypical for dishonest employees to elect to purchase from more expensive, lower quality suppliers with whom they may have some personal connection or relationship (i.e. family connections or businesses and suppliers paying them a commission on purchases). By closely surveying purchasing and procurement procedures, these deficiencies can be identified and halted in the aftermath of an audit.

Auditors will additionally compare purchase vouchers with the relevant tax invoices received from the sellers of goods received notes (GRNs) to confirm whether or not the quantities and



amounts match. This will allow auditors to check whether the rates of materials on invoices correspond to purchase orders raised by the company, and whether the dates on GRNs relate to the current accounting period. These checks can be time consuming, and it is recommended to have a properly trained accounting team in place to assist with these checks and make it easier for auditors to evaluate a complete paper trail.

## The production process

An effective auditor will additionally make note of an FIE's production and manufacturing process, and the various steps a company follows to convert raw materials into marketable goods. It is helpful to prepare a list of the main raw material inputs a business is using in production to facilitate this process. Companies can also expect auditors to check internal controls at this stage, especially those relating to the input of raw materials. In some respects, this aspect of the audit process relates back to the examination of purchasing and procurement procedures.

## Journal vouchers, tax expense, and cash

A company's auditor will also seek to verify whether the bills supporting journal vouchers and expenditures relate to the current period. While examining journal vouchers, an auditor will ensure that the tax deduction at source (TDS) was in fact deducted, wherever applicable. It is relatively common for companies to neglect to deduct TDS by mistake, and it is essential to ensure internal processes have not made such an oversight.

When claiming travel and other related expenses for tax deductions, companies should always ensure that supporting documentation is retained and provided to an auditor when necessary. It would be prudent to include in executives' job descriptions and employment contracts that they must provide evidence of expenditure on business trips and other related expenses so as to avoid any doubt or oversight in this respect. Auditors will often seek to confirm that these expenses are within the prescribed limits outlined in the relevant job description.

Auditors are also required to check that any payment in cash or aggregate payments in cash totaling over INR20,000 in one day are not claimed as a deduction (in accordance with Section 40A(3) of the Income Tax Act 1961), and also check other credit balances in cash. A company's Bank Reconciliation Statement should also be spot-checked by an auditor to verify expenditures.

## Inventory

Manufacturing businesses need to demonstrate that they have maintained their RG 23 books and stock registers for manufacturing or processing materials. An auditor will verify that this has been done correctly, and will need to ascertain whether the RG 23A Part II / RG 23C Part II are aligned with purchase registers, and whether input credits have been recorded correctly.



Auditors will also check a company's Personal Ledger Account (PLA) register to ensure that payments were accurately made through their PLA after considering input credit. Auditors are also expected to perform a physical inspection of stock to confirm that inventory counts match the company's inventory register.

## Other reconciliations

A company's auditor will also need to reconcile the following items:

- Excise/VAT returns with purchases and sales
- Provident fund contributions
- Professional tax contributions
- Employee state insurance contributions

These contributions are mandatory under statute and apply to all companies in India.

## Miscellaneous

### Management accounts opening balances

Businesses should also have management accounts ready in the event that an auditor wants to check that the opening balances in those accounts have been carried forward correctly from the previous year's audited financial statements. It is not uncommon for some minor adjustments to be necessary.

### Rental agreements

It is a good idea to ensure that the rent for a factory or office has been paid on time in accordance with the rental agreement, and that the rental agreements are up-to-date in advance of an audit.

### PANs for contractors

Companies must also ensure that they are properly maintaining photocopies of Permanent Account Number (PAN) cards for any contractors that come under TDS applicability. If a company has not been provided with a contractor's PAN but is required to deduct TDS, it is necessary to deduct TDS at the default rate of 20 percent.



## Summary

Audits are often seen by companies as annoying and unwelcome disturbances to their normal operations, and an audit in an unfamiliar country can be a particularly dreaded proposition. However, audits perform two vital functions.

First, they ensure that a business is complying with all relevant laws and regulations in India. They are needed to confirm that the business is correctly assessing its taxable income, backing up claimed deductions with the necessary receipts, and making the appropriate TDS deductions when required. Failure by an FIE to fulfill these legal obligations and improper record-keeping can result not only in fines from the Indian government, but also potential penalties imposed by other jurisdictions, such as under the U.S. Foreign Corrupt Practices Act or other similar legislation in Europe.

The second vital function of an audit is to identify any weaknesses or areas of improvement for a business. It is for this reason that many companies opt to conduct internal audits in addition to their legally required annual audit, as auditors often have the independence and experience to give valuable recommendations on how problems might be resolved. Audits can help to improve management practices and a company's internal controls should be prepared to accommodate and assist with audits.

If a company's annual audit reveals any deficiencies in its business processes or internal controls, it may be wise to closely examine those processes and controls. This may include assessing the staff charged with carrying out the company's operations to ensure they are competent in their roles. It is only by having adequate internal controls that a business can perform to its full potential, and an annual audit is an independent and valuable measure of the adequacy of those controls and procedures.

## Detecting and avoiding fraud

As an incidental objective associated with annual audit, detecting fraud and error can be as important as assessing whether a company's balance sheet accurately represents its current state of affairs. For companies with operations in India, it is important to maintain an awareness of what constitutes fraud, and the fine line between fraud and error in the eyes of an auditor.

According to Deloitte's 2016 India fraud survey, 65 percent of respondents believe that fraud will continue to rise in the coming years. This is despite efforts by management to establish a robust control environment. While management is inherently the first line of defense against fraud and error, internal and external auditors are often considered the second line of defense.



Fraud refers to the willful and deliberate misrepresentation of financial information with the intention of deceiving others (i.e. shareholders, the government, etc.). This can entail both defalcation involving the misappropriation of cash or goods, and the fraudulent manipulation of accounts by management or employees.

Defalcation involving the misappropriation of cash or goods can encompass a number of specific activities including, but not limited to:

- Recording fictitious or bogus payments
- Undercasting the receipt side total of a cashbook
- Showing the same payment twice
- Recording more payments than actual amounts paid by altering the figures on vouchers
- Misappropriating undisbursed wages
- Recording personal expenses as business expenses

Fraud through the manipulation of accounts typically implies presenting accounts more favorably than they are in reality, and distorting the profit or loss of a business and its financial state of affairs (also known as “window dressing”). This type of fraud is committed at the management level, and auditors will oftentimes suspect fraud if they encounter:

- Missing vouchers, invoices, checks, or contracts
- Balances that do not add up
- Significant fluctuations in the gross profit and net profit margin ratio
- A difference between the stock as per records and physically counted stock
- When the control account does not agree with subsidiary books
- When parties provide contradictory explanations for inconsistencies

The key difference between “fraud” and “error” often relates back to the intent to deceive, and distinguishing between the two can be challenging. Auditors are charged with exercising judgment when preparing their opinion for the final audit report, but do not make legal determinations of whether fraud has actually occurred. Rather, the auditor’s opinion is persuasive rather than conclusive in nature and based solely upon the information they reviewed and analyzed during the verification of financial statements.

