Nishith Desai Associates
LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI SILICON VALLEY BANGALORE SINGAPORE MUMBAI-BKC NEW DELHI MUNICH

Doing Business in India

With Special Reference to Tax Treaties between India and

- Germany
- Japan
- Mauritius
- Netherlands
- Singapore
- Switzerland
- UK
- USA

October 2013

www.nishithdesai.com

About NDA

Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Silicon Valley, Singapore, New Delhi, Mumbai and Munich. We specialize in strategic legal, regulatory and tax advice coupled with industry expertise in an integrated manner. We focus on niche areas in which we provide significant value and are invariably involved in select highly complex, innovative transactions. Our key clients include marquee repeat Fortune 500 clientele.

Core practice areas include International Tax, International Tax Litigation, Litigation & Dispute Resolution, Fund Formation, Fund Investments, Capital Markets, Employment and HR, Intellectual Property, Corporate & Securities Law, Competition Law, Mergers & Acquisitions, JVs & Restructuring, General Commercial Law and Succession and Estate Planning. Our specialized industry niches include financial services, IT and telecom, education, pharma and life sciences, media and entertainment, real estate and infrastructure.

Chambers & Partners has ranked Nishith Desai Associates as #1 for Tax, Technology-Media-Telecom (TMT) and Private Equity (2013). Legal Era, a prestigious Legal Media Group has recognized Nishith Desai Associates as the Best Tax Law Firm of the Year (2013). Legal 500 have ranked us in tier 1 for Investment Funds, Tax and TMT practices (2013/2012/2011). For the third consecutive year, International Financial Law Review (IFLR), a Euromoney publication, has recognized us as the Indian "Firm of the Year" (2012) for our TMT practice. We have been named an Asian MENA Counsel 'In-House Community Firm of the Year' in India for Life Sciences practice (2012) and also for International Arbitration (2011). We have received honorable mentions in Asian MENA Counsel Magazine for Alternative Investment Funds, Antitrust/ Competition, Corporate and M&A, TMT and being Most Responsive Domestic Firm (2012). We have been ranked as the best performing Indian law firm of the year by the RSG India Consulting in its client satisfaction report (2011). Chambers & Partners has ranked us #1 for Tax, TMT and Real Estate – FDI (2011). We have received honorable mentions in Asian MENA Counsel Magazine for Alternative Investment Funds, International Arbitration, Real Estate and Taxation for the year 2010. We have been adjudged the winner of the Indian Law Firm of the Year 2010 for TMT by IFLR. We have won the prestigious "Asian-Counsel's Socially Responsible Deals of the Year 2009" by Pacific Business Press, in addition to being Asian-Counsel Firm of the Year 2009 for the practice areas of Private Equity and Taxation in India. Indian Business Law Journal listed our Tax, Private Equity & Venture Capital and TMT practices in the India Law Firm Awards 2009. Legal 500 (Asia-Pacific) has also ranked us #1 in these practices for 2009-2010. We have been ranked the highest for 'Quality' in the Financial Times – RSG Consulting ranking of Indian law firms in 2009. The Tax Directors Handbook, 2009 lauded us for our constant and innovative out-of-the-box ideas. Other past recognitions include being named the Indian Law Firm of the Year 2000 and Asian Law Firm of the Year (Pro Bono) 2001 by the IFLR. In an Asia survey by International Tax Review (September 2003), we were voted as a top-ranking law firm and recognized for our cross-border structuring work.

Our research oriented approach has also led to the team members being recognized and felicitated for thought leadership. Consecutively for the fifth year in 2010, NDAites have won the global competition for dissertations at the International Bar

Association. Nishith Desai, Founder of Nishith Desai Associates, was awarded the "Best Tax Lawyer of the Year" by Legal Era (2013). He was listed in the Lex Witness 'Hall of fame: Top 50' individuals who have helped shape the legal landscape of modern India (August 2011). Nishith Desai has been the recipient of Prof. Yunus 'Social Business Pioneer of India' – 2010 award. He has been voted 'External Counsel of the Year 2009' by Asian Counsel and Pacific Business Press and the 'Most in Demand Practitioners' by Chambers Asia 2009. He has also been ranked No. 28 in a global Top 50 "Gold List" by Tax Business, a UK-based journal for the international tax community.

We believe strongly in constant knowledge expansion and have developed dynamic Knowledge Management ('KM') and Continuing Education ('CE') programs, conducted both in-house and for select invitees. KM and CE programs cover key events, global and national trends as they unfold and examine case studies, debate and analyze emerging legal, regulatory and tax issues, serving as an effective forum for cross pollination of ideas.

Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has now been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence ('GBOE').

Please see the last page of this paper for the most recent research papers by our experts.

Disclaimer

Contact

For any help or assistance please email us on ndaconnect@nishithdesai.com or visit us at www.nishithdesai.com

Contents

Contents

1. Introduction

The Republic of India is a vast country which has existed in one form or another for many millennia. Bound by cultural commonalities, independent India is the second largest country in the world — home to about a sixth of the human population — and the seventh largest country by sheer land mass. Following the liberalization of India's economy in 1991, India experienced unprecedented growth and has become an integral part of the global economy. India is now the world's fourth largest economy[1] and has been growing at an astounding annual rate of 7.8 per cent since 2002.[2] India's growth has resulted in a quantum leap from a primarily agrarian society in the 1980s to an increasingly service and industry oriented economy at present.

India's resilient and growing domestic markets along with its robust and well-regulated banking and foreign exchange laws have ensured that the current global economic slowdown does not greatly affect the country's economy. In fact, the forecasts by The Economist (see the table below) indicate that India is likely to maintain a real annual GDP growth rate of 5-8 per cent over the next five years.

India – Key Economic Indicators

Key Indicators	2012/Present	2011
Gross Domestic Product (% Growth)	+6.2	+9.3
Consumer Price Inflation (% Growth)	+8.4	+10.4
Industrial Production (% Growth)	2.9	+8.2

Key Indicators	2012/Present	2011
Lending Rate – 10 Year Govt Bonds (%)	8.1	8.44
Trade Balance (US$ BN)	-90.6	-131.1
Exchange Rate (Rs. : Us$)	54.21	51.9
Market Index (Bse Sensex Index)	19,742	16,175

SOURCE: Indian Economic Survey 2012-2013

India is also the world's largest democracy with an overall free market economy. Having emerged as a global center for services and outsourcing, India is also becoming an attractive destination for outsourcing industrial production, particularly for specialty manufacturing. In addition, the expanding Indian middle class is about the same size as the population of the US. It has seen a significant rise in its ability to pay for and desire to buy high-quality consumer products, thereby providing a large domestic market for companies that choose to set up consumer manufacturing operations and sales centers in India. Further, it is expected that as India continues to grow, its need for development of its physical and human infrastructure will correspondingly increase. In this context, it is anticipated that India will require around USD 1 trillion over the next five years to be invested into the infrastructure sector.[3] All in all, there is little doubt that India is one of the world's most attractive investment destinations and will continue to be so in the future.

Legal Regime

As a former British colony, India adopted a common law based legal system, under

1. http://www.worldbank.org/en/country/india/overview; http://www.therichest.org/world/worlds-largest-economies; http://business.gov.in/indian_economy/index.php.
2. Sources: IMF-IFS, Madisson, Groningen University

3. Source: http://www.financialexpress.com/news/huge-infrastructure-investment-scope-in-india-1tn-in-5-years-pranab/945471

which India's basic commercial laws are similar to those of other Commonwealth jurisdictions (including the UK, Canada, Australia, New Zealand, Singapore and Hong Kong). The Indian legal system is therefore based on a combination of legislation and judicial precedent (case law). India is a constitutional republic with a partly federal system of governance. The union and the states, both legislate on subjects as laid out in the Constitution, similar to that of the US. For this reason, there are plenty of legislations and authorities, which make the practice of Indian law both complex and well-laid out.