If fraud is suspected by an auditor, this suspicion will be reflected in their opinion and an interested party may subsequently decide to carry out an investigation into the matter in question.



## Fraud risk management

According to the Association of Certified Fraud Examiners Global Fraud Study 2016, the median loss caused by perpetrators of fraud in the first year of employment amounts to US \$49,000 while those with more than ten years at an organization can cause a median loss of nearly US\$250,000.

Mitigating the risk of fraud begins with a robust governance structure that includes the audit of budgeting processes, ethics policies, quality control, monitoring procedures by senior management, and rotation procedures. Any weakness in an organization's governance structure creates vulnerability for fraud.

Aside from ensuring an organization possesses a robust governance structure, providing an anonymous hotline or other channel for whistleblowers to alert management of fraudulent behavior can be an effective mode of fraud detection. The Companies Act, 2013 additionally mandates listed companies to establish a mechanism for whistleblowers to alert management of fraud at the director or employee level.



---

# Human Resources and Payroll Considerations

- ◆ Key considerations when hiring staff
- ◆ Payroll and social insurance

---

# Key considerations when hiring staff

## Visa application

When applying for a long-term visa in India, there are a number of procedures and legal frameworks that must be understood.

India provides two kinds of work-related visas: a business visa and an employment visa. For these visas, Indian authorities require documentation from the applicant as well as the applicant's employer. Applicants and employers should plan to allow at least one week to prepare the required documentation. Meanwhile, applicants applying for a visa by post should allow two to three weeks for visa application processing, despite declared visa processing times.

The documents required by Indian authorities are dependent on the applicant's nationality; applicants and their employer should verify all required documentation with the Indian consulate in the applicant's home country. Nevertheless, the majority of the required visa application documents are similar for most developed economies in Europe and North America.

Foreign nationals that intend to visit India for meetings with Indian companies should apply for a business visa. Depending on the applicant's nationality, a multiple entry business visa can be granted for a period of up to ten years. However, the maximum allowable stay period per visit is determined by the issuing Indian consulate. US applicants, for example, can obtain a multiple entry business visa that is valid for ten years, but each period of stay is limited to six months. To acquire a business visa for India, the application must ordinarily contain the following documents.

For both business and employment visa applications, each document provided by the employer needs to be drafted on company letterhead, signed by a senior manager, and marked with the company's official stamp. In addition, each of these documents need to be original copies. The only exceptions to these stipulations are the Incorporation Certificate and the PAN card, which can be scanned or photocopied. Still, these stipulations mean that employers must be prepared to send original copies to the applicant by post.

Companies that have successfully sponsored business and employment visas in the past are often well prepared to organize support documentation. However, companies that have not previously sponsored these visas should consider contracting an India-based visa consultant. Indian consular staff scrutinize and sometimes investigate the language of key documents, such as invitation letters for business visas or permission and justification letters for employment visas. Visa consultants are well acquainted with the application process and can provide form letters and useful advice to mitigate the potential for problems.

## Visa requirements for foreign nationals working in India



### Employee eligibility

1. At least 18 years old
2. In good health
3. Filling a position unsuitable for a qualified Indian employee
4. Will not be working in a routine, secretarial or clerical job
5. Must have an annual salary in excess of US\$ 25,000 (with the exception of language teachers, ethnic cooks, embassy staff and voluntary workers)



### Documents required from employee

7. A completed visa application form
8. A valid passport
9. A passport sized photo
10. Proof of address, such as a driver's license or utility bill
11. A detailed curriculum vitae



### Documents required from employer

12. Permission letter that requests approval for the applicant's visa
13. Sponsorship letter
14. Tax liability letter pledging responsibility for the applicant's income tax in India
15. Justification letter confirming that a qualified Indian candidate was unavailable/unsuitable
16. Details of the applicant's unique specialization and professional capabilities
17. Appointment letter detailing the job role and salary
18. Comprehensive employment contract
19. Copy of the company's Permanent Account Number (PAN) card
20. The company's Incorporation Certificate
21. Application form

**Approximate time to complete**



## Visa registration

Expatriates first in-country encounter with Indian bureaucracy often occurs at the Foreign Regional Registration Office (FRRO). After obtaining an Indian visa, registering the visa at a FRRO is often an afterthought for expatriates. Unfortunately, however, registering a visa is a cumbersome process.

If the duration of the visa exceeds six months (180 days), the visa holder must register the visa within 14 days of arrival at a FRRO. The only exception to this is for Pakistan nationals, who must register within 24 hours.

Long-term visa holders should plan to register their visa as soon as possible; failing to register a visa within the specified time period can result in a fine, and in some cases, an investigation. An investigation can take several weeks – the visa holder is not permitted to leave the country during this time period. In addition, investigations may complicate any future visa applications or renewals.

## Registration documents

Before visiting a FRRO to register an employment visa, a visa holder needs to prepare the registration documents required by Indian authorities. Like the visa application, both the visa holder and their employer must provide support documents to register the visa. This process requires coordination between the visa holder and their employer; visa holders and their employer should plan to allow 2-3 days to gather and complete these documents.

The visa holder must ordinarily provide:

- A completed visa registration application form
- Six passport size photos of the applicant
- A copy of the photo page within the passport
- A copy of the visa page within the passport
- Proof of address, such as a driver's license or utility bill, from the visa holder's home country
- A notarized copy of a lease deed/agreement or a C-Form from a hotel of residence
- Visa registration fees

The employer must ordinarily provide:

- Two copies of a permission letter that requests approval for the applicant's visa registration
- Two copies of a sponsorship letter that pledges responsibility for the applicant's activity in India and promises to repatriate the applicant at company cost if any adverse conduct comes to notice
- Two copies of a letter confirming the visa holder's residential address in India
- Two copies of an employment contract that specifically states the monthly salary, designation, tenure of employment, etc.
- The company's Incorporation Certificate

All documents, with an exception for the Incorporation Certificate, must be original copies, drafted on company letterhead, signed by a senior manager, and marked with the company's official stamp.

## Visiting FRROs

After the registration documents have been completed, visa-holders can register their visa at FRROs located across India.

Indian authorities ask visa-holders stationed outside of these regional centers to register their visa with the local police. However, visa-holders should attempt to register their visa with a FRRO if possible. Local police are often unaware of the visa registration process, which can lead to unnecessary delays and complications. Moreover, local police officers in rural and un-developed areas are often under-resourced.



**FOLLOW US ON TWITTER**

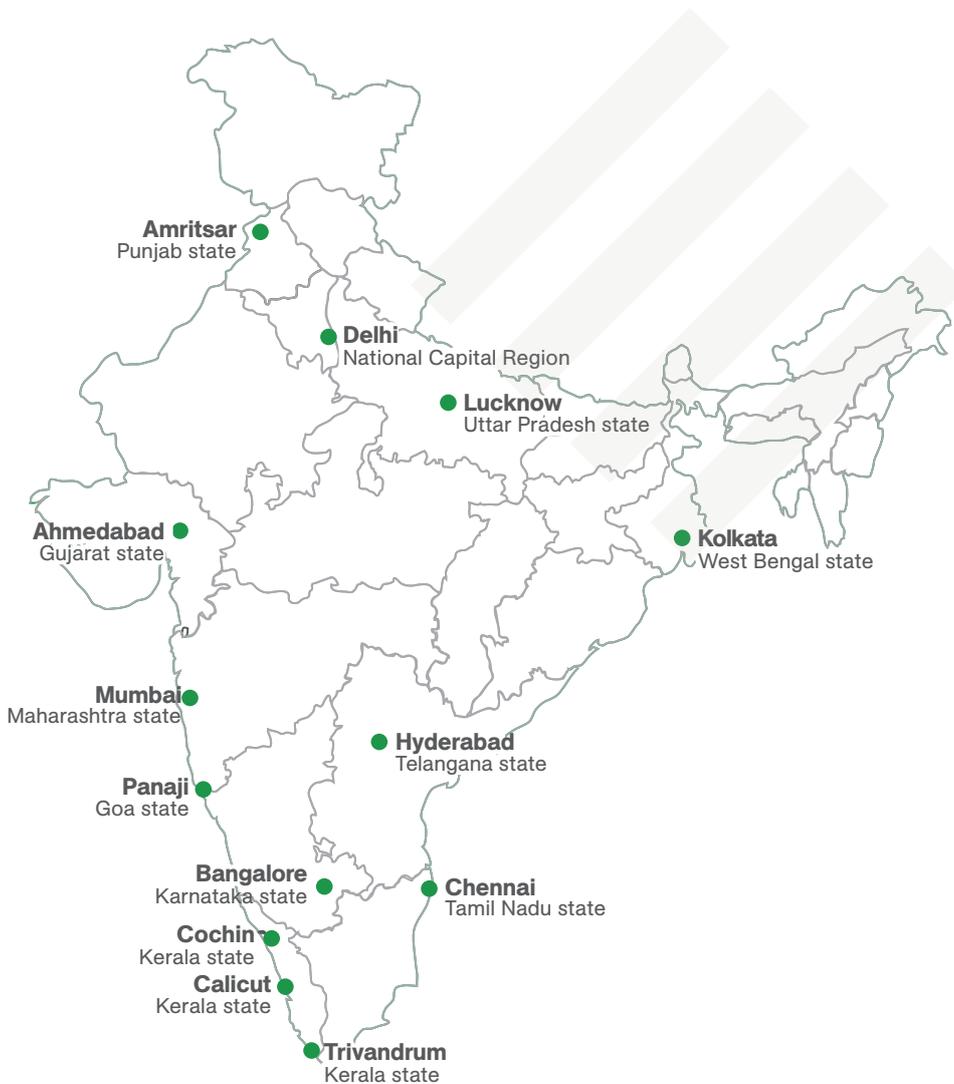
@DezanShira

@IndiaBriefing

For these reasons, many visa-holders stationed in rural and un-developed areas register their visa at a FRRO. This ensures that visa-holders receive the swiftest possible service and maintain privacy at their field location. To do so, the applicant must stay at a regional center with an FRRO for several days, listing a local affiliate office – such as a sales office – as a place of business.

The latest available listing shows that FRROs are located in the following cities:

### FRRO Locations



## Registering your visa

To register a visa, the applicant must bring all required documentation and physically visit an FRRO. Visa holders may schedule a visa registration appointment; however, many visa holders simply visit the FRRO at a time of their choosing. Visa holders that have not scheduled a registration appointment should arrive at the FRRO as early as possible to avoid large crowds.

While visa holders will likely need to wait several hours for a registration officer, well-organized applicants will receive a registration certificate from the officer in a matter of minutes. Once the process is completed, the visa holder becomes legally eligible to work and reside in India for the allowed period.

Although visa holders seeking to register their stay in India can successfully do so independently, many companies employ a local visa consultant. These consultants, who are often certified lawyers, can provide form letters and crosscheck registration documents to ensure that registration applications do not invite any undue scrutiny.

In addition, visa consultants can enter the FRRO with the visa holder to provide support during the registration. Visa holders are not allowed to bring local guests into the FRRO; the presence of a visa consultant ensures that the applicant is accompanied by someone who can speak the local language and answer technical questions during the registration.

## Cumbersome but valuable experience

Although registering an employment visa can be a burden for freshly arrived expatriates, the experience provides important insights into the Indian bureaucratic process. Expatriates unfamiliar with Indian bureaucracy will learn local practices that are critical for preparing and submitting official documents in India. Moreover, the process can help managers understand the amount of time and energy required for doing business with local government offices.

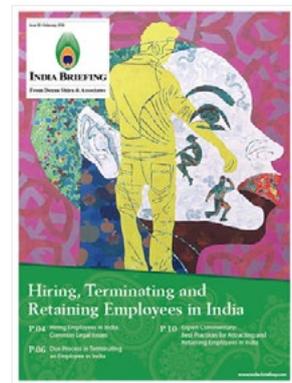
## Hiring employees in India: Common legal issues

Human resource (HR) teams that have not worked in India may find the country's hiring process complicated. Identifying and engaging talent can be a time-consuming and tedious process, while the administrative burdens of hiring employees are also complicated for the uninitiated. HR teams, however, that conduct some basic due diligence can prepare themselves to manage the process quickly and efficiently.