This paper attempts to introduce the basic legal regime governing the conduct of business in India and answer questions and issues commonly raised by foreign investors and merchants. It is intended to act as a broad legal guide for starting and carrying on operations in India. The laws discussed herein are subject to changes and may vary with time. We believe this paper will provide some clarity regarding India and its legal regime. However, it should not be used as a legal opinion on any specific matter. Please feel free to contact us in the event that you would like to invest in India or expand your operations into India. We are happy to be of assistance.

2. Entering India

International companies or investors seeking to set up operations or make investments in India need to appraise and structure their activities on three pillars:

i. Strategy

- Observing the economic and political environment in India from the perspective of the investment;
- Understanding the ability of the investor to carry out operations in India, the location of its customers, the quality and location of its workforce.

ii. Law

- **Exchange Control Laws:** Primarily the Foreign Exchange Management Act, 1999 ("FEMA") and numerous circulars, notifications and press notes issued under the same;
- **Corporate Laws:** Primarily the Companies Act, 1956 and Companies Act, 2013[4] (collectively the "Companies Act") and the regulations laid down by the Securities and Exchanges Board of India ("SEBI");
- **Sector Specific Laws:** Specific Laws relating to Financial Services (banking, non-banking financial services), Infrastructure (highways, airports) and other sectors.

iii. Tax

- **Domestic Taxation Laws:** The Income Tax Act, 1961 ("ITA"); indirect tax laws including laws relating to value added tax, service tax, customs, excise;
- **International Tax Treaties:** Treaties with favorable jurisdictions such as Mauritius, Cyprus, Singapore and the Netherlands.

Foreign Direct Investment

Setting up India operations or investing in India by non- residents requires conformity with India's foreign exchange regulations, specifically, the regulations governing foreign direct investment ("FDI"). Most aspects of foreign currency transactions with India, including investments, are governed by FEMA and the delegated legislation thereunder.

FDI, up to 100 per cent, is permitted in most sectors in India under the 'automatic route'. Under the automatic route, a company investing in India does not require the prior approval of India's central bank, the Reserve Bank of India ("RBI") or the approval of the Central Government (through the Foreign Investment Promotion Board ("FIPB")) from the FEMA perspective before making such an investment.

Certain sectors have caps on the amount of FDI allowed, including:

1. Banking-private sector (74 per cent)
2. Print Media (26 per cent)
3. Insurance (26 per cent)
4. Multi brand retail trading (51 per cent).

There are some sectors where FDI is prohibited, including:

1. Atomic Energy
2. Lottery business
3. Gambling and betting
4. Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes

4. As on date of this paper, 98 sections of the Companies Act, 2013 have been notified and the remaining provisions will be notified in a phased manner

There are some sectors where FDI is allowed only with the approval of the Central Government. Some of them are:

1. Telecom Services (approval required for foreign investment above 49 per cent)

2. Banking-public sector (approval required for foreign investment which is limited to 20 per cent)

3. Broadcasting (approval required for foreign investment above 49 per cent)

4. Commodity Exchanges (approval required for foreign investment above 49 per cent)

5. Print Media (approval required for foreign investment which is limited to 26 per cent)

6. Single brand product retail trading (approval required for foreign investment which is above 49 percent)

7. Multi brand retail trading (approval required for foreign investment which is limited to 51 per cent)

8. Air transport services (approval required for foreign investment which is limited to 49 per cent)

Further, certain sectors and businesses in India have minimum capitalization norms for a foreign investor intending to invest in these sectors and the foreign investor must invest atleast a minimum prescribed amount. These sectors include:

1. Non-Banking Financial Services

2. Development of townships, housing, built up infrastructure and construction development projects.

In addition to the prescription on investment amount, for few sectors, the FDI norms also contain, additional terms and conditions that are required to be complied with by the foreign investor. For example, with respect to single brand retail the following conditions should also be satisfied:

- Products to be sold should be of a 'single brand' and the products should be sold under the same brand internationally;

- If the FDI is proposed to be beyond 51 per cent then sourcing of 30 per cent of the value of the goods purchased should be done from India.

Recent changes in the FDI regime include permitting foreign equity participation in multi brand retail, upto 51 per cent with government permission. Such permission will be subject to certain conditions, such as:

- Minimum amount of USD 100 million to be invested by the foreign investor

- 50 per cent of the total FDI in the first tranche to be invested in the backend infrastructure within 3 years

- Retail sales outlets may be set up in those States which have agreed or agree in future to allow FDI in multi brand retail trade

- 30 per cent mandatory local sourcing requirement from Indian micro, small, medium industries which have a total investment in plant and machinery not exceeding USD 2 million.

However, foreign investment in e-commerce (single brand retail and multi brand retail) is not permitted under the current FDI regime. In order to boost the debt-ridden aviation industry, the government has allowed foreign airlines, to make investments in air transport services upto 49 per cent after taking government approval.
FDI into Indian companies may be direct or

indirect and FDI norms apply to both direct and indirect foreign investments into an Indian company. In case of direct investment, the non-resident investor invests directly into an Indian company.

Indirect FDI is referred to as the downstream investment made by an Indian company which is owned or controlled by non-residents into another Indian company. As per the FDI policy, such downstream investment is also required to comply with the same norms as applicable to direct FDI in respect of relevant sectoral conditions on entry route, conditionalities and caps with regard to the sectors in which the downstream entity is operating.

Companies are owned or controlled by foreign investors if they have a right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholdings or management agreements.

An investing Indian entity that is 'owned' and 'controlled' by resident Indian citizens and/or Indian companies, which are ultimately owned and controlled by resident Indian citizens is regarded as domestic companies. Any downstream investment by such investing Indian company, even if it has foreign investment, would not be considered for calculation of indirect foreign investment and is not required to be in compliance with the relevant sectoral conditions on entry route, conditionalities and caps, with regard to the sectors in which the downstream entity is operating.

Further, downstream investment made by a 100 per cent foreign owned and/or controlled banking company as a result of any loan structuring scheme, in trading books or acquisition of shares as a result of default in loan, will also not be considered as indirect foreign investment.

3. Incorporation

Once the foreign exchange regulations have been complied with, a foreign investor must choose how it wishes to set up its operations in India. The entities that foreign investors may set up in India may either be unincorporated or incorporated.

I. Unincorporated Entities

Unincorporated entities permit a foreign company to do business in India via 'offices' of certain types. These options are as follows:

i. Liaison Office

Setting up a liaison office requires the prior consent of the RBI. A liaison office acts as a representative of the parent foreign company in India. However, a liaison office cannot undertake any commercial activities and must maintain itself from the remittances received from its parent foreign company. The approval for setting up a liaison office is valid for 3 years. It is an option usually preferred by foreign companies that wish to explore business opportunities in India.

ii. Branch Office

The branch office of a foreign company in India must be set up with the prior consent of the RBI. It can represent the foreign parent company in India and act as its buying or selling agent in India. The branch office is permitted to remit surplus revenues to its foreign parent company subject to the taxes applicable. Operations of a branch office are restricted due to limitation on the activities that it can undertake. The tax on branch offices is 40 per cent *plus* applicable surcharges and the education *cess.* It is an option that is useful for companies that intend to undertake research and development activities in India.

iii. Project Office

A foreign company may set up a project office in India under the automatic route subject to certain conditions being fulfilled. The activities of a project office must be related to or incidental to the execution of the relevant project. A project office is permitted to operate a bank account in India and may remit surplus revenue from the project to the foreign parent company. The tax on project offices is 40 per cent *plus* applicable surcharges and the education *cess.* Project offices are generally preferred by companies engaged in one-time turnkey or installation projects.