The hiring of workers can depend on numerous factors, such as longevity of service, social insurance, collective agreements, qualifications and experience. While India has a large labor pool, skilled workers and senior management are typically difficult to recruit. Many employers use websites such as Monster.com or Naukri.com to source employees, but the most successful



### RELATED READING



### **Hiring, Terminating and Retaining Employees in India**

*February, 2016*

We examine issues related to hiring, firing and retaining employees in India. We highlight the most common legal issues that arise from India's employment process, summarize the procedures for terminating an employee, and detail some of the most important factors for attracting talent. In addition, we outline some cultural considerations for foreign personnel working with Indian employees.

AVAILABLE HERE



employers generally establish direct relationships with universities for graduate talent and local recruiters for experienced talent. Local consultancies that produce market research can assist foreign employers to gauge local labor markets and establish the relationships needed to source premium talent.

Separately, employers in India are increasingly reporting instances of resume fraud during the application process. This increase is largely a result of incongruence between a candidate's soft skills and their actual experience. Although not all employers are adversely affected by resume fraud, employers in India should adopt a rigorous application review process for technical and senior personnel, verifying employment, education, criminal records, as well as reference checks. Many local service providers can provide employment screening services for employees at any level, as well as more in depth background investigations for C-Suite candidates.

Beyond these general considerations, employers need to be aware of various federal and state mandated compliances. The vast majority of labor laws that govern employment are found at the national federal level, though employers will also find some sub-national variation at the state level, particularly through the various Shop and Establishment Acts. Employers that are unfamiliar with labor laws in India should engage a law firm or professional services firm to review laws and compliances that impact their business. Although not comprehensive, here we outline some of the key pieces of legislation that impact most employers in India.

## Contracts

Indian labor laws provide a minimum of guarantees and benefits to all employees, and employers should note that these laws supersede the provisions of labor contracts. In general, however, there are three types of employment contracts in India:

- Permanent (direct) contract
- Fixed contract
- Temporary contract

When drafting contracts, employers should pay special attention to the Industrial Disputes Act, which provides a large number of protections to employees; the Shops and Establishments Act, which governs the hours of work, payment of wages, leave, holidays, terms of service and other conditions; as well as the several wage and remuneration acts, which regulate the payment of wages, bonuses, and equalize pay for men and women. Any termination policy outlined within the contract should be checked against the current law prior to it being carried out. For example, companies that employ more than 100 workers need government permission to conduct layoffs.

## Important HR Laws in India

### Laws related to wages

The Payment of Wages Act, 1936; The Payment of Wages Rules, 1937; the Payment of Wages (Amendment) Act, 2005.	Designed to regulate the payment of wages to employees. Stipulates the wage periods, time and mode of payment of wages.
The Minimum Wages Act, 1948; The Minimum Wages (Central) Rules, 1950	Sets minimum wage levels that must be paid to skilled and unskilled workers.
The Payment of Bonus Act, 1965; The Payment of Bonus Rules, 1970	Governs bonus payments. Seeks to provide employees a share in the profits of a company. Applies to a workplace with 20 or more employees

### Laws related to working hours, conditions of service and employment

The Industrial Employment (Standing Orders) Act, 1946	Provides a standard model of service conditions for employees. Applies to all establishments where 50 or more workmen are employed.
The Factories Act, 1948	Designed to regulate working conditions in factories.
The Contract Labour (Regulations and Abolition) Act, 1970	Designed to regulate the employment of contract laborers. Applies to organizations with 20 or more people.
Shops and Establishment Act	Designed to regulate employee wages, hours of work, leave holidays and terms of service. Each state has its own version of the Act.

### Laws related to gender

The Maternity Benefits Act, 1961	Regulates employment of women before and after child birth. Applies to every establishment that has 10 or more employees.
The Equal Remuneration Act, 1976	Provides for the payment of equal wages to men and women employees.
Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013	Maintains that during an inquiry following a written request, an internal committee may recommend to transfer the aggrieved woman to any other workplace/grant leave of up to three months.

### Laws related to social security

The Employees' State Insurance Act, 1948; the Workmen's Compensation Act, 1923	Regulates employee compensation for injury by accident during employment.
The Employees' Provident Fund & Miscellaneous Provisions Act, 1952; The Employees' Provident Fund & Miscellaneous Provisions (Amendment) Act, 1996	Mandate the provision of the provident fund, pension fund and deposit-linked insurance fund. Applies to establishments with 20 or more people.
The Payment of Gratuity Act, 1972	Mandates a gratuity payment to employees in a company with ten or more people and applies to all employees regardless of salary.



Besides company rules and regulations, employers are advised to incorporate the following clauses into contracts:

- Non-disclosure
- Employee poaching
- Unfair competition
- Trademarks, patents and trade secrets

## Due process in terminating an employee in India

Employers are exposed to a number of legal and reputational risks resulting from wrongful termination, or not following due process. Employers should, therefore, plan to construct contracts and human resource (HR) materials to ensure that senior management, HR personnel and employees are fully apprised of their rights and responsibilities.

There is no standard process to terminate an employee in India. An employee may be terminated according to the individual labor contract signed between the employee and the employer, if the contract defines a process for termination. Employers should be aware, however, that labor laws supersede the provisions of labor contracts – any termination policy or clause outlined within a contract should be checked against the law by a professional.

In the case that there is no labor contract, or the labor contract does not define a method of termination, then the employer has to follow the state law. In this scenario, an employer needs to abide by India's distinct, state-specific labor legislations in order to terminate the employee.

# Payroll and Social Insurance

## Withholding tax returns filing

Similar to China, businesses in India are required to withhold Individual Income Tax (IIT) from an employee's salary on a monthly basis. During the first seven days of each month, employers must deposit the deducted tax from the previous month with the central government. The only exception to this rule involves the month of March, during which tax deducted may be deposited on or before April 30th.

Employers are required to withhold tax on various payments including rent, interest, dividend, royalty, and service income. In this sense, the compliance requirements for employers are more complex in India than in many other countries. Businesses should actively coordinate with employees to understand the details of supplementary income they are receiving and make the relevant calculations and submission of tax before deducting them from the salary.

Quarterly withholding tax return statements must also be submitted by the last day of the month following the end of a quarter to the central government reporting the tax deducted at source during the quarter. Failure to meet either this deadline or the monthly TDS deposit deadline can result in both interest and penalties being imposed on a company.

## Individual Income Tax (IIT)

### Liability determination

For expatriates, the extent to which services rendered in India are taxable is irrespective of whether the salary is received from inside India or outside India. The taxation of individuals is determined by residence status. Under the Income Tax Act, an individual can have the status of Resident and Ordinarily Resident, Non-resident, or Resident but not Ordinarily Resident. A quick guide to residential status is as outlined below:

Period of Stay		Residential Status			
Conditions		Resident	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
Basic Conditions	Stay in India is 182 days during tax period	Satisfies either condition			Satisfies neither condition
	Stay in India is 60 days during tax period and 365 days in 4 preceding tax periods				
Additional Conditions	Non-Resident in at least 9 of the 10 preceding tax years	Satisfies neither condition		Satisfies either condition	
	Stay in India is less than 729 days in 7 preceding tax periods				



It is also important to note that under the following conditions, 60 days is substituted by 182 days for:

- An Indian citizen or a person of Indian origin who visits India during any tax period
- An Indian citizen who leaves India during any tax period for the purpose of employment outside India

Income in the form of salaries includes remuneration in any form for personal services provided under an expressed or implied contract of employment or service. Such income is subject to tax on a 'due' or 'receipt' basis, whichever is earlier, and includes wages, annuity or pension, gratuity, fees, commission, prerequisites, or profits in lieu of salary, advance salary, leave encashment, etc. Except for under provisions dealing with short stay exemptions, no specific expatriate concessions are available under India's tax laws.

An expatriate can be a resident of two countries at the same time. In such a scenario, there could be double taxation of the same income, but relief from double taxation may be available under the relevant Double Taxation Avoidance Agreements (DTAAs). Taxation relief can be available in the form of a tax credit in the country of permanent residency. Further, submission of a Tax Residency Certificate containing prescribed particulars is a necessary condition for availing of benefits under DTAAs. An application under Form 10FA must be made to obtain a tax residency certificate in India.

## Income tax returns

The process for filing income tax returns is a fairly straight forward one. You must:

### 1. Acquire a PAN number

A permanent account number (PAN) is absolutely necessary for income tax returns. It is a ten-digit number that is issued on a laminated card, and will be used as your ID when registering on CBDT's website.

### 2. Select the appropriate tax return form

There are several income tax return forms according to your specific situation. These include forms for individuals with a single house, for companies, and for persons who are applicable for special taxation schemes, and can be found on Indian Income tax's website. Ensure that you select the relevant one.

### 3. Work out which rate of tax you are on

The rates of income tax are listed in the country's Finance Bill, which is reviewed and amended every year. Under current policy, the key rates of tax are:

- » For a resident individual aged between 60 and 80, the basic exemption limit is US\$4,473
- » For a resident individual aged 80 or above, the basic exemption limit is US\$7,455
- » Rebate from tax of up to US\$75 or 100 percent of the tax, whichever is less available for a resident individual whose total income is below US\$7,455
- » A 15 percent surcharge is applicable, if the total income exceeds US\$149,109. A marginal relief is available.
- » A three percent education cess is applicable on income tax (inclusive of surcharge, if any).

#### Individual Income Tax Rates in India

Estimated yearly taxable income (TI) in US\$ (for comparison only)	Tax rate
3,725 or less	0%
3,726 - 7,450	10%
7,451 - 14,910	20%
14,911 and above	30%

Domestic companies are taxed at a flat rate of 30 percent. Apart from that, education cess is levied at a rate of two percent of income-tax and secondary and higher education cess is levied at one percent of income-tax.

In addition, surcharge is levied at a rate of seven percent if net income exceeds US\$149,064 but does not exceed US\$1,490,646. If the total income exceeds US\$1,490,646, the surcharge levied is 12 percent.

Foreign companies are taxed a flat rate of 40 percent. Apart from that, education cess is levied at a rate of two percent of income-tax and secondary and higher education cess is levied at one percent of income-tax.

In addition, surcharge is levied at a rate of two percent if net income exceeds US\$149,064 but does not exceed US\$1,490,646. If the total income exceeds US\$1,490,646, the surcharge levied is five percent.

As mentioned previously, companies and individuals not working in India but earning an income there are still applicable for tax. It used to be that long-term capital gains were waved for taxation, but this is no longer the case. The rates of tax for non-residents are:

- » On any investment income, the income tax rate is 20 percent;
- » For long-term capital gains, the rate will either be 10 percent or 20 percent, depending on the nature of your operation;
- » On short-term capital gains, 15 percent.

#### **4. Calculate your income tax rate**

- » You should then calculate your tax amount against the above rates of tax. You can use the tax calculator on CBDT's website to do this. Make sure that the information you enter is absolutely accurate, otherwise your tax return application will be rejected.
- » After using the tax calculator, you can then follow the prompts on CBDT's website to complete your tax return. Alternatively, you can use a non-government website to perform the tax return for you, but these will invariably charge a fee for doing so.

#### **5. Retain your tax documents**

Having completed your tax return, ensure that you retain printouts and statements of your taxable income in the event that you are contacted by the tax authorities.

## **India's Provident Fund scheme**

While much of the Indian population does not participate in the country's social insurance program known as the Provident Fund scheme, Indian citizens in the organized sector are entitled to coverage.

International workers including expatriates working for an employer in India are also eligible to participate in the Provident Fund scheme. Employers are required to contribute 12 percent of their employees' specified salary to the scheme, and contributions must be deposited on a monthly basis by the 15th of the subsequent month.

The Employee Provident Fund scheme ("EPF") is one of the main platforms of savings for all employees working in government, public, or private sector organizations. It came into existence with the promulgation of the Employees' Provident Funds Ordinance on the 15th November, 1951. It was replaced by the Employees' Provident Funds Act, 1952 and is now referred as the Employees' Provident Funds & Miscellaneous Provisions Act, 1952 which extends to the whole country except Jammu and Kashmir state.

A provident fund is created to provide financial security and stability to employees. The contributions are made regularly. The primary purpose of the PF fund is to help employees save a fraction of their salary every month so that they can use the same in an event that the employee is temporarily unable to work or at retirement.

The tax free interest and the maturity award ensure a good growth to an employee's money. The PF can be used for multiple purposes at different moments as it guarantees benefits such as:

- Accumulation plus interest upon retirement, resignation, and death
- Partial withdrawals allowed for specific expenses such as house construction, higher education, marriage, illness etc.

<b>Employer and Employee Contributions</b>						
<b>Particulars</b>	<b>Contribution account</b>			<b>Administration account</b>		<b>Total</b>
	<b>EPF</b>	<b>EPS</b>	<b>EDLI</b>	<b>EPF</b>	<b>EDLI</b>	<b>Total</b>
Employee	12	0	0	0	0	12
Employer	3.67	8.33	0.5	0.85	0.01	13.36
<b>Total</b>	<b>15.67</b>	<b>8.33</b>	<b>0.5</b>	<b>0.85</b>	<b>0.01</b>	<b>25.36</b>

## Possible changes for this year

The Employees' Provident Fund Organization has recently proposed changes to India's Provident Fund scheme. Should the changes be accepted and implemented, the mandatory limit for registration will decrease from 20 to 10 employees, and the compulsory contribution of between 10 and 12 percent will be reduced or even waived for a particular period.