iv. Limited Liability Partnership

A Limited Liability Partnership ("LLP") is a form of business entity which permits individual partners to be shielded from the liabilities created by another partner's business decision or misconduct. In India, LLPs are governed by The Limited Liability Partnership Act, 2008. The LLP is a body corporate and exists as a legal person separate from its partners. Foreign investment in LLPs is permitted under the government approval route only in LLPs operating in sectors where 100 per cent FDI is allowed through the automatic route and there are no performance linked conditions.

v. Partnership

A partnership is a relationship created between persons who have agreed to share the profits of a business carried on by all of them, or any of them acting for all of them. A partnership is not a legal entity independent of its partners. The partners own the business assets together and are personally liable for business debts and taxes. In the absence of a partnership agreement, each partner has an equal right to participate in the management and control of the business and the profits/losses are shared equally amongst the partners. Any partner can bind the firm and the firm is liable for all the liabilities incurred by any partner on behalf of the firm. Foreign investment is permitted in Indian partnership firms subject to prior approval of RBI.

vi. Trust

A trust arises when one person (the "trustee") holds legal title to property but is under an equitable duty to deal with the property for the benefit of some other person or class of persons called beneficiaries. Like a partnership, a business trust is not regarded as a legal entity. The trust, as such, does not incur rights or liabilities. The beneficiaries do not generally obtain rights against or incur liabilities to third parties because of the transactions or actions undertaken by the trustee in exercising its powers and carrying out its duties as a trustee. If the trustee of a business trust is a corporation, the participants may effectively limit their liability to the assets of the corporate trustee and the assets held by the corporation on trust for the beneficiaries. A foreign resident may only be the beneficiary of a trust, which is set up as a venture capital fund and only after receiving the prior consent of the FIPB.

II. Incorporated Entities

Incorporated entities in India are governed by the provisions of the Companies Act. As mentioned in the previous Chapter, the Companies Act, 2013 has been enacted and 98 sections of this 2013 Act has been notified and brought into effect. The remaining sections will be brought into force in a phased manner as and when notified. The Rules applicable is also in the process of finalization and shall be brought into force by appropriate notification by the Central Government. Once all the sections of the 2013 Act are notified, the Companies Act, 1956 will stand replaced.

The authority that oversees companies and their compliances is the Registrar of Companies ("RoC"). Companies may either be 'private limited companies' or 'public limited companies':

i. Private Limited Company

A private limited company must have a minimum paid-up share capital of INR 100,000 (approx. USD 1595[5]). It carries out business in accordance with its memorandum and articles of association. A private limited company has certain distinguishing characteristics. It must, in its articles of association, restrict the right to transfer shares; the number of members in a private limited company is a minimum of 2 and a maximum of 200 members (excluding the present and past employees of the company); its Articles of Association must prohibit any invitation to the public to subscribe to the securities of the company. About 3-4 weeks is required to incorporate a private limited company, but this may vary from state to state.

ii. Public Limited Company

A public limited company must have a minimum paid-up share capital of INR 500,000 (approx. USD 7679[6]). It is defined as a company which is not a private company (but includes a private company that is the subsidiary of a public company). A public company can only commence business after being issued a 'Certificate of Commencement of Business' by the RoC. A public limited company shall have a minimum of 7 members but may have more than 200 shareholders and may invite public to subscribe to its securities. A public limited company may also list its shares on a recognized stock exchange by way of an initial public offering ("IPO").

5. As per the exchange rate on September 25, 2013
6. As per the exchange rate on September 25, 2013

III. Advantages and Disadvantages of a Private Company

» Not as stringently regulated as a large public company
» More flexibility than public companies in conducting operations, including the management of the company, issuance of different types of securities and the payment of managerial remuneration
» Faster incorporation process

» Restrictions on invitation to public to subscribe to securities.
» Limited exit options

IV. Incorporation Process

The process for incorporating a company in India is not exceptionally different from the processes in other Commonwealth nations. The important steps with an indicative time frame involved in the incorporation process are:

i. Name Approval (7-10 days)

- The RoC must be provided with one preferred name and five alternate names which should not be similar to the names of any existing companies. A no-objection certificate must be obtained in the event that the word is not an 'invented word'.

- The use of certain words in the name of the company requires minimum capitalization as outlined in the table below:

Minimum Capitalization

No.	Keywords	Minimum Authorized Capital (INR)
1.	Corporation	250 million
2.	International, Globe, Universal, Continental, Inter-Continental, Asiatic, Asia, being the first word of the name	50 million
3.	If any of the words at (2) above is used within the name (with or without brackets)	20 million
4.	Hindustan, India, Bharat, being the first word of the name	20 million
5.	If any of the words at (4) above is used within the name (with or without brackets)	2.5 million
6.	Industries / Udyog	50 million
7.	Enterprises, Products, Business, Manufacturing	5 million

***Source:** Companies (Name Availability) Rules, 2011*

- The proposed name must not violate the provisions of the Emblems and Names (Prevention of Improper Use) Act, 1950.

ii. Filing of Charter Documents (10-15 days)

- The Memorandum and Articles of the company will need to be prepared in accordance with the needs of the business and the same must be filed with the RoC.

- The RoC will need to be provided with certain information, such as the proposed first directors of the company and the proposed address of its registered office.

- The proposed directors of the company will have to obtain 'Director Identification Numbers' and, in order to hasten the incorporation process, should also obtain 'Digital Signature Certificates'.

- A private limited company must have at least 2 shareholders and 2 directors whereas a public limited company must have at least 7 shareholders and 3 directors.

iii. Certificate of Incorporation

- The Certificate of Incorporation provided by the RoC at the end of the incorporation process acts as conclusive proof of the incorporation of the company.

- A private company can commence business immediately upon receiving its Certificate of Incorporation, whereas a public company may only commence business once it has obtained a 'Certificate of Commencement of Business' from the RoC.

- The company should preferably be capitalized within a month of receiving the certificate of incorporation.

iv. Post Incorporation

Once a company is incorporated, it must undertake certain other actions in order to become fully functional:

- The company must hold its first board meeting.

- The company may appoint additional directors (if any).

- The company must apply for its 'Permanent Account Number' (PAN) and 'Tax Deduction Account Number' (TAN).

- The company must register itself with statutory authorities such as indirect tax authorities and employment law authorities.

- The company must open a bank account.

- The company must put in place the contracts with suppliers and customers that are essential to running the business.

V. Types of Securities

Indian companies may issue numerous types of securities. However, while private companies are free to create any number of classes of securities, public companies are required to comply with the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. Further, it is more difficult for a public company to receive the necessary consent from its shareholders that are mandatory in order to issue different classes of securities. The primary types of securities used in foreign investments into India are:

i. Equity Shares

Equity shares are normal shares in the share capital of a company and typically come with voting rights and dividend rights. A private company may issue shares that have weighted voting rights or no voting rights at all.

ii. Preference Shares

Preference shares are shares which carry a preferential right to receive dividends at a fixed rate as well as preferential rights during liquidation as compared to equity shares. Convertible preference shares are a popular investment option. Further the preference shares may also be redeemable. An Indian company can only issue compulsorily convertible preference shares to a non-resident.

iii. Debentures

Debentures are debt securities issued by a company, and typically represent a loan taken by the issuer company with an agreed rate of interest. Debentures may either be secured or unsecured. Like preference shares, debentures issued to non-residents are also required to compulsorily convertible to equity shares.

For the purposes of FDI, fully and compulsorily convertible preference shares and debentures are treated on par with equity and need not comply with the external commercial borrowings guidelines ("ECB Guidelines").[7]

The ECB Guidelines place certain restrictions and requirements on the use of ECBs. Indian companies, other than those in the hotel, hospital and software sectors, may only use ECBs up to a limit of USD 750 million per company per year under the automatic route. The companies involved in the services sector such as hotels, hospitals and software sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year under the automatic route. In order to raise ECBs, the Indian company must be an eligible borrower and the foreign financier must be a recognized lender. Further, there remain restrictions on the permitted end-uses of foreign currency expenditure such as for the import of capital goods and for overseas investments.

VI. Return on Investments

Extracting earnings out of India can be done in numerous ways. However it is essential to consider the tax and regulatory issues around each mode of return / exit:

i. Dividend

Companies in India, as in other jurisdictions, pay their shareholders dividends on their shares, usually a percentage of the nominal or face value of the share. For a foreign investor holding an equity interest, payment of dividend on equity shares is a straightforward way of extracting earnings. However, the dividend distribution tax borne by the company distributing such dividend may not necessarily receive credit against any direct tax payable by the foreign investor who receives such dividend in its home jurisdiction.

7. Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000

ii. Buyback

Buyback of securities provides an investor the ability to extract earnings as capital gains and consequently take advantage of tax treaty benefits. However, buybacks in India have certain restrictions and thus need to be strategically planned. For instance, a company may not buy back more than 25 per cent of its outstanding equity shares in a year.

iii. Redemption

Preference shares and debentures can both be redeemed for cash. While redemption is perhaps the most convenient exit option for investors, optionally convertible securities, which are effectively redeemable, have been classified as ECB. This entails greater restrictions.

iv. IPO

An IPO is the first offer for sale of the shares of a company to the public at large via listing the company's stock on a stock exchange. While an initial public offering may usually be regarded as a long term exit option, it is also usually included as an exit option in transaction documents as it may provide investors with large returns. IPOs are discussed in further detail in the next chapter.

The use of 'Put Options', wherein foreign investors retain a right to 'put' or sell securities to Indian promoters as an exit option, has become a contentious issue of late. The Department of Industrial Policy and Promotion under the Ministry of Commerce & Industry of the Government of India (the "DIPP") recently removed a proposed restriction on 'Put Options' in India's FDI Policy. However, the RBI, still frowns upon the existence and use of 'Put Options'.

4. Capital Markets in India

Like any other free-economy country, Indian companies are allowed to raise capital and access financial markets through public issues of shares and other instruments within the regulatory confines of SEBI Once issued, the public issues are traded as securities on SEBI-approved stock exchanges in India, such as the BSE Limited ("BSE") and the National Stock Exchange of India Limited ("NSE"). The BSE is the world's largest stock exchange in terms of number of listed companies (over 4900) with a total market capitalization of USD 1,320 billion in January, 2013.

I. Public Issues

Public issues in India can be classified into two types: an IPO or a further public offer ("FPO"). An IPO is the process through which an issuer company allots fresh securities or securities from its existing shareholders / investors or both types of securities to the public for the first time. This paves the way for the listing and trading of the issuer company's securities on SEBI-approved stock exchanges in India. In the case of an FPO, an existing publicly listed company makes a fresh, additional issuance of its securities to the public or performs an offer for sale of its existing securities to the public, through an offer document.

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("ICDR Regulations") govern the process of making an IPO or an FPO by an Indian company, besides other offerings such as qualified institutional placement, preferential allotment, etc.

Besides the ICDR Regulations, the other important legislations that govern IPOs or FPOs include the Companies Act, the Securities Contracts (Regulation) Rules, 1957 ("SCRR") and the listing agreements of the recognized stock exchanges where the securities are proposed to be listed. The ancillary legislations that may get applicable to an IPO are the FEMA and the various regulations, press releases and circulars issued thereunder from time to time by the RBI, the foreign direct investment policy of the Government of India, and the various industry specific laws and regulations.

II. Eligibility Requirements

An unlisted company may do an IPO of its equity shares and any convertible securities only if it satisfies the following eligibility requirements:

- The issuer company has net tangible assets of at least INR 30 million in each of the 3 preceding years, of which not more than 50 per cent is held in monetary assets;

- The issuer company has minimum average pre-tax operating profit of INR 150 million, calculated on a restated and consolidated basis, during the 3 most profitable years out of the immediately preceding 5 years;

- The issuer company has a net worth of at least INR 10 million in each of the 3 preceding full years;

- The proposed issue size and all previous issues in the same financial year does not exceed 5 times its pre-issue net worth as per the audited balance sheet of last financial year; and

- If the issuer company has changed its name within the last 1 year, at least 50 per cent of the revenue for the preceding 1 year is earned from the activity indicated by the new name.

The unlisted company cannot perform an IPO, if the company has less than 1,000 prospective allottees and there are outstanding convertible securities or any other right which would entitle any person any option to receive equity shares after the initial public offer, amongst other such conditions.

III. Minimum Offer Requirements

The issuer company is required to offer at least 25 per cent of each class or kind of securities to the public. If the said minimum offer requirement is not fulfilled then the issuer company has to comply with the rules under the SCRR. Rule 19(2)(b) of the SCRR stipulates that an issuer company may offer at least 10 per cent , as opposed to the 25 per cent stated earlier, of its total issued and subscribed share capital to the public provided:

a) It has offered a minimum of 2 million securities to the public;

b) The size of the offer is minimum INR 1 billion; and

c) The Issue is made only through the book building method with an allocation of 60 per cent of the issue size to the Qualified Institutional Buyers.

IV. Promoters' Contribution

A promoter, under the ICDR Regulations, has been defined to be a person or persons who are in control of the issuer company and who are instrumental in the formulation of a plan or programme pursuant to which securities of the issuer company are offered to the public and those whose names are mentioned in the prospectus for the offering as a promoter of the issuer company.

As per the ICDR Regulations the promoters are required to contribute not less than 20 per cent of the post-IPO share capital of an issuer company. The promoters have to bring the full amount of the promoters' contribution including premium at least one day prior to the issue opening date and such amount is to be kept in an escrow account specially opened for this purpose.

There are certain securities which by the nature of their existence are ineligible for the computation of the promoter contribution, including certain bonus shares, pledged securities and shares acquired for consideration other than cash.

V. Lock-in Restrictions

"Lock-in" means a freeze on dealing in the securities. The ICDR Regulations specify certain lock-in restrictions with respect to the holdings of the promoters as well as other shareholders in the issuer company. The lock-in applicable to securities held by promoters is necessary to ensure that the promoters retain some interest in the issuer company post-IPO and to avoid fly-by-night operators. The entire pre-issue capital of the issuer company (other than the securities locked-in for 3 years as minimum promoters' contribution) remains locked-in for a period of 1 year from the date of allotment. Certain exceptions include shares held by domestic and foreign venture capital investors (who have obtained the necessary registrations and consents) and pre-IPO employee stock options.

VI. Offer for Sale

Strategic investors, in order to participate in an offer for sale of the securities of an investee company, should have held the equity shares in the investee company for a period of at least 1 year prior to the date of filing of the draft prospectus with SEBI.

The strategic investors are exempt from this pre-requisite 1 year holding period, if either one of the following conditions is met:

a) The IPO is of securities of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;

b) The investors had acquired shares pursuant to any scheme approved by the High Court under sections 391 to 394 of the Companies Act, in lieu of business and invested capital which had been in existence for a period of more than one year prior to such approval.

VII. Pricing

The issuer company may freely price its equity shares or any securities convertible into equity shares at a later date in consultation with the lead managers (i.e. the merchant bankers) or through book building process.