---

## Operational Issues

- ◆ Import and export procedures
- ◆ An introduction to sourcing from India

# Import and export procedures

The Indian government has made efforts to relax regulations for importers and exporters recently. Prime Minister Narendra Modi has pledged to streamline import and export procedures and further revamp laws that may obstruct foreign businesses engaged in importing and exporting. This is partly reflected in the new Foreign Trade Policy 2015-2020, which simplified export schemes in the Single Merchandise Exports from India Scheme (MEIS), Service Exports from India Scheme (SEIS) as well as the new freely transferable duty scrips system. Nevertheless, most basic procedures remain the same.

Imports and exports are governed by the Foreign Trade (Development & Regulation) Act, 1992 and India's Export Import (EXIM) policy. The country's Directorate General of Foreign Trade (DGFT) is the main governing body responsible for the EXIM policy. First time importers and exporters must register with the DGFT and acquire an Importer Exporter Code Number (IEC), which is done by submitting the Aayaat Niryaat Form (ANF2A) to the nearest regional authority via the DGFT online portal, post or in person. Along with the ANF2A form, the following must also be submitted:

- Two passport-sized photographs of the legally responsible person;
- Permanent account number (PAN) – a ten digit number which can be obtained by submitting an application;
- Current bank account number;
- Banker's Certificate.

## Import procedures

The Indian Trade Classification – Harmonized System (ITC-HS) allows for the free import of most goods without a special import license. However, certain goods that fall under the following categories require special permission or licensing:

- **Licensed (Restricted) items:** Licensed items can only be imported after obtaining an import license from the DGFT. These include some consumer goods such as precious and semi-precious stones, safety and security products, some agricultural products such as seeds, insecticides, pharmaceuticals and chemicals, and some electronic items.
- **Canalized items:** Canalized items can only be imported via specified transportation channels and methods, or through government agencies such as the State Trading Corporation (STC). These include petroleum products, bulk agricultural products such as grains and vegetable oils, and some pharmaceutical products.
- **Prohibited items:** These goods are strictly prohibited from import and include tallow fat, animal rennet, wild animals, and unprocessed ivory.



### RELATED NEWS

#### Import and Export Licensing Procedures in India

*India Briefing News*  
November, 2016

AVAILABLE HERE

---

An importer also has to submit a Bill of Entry, which certifies the description and value of goods entering the country. A Bill of Entry should be submitted with the following:

- The original and duplicate for customs;
- A copy for the importer;
- A copy for the bank;
- A copy for making remittances.

Under the Electronic Data Interchange (EDI), no formal Bill of Entry is required (as it is recorded electronically), but the importer is required to file a cargo declaration after prescribing particulars required for processing of the entry for customs clearance. Bills of Entry can be one of three types:

- **Bill of Entry for Home Consumption** – This form is used when the imported goods clear on payment of full duty. Home consumption means use within India. It is informally known as the 'white bill of entry' due to its color.
- **Bill of Entry for Housing** – If the imported goods are not required immediately, importers may store the goods in a warehouse without the payment of duty under a bond and then clear them from the warehouse when required on payment of duty. This will enable the deferment of payment of the customs duty until goods are actually required. This Bill of Entry is printed on yellow paper and is thus often called the 'yellow bill of entry'. It is also called the 'into bond bill of entry' as the bond is executed for the transfer of goods in a warehouse without paying duty.
- **Bill of Entry for Ex-Bond Clearance** – The third type is for ex-bond clearance. This is used for clearance from the warehouse on payment of duty and is printed on green paper.

Payments can be made to member countries of the Asian Clearing Union (excluding Nepal) and in any permitted currency. For all other countries payment can be made in any permitted currency, including Indian Rupees.

## Export procedures

The following is required to export from India:

- A PAN based Business Identification Number (BIN) from the DGFT. This must be acquired before filling out a shipping bill or a bill of export for exported goods.
- If exporting by air or sea, a shipping bill must be filled out, or if exporting by road, a bill of export must be completed. These bills contain information relevant to exporting from India, including the name of the exporter, invoice number, consignee, description and quantity of goods, free on board (FOB) value, etc.

- 
- At the same time as submitting a shipping bill/bill of export, other relevant documents must also be provided, including invoices, export contracts, and packing lists.
  - A certificate of origin must also be submitted. This is used to verify where goods have been produced.

Goods can be exported freely if they are not mentioned in the classification of ITC (HS). The ITC classification of goods for export is as follows: restricted, prohibited and State Trading Enterprise (STE).

## Restricted goods

Before exporting any restricted goods, the exporter must obtain a license explicitly permitting the exporter to do so. The restricted goods must be exported through a set of procedures detailed in the license.

## Prohibited goods

These are items which cannot be exported. The vast majority of these include wild animals, and animal articles that may carry risk of infection.

## State Trading Enterprise (STE)

Certain items can be exported only through designated STEs. The export of such items is subject to the conditions specified in the EXIM policy.

In addition, certain restrictions apply to the import and export of goods from and to certain countries. While most goods can be imported or exported to countries, India has a Most Favored Nation (MFN) agreement, making trade with certain countries prohibited as per UN sanctions or international conventions.

## Mode of payment

The value of the exported goods is received through a bank in the following ways:

- Bank draft, pay order, banker's or personal cheques
- Foreign currency notes/foreign currency travellers' cheques from the buyer during his visit to India.
- Payment out of funds held in the Foreign Currency Non Resident (FCNR) or Non Resident Rupee (NRE) account maintained by the buyer
- International credit cards of the buyer.

In the early 1990s, India began economic reforms that have made its trade regime increasingly transparent. The reforms have been accompanied by a decline in import tariff rates – from a peak of 350 percent in June 1991 to a current average of 10 percent.

However, India's tariffs are still relatively high by international standards. High tariffs and import restrictions have constrained foreign firms from selling in India. They have also prevented investors from importing competitively in several industries.

While India has progressively cut duties and taxes, domestic industry still enjoys relatively high levels of protection in several areas. Foreign companies encounter tariff and non-tariff barriers, including a complex tariff regime. Further, the Indian government is not shy about imposing both civil and criminal penalties for not following customs regulations.