VIII. Disclosure Requirements

The ICDR Regulations stipulate the disclosure requirements in relation to promoters and members of the promoter group which has to be made in the offer documents that is to be filed with SEBI. The offer documents include sections such as issue details, risk factors (internal and external), capital structure of the issuer company, objects of the offering, terms of the issue, interest of the directors, financial information of the issuer company, charter documents of the company, business of the issuer company, regulatory approvals, outstanding litigations, the issue procedure, *etc.*

IX. Filing of the Offer Document

The issuer company has to file a draft red herring prospectus with SEBI and stock exchanges (where securities are proposed to be listed) prior to the filing of the prospectus with RoC. SEBI and the recognised stock exchanges can specify changes / observations on the draft red herring prospectus. At this stage, the issuer company also has to obtain in-principle approval from all the stock exchanges on which the issuer company intends to list the securities through the prospectus. Thereafter, the issuer company has to carry out such changes or comply with such observations in the draft red herring prospectus before filing the prospectus with the ROC.

Overall, doing an IPO is not only a plausible but also a preferred option for exit for strategic investors in Indian companies. However, as mentioned above, they have to be mindful of certain regulatory requirements and accordingly plan in advance. In addition to the key pre-issue obligations discussed herein, issuer companies have to comply with a comprehensive list of post-issue obligations as well.

X. Listing on Exchanges Outside India

Indian Companies are permitted to list instruments linked to their securities on stock exchanges abroad. This may be achieved through the issue of depository receipts – known commonly as 'American Depository Receipts' or 'Global Depository Receipts' depending on the location where the Company chooses to list. The Company can only list outside India if it is:

a) Already listed on an Indian stock exchange; or

b) The Company is in the process of listing on an Indian stock exchange

XI. Foreign Companies Listing in India

Similar to the ability of Indian Companies to raise capital abroad, foreign Companies are permitted to raise money on Indian capital markets by issuing 'Indian Depository Receipts' ("IDRs"). However, a foreign Company intending to issue IDRs must meet the following eligibility requirements to list in India:

i. Mandatory Listing in Home Country

The Company must be listed in its home country;

ii. No Prohibition

The Company must not be prohibited from issuing securities by any regulatory body;

iii. Net-worth and Capitalization Ceilings

The Company should have a pre-issue paid up capital and free reserves of at least USD 50 million with a minimum average market capitalization of at least USD 100 million in its home country, during the last 3 financial years preceding the issue;

iv. Compliance Track Record

The Company must have a good track record of compliance with securities market regulations in its home country;

v. Trading Track Record

The Company is required to have a continuous trading record or history on a stock exchange in its home country for at least 3 years immediately preceding the issue; and

vi. Profit Track Record

The Company should have had a track record of distributable profits for at least 3 out of the 5 years immediately preceding the proposed IDR listing.

A foreign Company must then comply with the provisions of the following statutes, rules and regulations after listing:

a) The Companies Act;

b) The Companies (Issue of Indian Depository Receipts) Rules, 2004; and

c) The ICDR Regulations.

5. Structuring Investments: Indian Regulatory & Tax Considerations

I. Regulatory Issues

Foreign investment is freely permitted in most sectors of the Indian economy. However, FDI is prohibited in few areas including companies engaged in dealing in immovable property, agricultural activities (excluding certain activities like floriculture, horticulture and others), manufacture of tobacco products, atomic energy, etc. Investment caps or specific qualifications apply with respect to investments in certain sectors such as telecom, aviation, multi brand retail trading, etc. In such cases investors , may be required to obtain prior approval from the regulators including the FIPB or the RBI. Therefore where the investment is not possible under the automatic route it may have to be done under the approval route. Restrictions also apply with respect to downstream investments by Indian Companies that are owned or controlled by non-residents.

Foreign investment is usually in the form of subscription to or purchase of equity shares and/or convertible preference shares / debentures of the company. The investment amount is normally remitted through normal banking channels or into a Non-Resident External Rupee ("NRE")/Foreign Currency Non-resident ("FCNR") account of the Indian company with a registered Authorized Dealer (a designated bank authorized by the RBI to participate in foreign exchange transactions).

The company is required to report the details of the consideration received for issuing its securities to the regional office of the RBI in the prescribed forms together with copies of the Foreign Inward Remittance Certificate ("FIRC"), arranged for by the Authorized Dealer ("AD") evidencing the receipt of the remittance along with the submission of the "Know Your Customer" ("KYC") report of the non-resident investor. A certificate from the Statutory Auditors or Chartered Accountant indicating the manner of calculating the price of the shares also needs to be submitted.

Transfer or issue of shares of an Indian company to a non-resident will be subject to certain, pricing guidelines. These guidelines are laid down by the RBI (in the case of companies not listed on a stock exchange) and by SEBI (in the case of listed companies).

All of these documents must be submitted within 30 (thirty) days of the receipt of the foreign investment and must be acknowledged by the RBI's concerned regional office, which will subsequently allot a Unique Identification Number ("UIN") for the amount reported. The Indian company is required to issue its securities within 180 days from the date of receipt of foreign investment. Should the Indian company fail to do so, the investment so received would have to be returned to the person concerned within this time-frame.

Indian company may also raise debt or borrow funds from foreign sources subject to limitations under the External Commercial Borrowings ("ECB") Guidelines prescribed by the RBI. These guidelines restrict both the source of funds as well as the end use of such funds and also prescribe ceilings on interest payable on the debt.

Separate and varying degrees of regulations have been prescribed to govern foreign portfolio investment regimes in India. SEBI and the RBI under extant securities and exchange control laws, allow portfolio investments in India by SEBI registered foreign institutional investors ("FIIs") and by certain qualified non-residents ("QFIs") without being subjected to FDI restrictions. Subject to applicable conditions, the regulations permit FIIs (and its sub-account) and QFIs to invest in unlisted or listed shares, convertible or non-convertible debentures (listed and unlisted), Indian depository receipts, domestic mutual fund units, exchange traded derivatives and similar securities.

II. Taxation in India

Any person investing or doing business in India has to consider various direct (income) and indirect (consumption) taxes which are levied and collected by the Union Government and the State Governments.

i. Corporate tax

Income tax in India is levied under the Income Tax Act, 1961 Resident companies are taxed at 32.44 per cent and nonresident companies are taxed at the rate of 42.02 per cent While residents are taxed on their worldwide income, non-residents are only taxed on income arising from sources in India. A company is said to be resident in India if it is incorporated in India or is wholly controlled and managed in India. A minimum alternate tax is payable at the rate of around 20 per cent (18.5 per cent plus surcharge and education cess).

ii. Dividends

Dividends distributed by Indian companies are subject to a dividend distribution tax at the rate of 16.22 per cent, payable by the company. However, no further Indian taxes are payable by the shareholders on such dividend income once dividend distribution tax ("DDT") is paid. An Indian company would also be taxed at the rate of 21.63 per cent on gains arising to shareholders from distributions made in the course of buy-back or redemption of shares.

iii. Capital Gains

Tax on capital gains depends on the period of holding of a capital asset. Short term gains may arise if the asset is held for a period lesser than 3 years (or 1 year for securities). Long term gains may arise if the asset is held for a period more than 3 years (or 1 year for securities). Long term capital gains earned by a non-resident on sale of unlisted securities may be taxed at the rate of 10.5 per cent or 21 per cent depending on certain considerations. Long term gains on sale of listed securities on a stock exchange is exempt, and only subject to a securities transaction tax ("STT"). Shorter term gains earned by a non-resident on sale of listed securities (subject to STT) is taxable at the rate of 15.76 per cent, or at ordinary corporate tax rate with respect to other securities.

India has recently introduced a rule to tax non-residents on the transfer of foreign securities the value of which are substantially (directly or indirectly) derived from assets situated in India.

iv. Interests, Royalties & Fees for Technical Services

Interest earned by a non-resident may be taxed at a rate between 5.26 per cent to around 42.02 per cent depending on the nature of the debt instrument.

Royalties and fees for technical services earned by a non-resident would be subject to tax at the rate of around 26.27 per cent (which was recently increased from 11 per cent). These rates are subject to available relief under an applicable tax treaty. The scope of royalties and fees for technical services under Indian domestic law is much wider than what is contemplated under most tax treaties signed by India.

v. Withholding Taxes

Tax would have to be withheld at the applicable rate on all payments made to a non-resident, which are taxable in India. The obligation to withhold tax applies to both residents and non-residents. Withholding tax obligations also arise with respect to specific payments made to residents. Failure to withhold tax could result in tax, interest and penal consequences.

vi. Wealth Tax

Wealth tax is payable at the rate of 1 per cent on certain specific non productive assets the value of which exceeds INR 3million. Assets such as shares and certain other securities are not covered similar to that of a non resident. Commercial and business assets are also exempt from wealth tax.

vii. Personal Income Tax

Individuals are taxed on a progressive basis, with a maximum marginal rate of tax of around 31%. An individual may be treated as a resident if he is in India for a period of at least 182 days in a specific year or 60 days in the year and 365 days in the 4 preceding years. A separate category of persons is considered to be 'resident but not ordinarily resident', with tax consequences similar to that of a non-resident.

India currently does not impose any estate or death taxes. Although there is no specific gift tax, certain gifts are taxable within the framework of income tax.

viii. Double Tax Avoidance Treaties

India has entered into more than 80 treaties for avoidance of double taxation. A taxpayer may be taxed either under domestic law provisions or the tax treaty to the extent it is more beneficial. A non-resident claiming treaty relief would be required to file tax returns and furnish a tax residency certificate issued by the tax authority in its home country. The tax treaties also provide avenues for exchange of information between States and incorporate measures to curb fiscal evasion.

ix. Anti Avoidance

A number of specific anti-avoidance rules apply to particular scenarios or arrangements. This includes elaborate transfer pricing regulations which tax related party transactions on an arm's length basis.

India has also introduced wide general anti avoidance rules ("GAAR") which provide broad powers to the tax authorities to deny a tax benefit in the context of 'impermissible avoidance arrangements'. GAAR will come into effect from April 1, 2015 and would override tax treaties signed by India.

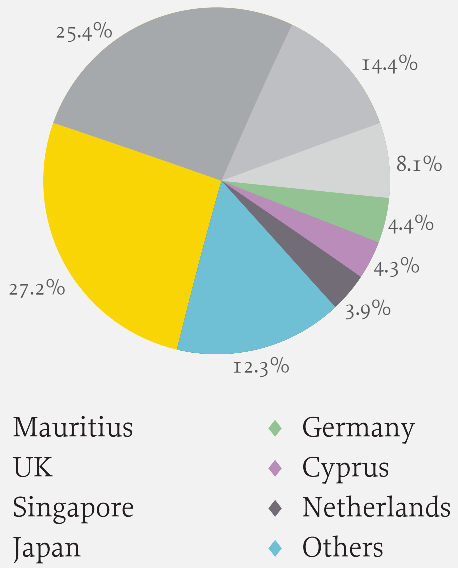
x. Direct Tax Code

A new Direct Taxes Code is currently pending consideration by the Indian Parliament. This new legislation, once enacted, will replace the existing law on income tax. Some of the notable changes include change in residency criteria, structure of capital gain tax, introduction of controlled foreign corporation rules, etc.

III. Structuring Investments

Investments into India are often structured through holding companies in various jurisdictions for number of strategic and tax reasons. For instance, US investors directly investing into India may face difficulties in claiming credit of Indian capital gains tax on securities against US taxes, due to the conflict in source rules between the US and India. In such a case, the risk of double taxation may be avoided by investing through an intermediary holding company.

Break up of FDI by countries of origin (FY12)



***Source:** Department of Industrial Policy & Promotion, Government of India*

While choosing a holding company jurisdiction it is necessary to consider a range of factors including political and economic stability, investment protection, corporate and legal system, availability of high quality administrative and legal support, banking facilities, tax treaty network, reputation and costs.

Over the years, a major bulk of investments into India has come from countries such as Mauritius, Singapore, Netherlands and Cyprus, which are developed and established financial centers that have favorable tax treaties with India. Some of the advantages offered by these treaties are highlighted in the table below.

	Mauritius	Cyprus	Singapore	Netherlands
Capital gains tax on sale of Indian securities	Mauritius residents not taxed. No local tax in Mauritius on capital gains.	Cypriot residents not taxed. No local tax in Cyprus on capital gains.	Singapore residents not taxed. Exemption subject to satisfaction of certain 'substance' criteria and expenditure test by the resident in Singapore. No local tax in Singapore on capital gains (unless characterized as business income).	Dutch residents not taxed if sale made to non-resident. Exemption for sale made to resident only if Dutch shareholder holds lesser than 10% shareholding in Indian company. Local Dutch participation exemption available in certain circumstances.
Tax on dividends	Indian company subject to dividend distribution tax ("DDT") at the rate of 16.22 per cent.	Indian company subject to DDT at the rate of. 16.22 per cent	Indian company subject to DDT at the rate of. 16.22 per cent	Indian company subject to DDT at the rate of 16.22 per cent
Withholding tax on	No relief. Taxed	10 per cent	15 per cent	10 per cent

	Mauritius	Cyprus	Singapore	Netherlands
outbound interest	as per Indian domestic law.			
Withholding tax on outbound royalties and fees for technical services	15 per cent (for royalties). FTS may be potentially exempt in India.	15 per cent	10 per cent	10 per cent
Other comments	Mauritius treaty in the process of being renegotiated. Possible addition of 'substance rules'.	Cyprus economic crisis and financial situation to be taken into consideration.	There are specific limitations under Singapore corporate law (e.g. with respect to buyback of securities).	To consider anti-abuse rules introduced in connection with certain passive holding structures.

IV. Indirect Taxation

India does not have a central value added tax regime in the conventional sense; although a Central Sales Tax ("CST") is levied on the movement of goods between states, and a Central Value Added Tax ("CENVAT") is levied on the production or manufacture of goods in India.

Efforts are being made to replace the existing indirect tax system which provides for separate levy for goods and services with a unified Goods and Services Tax system ("GST"). Steps have been undertaken by the Government to implement GST, the first being the introduction of a uniform Value Added Tax regime across all states in India.

i. Central Sales Tax

CST is imposed on the sale of goods in the course of inter-state trade or commerce. Sales of goods are deemed to take place in the course of inter-state trade if they involve movement of goods from one state to another, or if such sales are effected by the transfer of documents of title to the goods during their movement from one state to another. No CST is levied on direct imports or exports or the purchase or sale effected in the course of imports or exports. The process of phasing out CST commenced with a reduction in the CST rate from 4 per cent earlier to 2 per cent

ii. Value Added Tax ("VAT")

VAT is levied on the sale of goods within a particular state and rates may vary from 0 per cent, 1 per cent, 4 per cent, to 12.5 per cent although there may be further variations depending on the state. VAT is a state specific levy and most states in India have introduced specific legislations for VAT Under the VAT regime, a system of tax credits on input goods procured by the dealer is also available, to avoid the cascading effect of taxes that was prevalent under the erstwhile sales tax regime.

iii. CENVAT

CENVAT is a duty of excise which is levied on all goods that are produced or manufactured in India, marketable, movable and covered by the excise legislation. The peak duty rate was reduced from 16 per cent to 14 per cent and has further been reduced recently to 8 per cent, although there are other rates ranging upwards, or based on an ad valorem / quantity rate.