## Duties explained

Customs or import duties are levied by the national government when goods are imported into India. There is no de-minimis amount. All goods imported into India are subject to duty. The value of imported goods is said to be the transaction value between parties.

While the basic customs duty rate is 10 percent, additional duties bring the aggregate customs duty up to 2944 percent in 2015. Rates may vary depending on the classification of goods. As there are thousands of goods that are imported into India, it is not feasible to prescribe rates of duty for each type of merchandise here. However, the basic calculation of import duties is as follows:

Description of Duty	Percentage of Duty Levied	Amount in US\$
Value of imported goods (including freight, insurance, and 1% customs handling fee)		1,000,000
Basic Customs Duty (BCD)	10 %	100,000
Basis for calculating CVD		1,100,000
Countervailing Duty Rate	12.5 %	137,500
Basis for calculating Education Cess		237,500
Education Cess	2 %	4,750
Secondary Education Cess	1 %	2,375
Basis for calculating Special CVD (Includes Assessable Value, BCD, CVD, Ed Cess)		1,244,625
Special CVD	4 %	49,785
Total Customs Duty		294,410

## Basic Customs Duty (BCD)

This duty is levied most commonly ad-valorem, based on the assessed value of the goods. The duty is calculated on the value of the goods plus shipping and insurance charges. In general the BCD rate is 10 percent. For capital goods, the rate is 7.5 percent. For agricultural goods the rate is between 30 percent and 85 percent. Textile rates vary between 10 and 30 percent.

## Countervailing Duty (CVD)

This duty is levied on the assessed value of goods plus basic customs duty. Goods that fall into this category are imported goods that are similar to goods manufactured in India. The tax is levied in lieu of the excise tax that is leviable on goods manufactured in India and is essentially equal to the central excise duty on the goods in question. In general this rate is 12.5 percent. All products imported by Special Economic Zones (SEZ) enjoy zero percent CVD.

## Special Additional Countervailing Duty (known as Special CVD)

Special CVD tax is applicable on all items. It is levied at the rate of 4 percent of the basic and the excise duty on all imports in order to countervail the VAT or sales tax on local goods in India. This duty can be refunded to traders who sell imported goods in India after charging VAT/Sales tax.

## Anti-dumping duty

This is levied on specified goods imported from specified countries – including the U.S. – to protect Indian industries. India can impose duties up to, but not exceeding, the margin of dumping, or the difference between the normal value and the export price.

## Safeguard duty

The Indian government may by notification impose a safeguard duty on articles after concluding that increased imported quantities will cause or threaten to cause serious injury to domestic industry. The government has broad authority to set rates for safeguard duties not exceeding the amount which has been found adequate to prevent or remedy 'market disruption'.

## Customs education cess

Effective July 2004, India introduced an education cess (duty). The current rate for the Education Cess is two percent with the Higher Education Cess set at one percent of BCD and CVD.

## Customs handling fee

The Indian government assesses a one percent customs handling fee on all imports in addition to the applied customs duty.

## Total duty

Therefore, for most goods:

$$\text{TOTAL DUTY PAYABLE} = \text{BCD} + \text{CVD} + \text{SPECIAL CVD} + \text{EDUCATION CESS} + \text{CUSTOMS HANDLING FEE}$$

As an example, we can examine figures for a company that imported goods worth US\$1,000,000 into India. The US\$1,000,000 assessed value includes shipping, insurance, and the 1 percent customs handling fee. In general, the customs duty would be calculated as above.

Customs duty rates are revised in each annual budget in February and are published in various sources; however, there is no single official publication that has all information on tariffs and tax rates on imports. Furthermore, each state has its own taxes on interstate commerce. As civil and criminal penalties for violation of customs regulations are severe, it is recommended that individuals and businesses importing goods into India consult with a professional.

# An introduction to sourcing from India

Choosing where to source from can be a stress-inducing process, for although the practice is now commonplace, it is nevertheless still fraught with various risks and difficulties that can just as easily cripple a business as make it more profitable. Key considerations include understanding how to navigate the regulatory framework of the country in question, knowing if it has a workforce capable of producing the intended goods for export, and identifying the most suitable type of sourcing platform.

For the past twenty years, China has been dominant as a sourcing destination. The country's extensive, cheap and skilled labor force has long since established China as a sourcing favorite in Asia, but its star no longer shines as bright as it once did. With a complex regulatory framework and rising labor costs, businesses may wish to consider other locations in order to ensure their competitive edge is not blunted.

## India's sourcing edge

Among China's competitors, India is one of the most appealing alternatives at the moment. In this section, we take a look at India's export industry and analyze some of the key advantages that the county possesses as a sourcing destination.

### Low labor costs

One of India's principal strengths is its cost-effectiveness. In contrast to China, India's labor costs have remained consistently low since the turn of the century, as can be seen in the following graph.

Hourly compensation costs in manufacturing for China and India, in 2008-2012



This trend appears set to continue for the foreseeable future. Where the average Chinese salary looks fixed to markedly increase for 2016, the average Indian salary will remain mostly the same once inflation is taken into account, as shown in a recent salary report conducted by Towers Watson:

Country	Overall Salary Increase	Salary Increase after Inflation
India	10%	440%
China	7%	4.70%

## Cost of living

In most instances, the cost of living in India and China is roughly equal. Electricity prices in both are amongst the cheapest in the world, each averaging approximately US\$8 cents per kilowatt hour. In the past year, both have raised their gas prices to roughly the same amount, but India still slightly trumps China, averaging around US\$840 per million British thermal units (mmBtu) to China's US\$10.

One area that is seeing a great deal of fluctuation on China's part is property prices. Rental costs – which must be considered both for personal living and a sourcing platform's office space – have been continuously rising in China for the past four years. In Beijing, for instance, rental prices rose by 6.2 percent in June 2013, according to Global Property Guide. Conversely, India's property prices have remained mostly stable. From Q4 2012 to Q1 2013, Mumbai's average rent fell between one and four percent, and Delhi's remained mostly the same. Whilst it was previously thought that prices may rise under the Modi administration, realty experts are now predicting that no noticeable increase will come for some time.

## Special Economic Zones

The government introduced India's first special economic zones (SEZs) in April 2000. Structured closely on the already successful model of China, they are designed to help stimulate both foreign and domestic investment, boost India's exports, and create new employment opportunities. Notable zones include Nodia, Chennai, Cochin, and Falta, and the Indian government is now accepting proposals for additional, far smaller SEZs. As of August 2016, almost 200 SEZs were in operation and a further 565 were formally approved for operation.