In order to avoid the cascading effect of excise duty and double taxation, a manufacturer of excisable goods may avail of credit of duty paid on certain inputs and capital goods barring certain inputs used in the specified manufacture of certain products in accordance with the CENVAT Credit Rules. The credit can be utilized towards the duty payable on removal of the final product. The CENVAT scheme also takes into account credits with respect to any service tax paid by the manufacturer on input services received.

iv. Service Tax

Service tax is levied under the service tax legislation on all but certain excluded taxable services and is generally required to be paid by the service provider. Currently the rate of service tax is 12.36 per cent. This rate is computed on the 'gross amount' charged by the service provider for the taxable services rendered by him. Service tax is a consumption tax and is typically passed on to the consumer of the service as part of the price.

As it is a consumption based tax, there is no consequence upon services considered to have been exported. The conditions for export are specified in the service tax legislation and rules. In case of a service imported into India i.e. when a taxable service is provided by a person from outside India and is received by a person in India, the service rendered is chargeable to service tax in India and payable by the recipient of services. The CENVAT Credit Rules provides a mechanism for service providers to take credit on the inputs and input services that are received by the service provider for providing the taxable service.

V. Special Schemes

In light of the liberalization of foreign trade and investment into India, the Indian Government has implemented various special schemes to incentivize investments into specific sectors or areas. Most schemes have been subject to sunset clauses, although the special economic zone scheme continues to subsist.

Special Economic Zones ("SEZ")

Following are the key benefits available for units set up in SEZs

- 100 percent income tax exemption on export income derived from SEZ units for the first five years of manufacturing and thereon 50 percent income tax exemption for the next five years. However, minimum alternate tax would be applicable.
- Exemption from capital gains arising on transfer of capital assets in case of shifting of industrial undertaking from urban areas to any SEZ;
- 100 per cent customs duty exemption on the import of goods or services into the SEZ. However, any goods removed from the SEZ into a domestic tariff area will be subject to customs duty.
- 100 per cent excise duty exemption on goods brought from a domestic tariff area into the SEZ.
- 100 per cent service tax exemption.
- 100 per cent exemption from securities transaction tax.
- Exemption from the levy of taxes on the sale or purchase of goods other than newspapers under the Central Sales Tax Act, 1956 if such goods are meant to carry on the authorized operations by the Developer or entrepreneur.

6. Trade With India

While some may wish to do business in India, many manufacturers and service providers are interested in doing business with India. With a potential market of over 1 billion people, India is a lucrative export destination. The primary tax relevant to the import of goods into India is customs duty.

I. Customs Duty

Customs duties are levied whenever there is trafficking of goods through an Indian customs barrier i.e. levied both for the export and import of goods. Export duties are competitively fixed so as to give advantage to the exporters. Consequently a large share of customs revenue is contributed by import duty.

Customs duty primarily has a 'Basic Customs Duty' for all goods imported into India and the rates of duty for classes of goods are mentioned in the Customs Tariff Act, 1975 (the "Tariff Act"), which is based on the internationally accepted Harmonized System of Nomenclature ("HSN"). The general rules of interpretation with respect to tariff are mentioned in the Tariff Act. The rates are applied to the transaction value of goods (for transactions between unrelated parties) as provided under the Customs Act, 1962 (the "Customs Act") or by notification in the official gazette.

A further duty, known as Additional Customs Duty or the Countervailing Duty ("CVD") is imposed to countervail the appreciation of end price due to the excise duty imposed on similar goods produced indigenously. To bring the price of the imported goods to the level of locally produced goods which have already suffered a duty for manufacture in India (excise duty), the CVD is imposed at the same rate as excise duty on indigenous goods.

In addition to the above, there are also Additional Duties in lieu of State and local taxes ("ACD") which are also imposed as a countervailing duty against sales tax and value added tax imposed by States. The ACD is currently levied at the rate of 4 per cent.

Further, the Central Government, if satisfied that circumstances exist which render it necessary to take immediate action to provide for the protection of the interests of any industry, from a sudden upsurge in the import of goods of a particular class or classes, may provide for a Safeguard Duty. Safeguard Duty is levied on such goods as a temporary measure and the intention for the same is protection of a particular industry from the sudden rise in import.

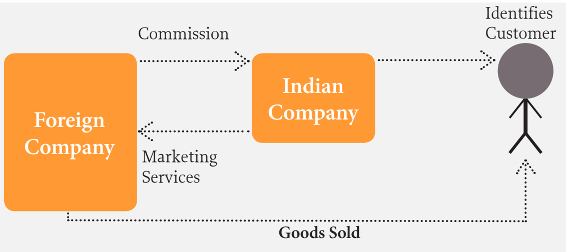
Under Section 9A of the Tariff Act, the Central Government can impose an Antidumping Duty on imported articles, if it is exported to India at a value less than the normal value of that article in other jurisdictions. Such duty is not to exceed the margin of dumping with respect to that article. The law in India with respect to anti-dumping is based on the 'Agreement on Anti-Dumping' pursuant to Article VI of the General Agreement on Tariffs and Trade, 1994.

II. Trade Models

There are many ways in which one can trade with India. While setting up an operation in India and trading through it is one option, there are numerous ways of trading with India without actually setting up operations. Some of these are discussed below.

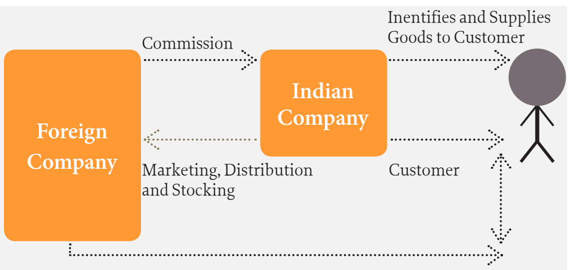
i. Marketing

Under this non-exclusive arrangement, a foreign company engages an Indian company to render marketing services on behalf of the foreign company. In the event a customer is identified, the Indian company informs the foreign company and the foreign company directly enters into an agreement and provides the goods to such customer. A commission is paid to the Indian company for the marketing services provided. All obligations to import the goods in India shall vest with the customer. Further, the Indian company does not have the right to conclude any agreements on behalf of the foreign company. A diagrammatic representation of the structure is contained below:



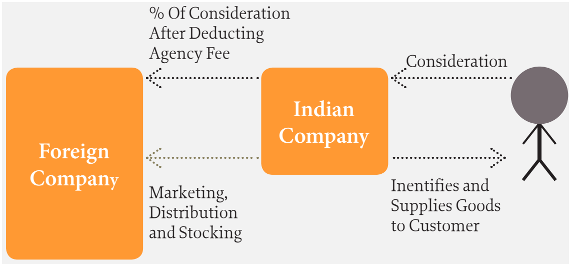
ii. Marketing and Distribution

Under this arrangement, a foreign company engages an Indian company for rendering marketing and distribution services on behalf of the foreign company. Under such an arrangement the goods are already stocked with the Indian company and in the event a customer is identified, the Indian company supplies the goods to the customer. All rights and obligations, including payment obligations flow between the foreign company and the customer. A commission is paid to the Indian company for marketing, distribution and stocking of goods. A diagrammatic representation of the structure is contained below:



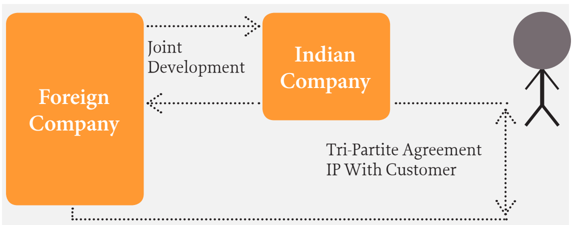
iii. Agency

Under this arrangement, the foreign company appoints an Indian company to act as its agent in India. As the agent, the Indian company markets, stocks and distributes the goods and retains a part of the consideration paid by the customer as an agency fee. This structure is described in the diagram below:



iv. Teaming Agreements (Joint Development)