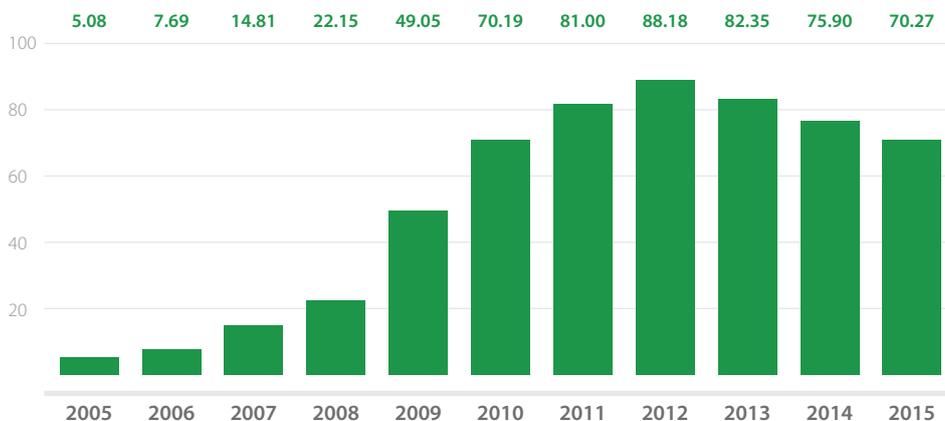
The advantages of setting up a sourcing platform within a SEZ are numerous and include:

- Duty free domestic procurement of goods;
- 100 percent income tax exemption on export income for the first five years and 50 percent for the five years following;
- Exemption from Minimum Alternate Tax, Central Sales Tax, Service Tax, State Sales Tax, and a number of other taxes usually levied by local governments;
- External commercial borrowing allowed up to US\$500 million per year without restriction;
- Permission to manufacture products directly, as long as the goods produced fall within a sector which allows 100 percent FDI.

The impact of India's new SEZ policy has been massive. Since 2005, exports from the country have almost continually been increasing, as seen below:

### Exports from SEZ's from 2005-2015

Unit: US\$ Billion





India's world image and reputation has often hindered it from directly competing with China as a sourcing destination. Unlike China, whose 'Open Door' and investor friendly policies stretch back to the late 1970s, India's economic reforms only began in the 1990s. Since then, the country has struggled to eliminate some of the problems that have hindered foreign investment; namely, some of its more complex trading regulations were not revamped, its infrastructure remained largely underdeveloped, and corruption went mostly unchallenged.

Modi's BJP party has already taken steps to eliminate some of the issues companies have had about establishing a sourcing platform in India: money is being invested in the country's poor infrastructure, allowing for the easier transportation of goods within India's borders, and the government has raised the cap levels on numerous sectors for foreign direct investment (FDI), including a massive increase in its railway sector from zero percent to 100 percent. Looking to the future, Modi has said that the government will be introducing new laws to further simplify the process for establishing a foreign presence in India.

India's cost-effectiveness and policy reforms are what separate it from other sourcing destinations and the India of yesteryear. This has already begun impacting the future of the country's existing foreign export industries. By 2020, back office service sourcing is estimated to more than double from its current worth of US\$23 billion to US\$50 billion, and various Western companies have announced their intention to increase the amount they source from India in the near future. Whilst it is still a developing sourcing destination, India now presents an exceptionally attractive global sourcing option.

## Sourcing and procurement: Key considerations

As touched upon previously, there are numerous advantages a company can gain by global sourcing. These advantages can be viewed as the objectives of a sourcing operation in India and its success can subsequently be measured against them. Broadly speaking, a company should ask whether their operation:

- Reduces operational costs;
- Enhances efficiency;
- Stabilizes the supply chain in the long term;
- Minimizes risk;
- Allows access to an appropriately skilled workforce.

## Indirect and direct sourcing models

There are two principal options available to foreign companies seeking to enter and establish a sourcing platform in India. The first is to find and agree terms with a local partner, who would act as a company's primary representative for their operation in India. This option is certainly the easiest to execute, as exporting from India without maintaining a personal footprint there



will bypass the need to go through the legal processes that are necessary for establishing a foreign presence.

### **Locating a sourcing partner**

Choosing a sourcing partner can be a difficult process, as the choice will invariably have a direct impact on the quality of a company's products and, consequently, its reputation. It should therefore be approached and conducted in a very careful manner. Key considerations include:

- The potential partner's level of experience (whether they have exported from India before);
- The location of the partner and where the goods are being produced (whether they will be operating in an SEZ and thus qualify for tax benefits?);
- Where the partner is based (answering questions such as if their location is near the coast or factoring how much the added costs will amount to, based on their location, to procure necessary materials)

### **Locating and screening a sourcing partner**

There are a number of ways a company can go about finding a sourcing partner, with the most common means being hiring a professional sourcing agent, consulting official government databases, and searching on various sourcing websites, such as Alibaba.com and GlobalSources.com.

The obvious downside of taking this route is the lack of direct control a foreign company would have over its operations. Although a deep pool of skilled workers exists in India, leaving a company's platform indirectly supervised can negatively affect the rate and quality of production.

Using a sourcing partner in India can therefore be seen as an 'indirect' way of managing a sourcing operation. Whilst it is comparatively simple and cheap, the lack of direct involvement makes it harder to ensure that all sourcing objectives are being met. This should always be born in mind when choosing to handle sourcing operations in India without a personal footprint in the country.

### **Establishing an office on the ground**

The second option is to actually establish a local presence within India. Although creating an office on the ground inevitably necessitates a greater financial and legal burden for the company in question, it is an effective means of ensuring higher performance levels for a sourcing platform in India. This can be done by establishing a liaison office or branch office as mentioned earlier.



# DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia



**Business Intelligence | Due Diligence  
Advisory | Corporate Establishment | Tax  
Accounting | Audit | Compliance  
Payroll | IT Solutions**

## Our Offices in India

### **Delhi**

+91 9555440455  
delhi@dezshira.com

Unit No. T-15, 3rd Floor, Rasvilas  
Saket District Centre  
New Delhi 110017, India

### **Mumbai**

+91 22 2204 6117  
mumbai@dezshira.com

35, 3rd Floor, Mittal Chambers  
Nariman Point  
Mumbai 400021, India

**China | Hong Kong | India | Singapore | Vietnam**

**Dezan Shira Asian Alliance Members** Indonesia | Malaysia | The Philippines | Thailand

**Dezan Shira Liaison Offices** Germany | Italy | United States



**25** Years  
1992-2017