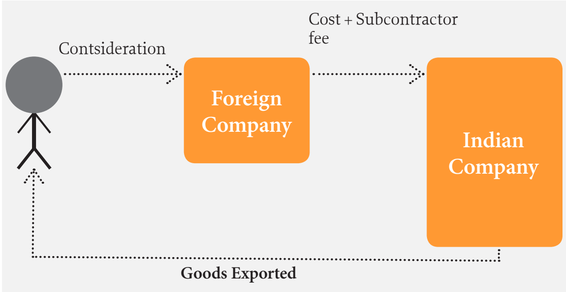
Under this arrangement, a foreign company and an Indian company team up for the development of products for an identified customer. In such situations the foreign company provides its technology, know-how and confidential information to the Indian company which in turn undertakes the manufacturing of the products in India and supplies the same to the customer. The rights and obligations, including payment obligations are mutually agreed between the foreign company, Indian company and the customer. A diagrammatic representation of the structure is contained below:



v. Subcontractor

Under this arrangement, a foreign company engages an Indian company to manufacture certain goods. The goods manufactured by the

Indian company are in turn exported to the customers of the foreign company. Although all such exports would be done by the Indian company, the same shall be undertaken on behalf of the foreign company. The foreign company pays the Indian company on a cost-to-cost basis, along with a percentage as commission. The customers pay the foreign company for the goods received. A diagrammatic representation of the structure is contained below:



7. Human Resources

Human resources in India are abundant. With an increasingly educated middle class comprising almost 200-300 million individuals, there is no dearth of intellectual capital for any kind of business activities. Further, with a total population of over one billion, there is availability of skilled, semi-skilled and unskilled labour.

I. Statutes

India has myriad of employment related legislations at both the central (federal) and state levels which are applicable to large cross-sections of establishments and its employees. Some of the important employment and labour laws are discussed hereunder:

Important HR Statutes*

Statutes	Applicability
Training, Recruitment and Screening	
The Apprentices Act,1961	The Apprentices Act provides for the practical training of technically qualified persons and the regulation and control thereof.
Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959 (The "EECNV Act")	The EECNV Act seeks to inform job seekers about vacancies in various employment sectors and requires the establishments to notify to the employment exchanges of any vacancy in employment positions, prior to filling up such vacancy. The EECNV Act is applicable to every public establishment and establishments in the private sector excluding agriculture, having a minimum of 25 employees.
Contract Labour (Regulation and Abolition) Act, 1970 ("CLRA Act")	The CLRA Act regulates the conditions of employment of contract labour and inter alia requires the principle employer and the contractor to obtain certain registrations / licenses prior to engaging contract labour. The central and state government's have the authority to abolish the employment of contract labourers in any industry or establishment.
Child Labour (Prohibition and Regulation) Act, 1986 ("Child Labour Act")	The Child Labour Act prohibits the engagement of children (below the age of 14) in certain employments and regulates the conditions of work of children in certain other employments where they are not prohibited from working.
Pay, Salary and Bonus	
Minimum Wages Act, 1948 ("Minimum Wages Act")	The Minimum Wages Act provides for fixing of minimum rate of wages by the state government in various industries.
Payment of Wages Act, 1936 ("Payment of Wages Act")	The Payment of Wages Act governs the payment of wages to persons employed in any factory. The enactment governs the manner and timing of payment of wages.
Equal Remuneration	The object of the Equal Remuneration Act is to

Statutes	Applicability
Act, 1976 ("Equal Remuneration Act")	prohibit discrimination on the ground of sex by providing for the payment of equal remuneration to men and women employees in the matter of employment or otherwise.
Payment of Bonus Act,1965 ("Payment of Bonus Act")	The Payment of Bonus Act governs the payment of an annual bonus to persons employed in certain establishments h. The Payment of Bonus Act is applicable to every factory and every other establishment in which 20 or more persons are employed on any day during an accounting year. The statute provides the mode and method for calculating the bonus payable.
The Payment of Gratuity Act, 1972 ("Payment of Gratuity Act")	The Payment of Gratuity Act provides for and governs the scheme for the payment of gratuity, an amount payable to an employee on the termination of employment after such employee has rendered service for at least five years. This statute is applicable to every factory, mine, oil field, plantation, port, railways company; and every shop or establishment where 10 or more persons are employed or were employed on any day of the preceding 12 months.
Employment Terms, Conditions and Benefits	
Factories Act, 1948 ("Factories Act")	The Factories Act prescribes for various measures relating to working conditions, health and safety with respect to factories. The Factories Act also regulates aspects such as working hours, rest intervals, overtime, holidays, leave, termination of service, employment of children, young persons and women; other rights and obligations of an employer and employees.
Shops and Commercial Establishments Acts	Most of the Indian states have their own enactment relating to shops and establishments (non-factories). The state-specific shops and commercial establishments acts mandate the registration of every shop and establishment including commercial establishments and regulate the working and employment conditions of workers. The statutes regulate aspects such as working hours, rest intervals, overtime, holidays, leave, termination of service, employment of children, young persons and women and other rights and certain other obligations of an employer and its employees.
Industrial Employment (Standing Orders) Act, 1946 ("Standing Orders Act")	The Standing Orders Act requires employers in industrial establishments to define the broad conditions of employment.
Maternity Benefit Act, 1961	The Maternity Benefit Act regulates the employment

Statutes	Applicability
("Maternity Benefit Act")	of women for certain periods before and after child-birth and provides for maternity benefit and certain other benefits.
Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ("Sexual harassment Act")	The Sexual Harassment Act has been enacted with the objective of providing women protection against sexual harassment at the workplace and for the prevention and redressal of complaints of sexual harassment. . Though the statute has been published in the official gazette, it is yet to be notified.
Social Security, Insurance and Compensation	
Employees' Provident Funds and Miscellaneous Provisions Act, 1952 ("EPF Act")	The EPF Act is onemost important social security legislation in India which provides for the constitution of provident funds, family pension funds and deposit linked insurance fund for the employees in factories and other establishments.
Employees' State Insurance Act, 1948 ("ESI Act")	The ESI Act provides for the establishment of the Employees' State Insurance Corporation to which both employers and employees are required to make contributions so as to insure the employee against accidents, injuries and diseases.
Employee's Compensation Act, 1923 ("Employee's Compensation Act")	The Employees Compensation Act provides for the payment of compensation to the employee by the employer in case of injury by accident.

Statutes	Applicability
Disputes and Liabilities	
Industrial Disputes Act, 1947 ("ID Act")	The ID Act, one of India's most important labour legislation, essentially provides for the investigation and settlement of industrial disputes, connected with the employment or the terms of employment or with the conditions of labour of a workman. The enactment also deals with strikes, lock-outs, lay-offs, retrenchments, transfer of undertaking, closure of business etc.
Employer's Liability Act, 1938 ("Employer's Liability Act")	The Employers' Liability Act bars the use of certain defences by an employer in case of injury to employees.
Labour Unions / Collective Bargaining	
Trade Unions Act, 1926 ("Trade Unions' Act")	The Trade Unions Act provides for the registration of trade unions and lays down the law relating to registered trade unions in certain respects.

** The list of employment and labour laws does not reflect labour laws specific to certain industries and/or activities. The list also does not provide the details of compliances to be undertaken by the employer for each applicable labour law. Further, the applicability of each labour law (for the employer as well as its employees) needs to be determined based on various aspects including the exact nature of activities, number of employees, role and responsibilities of the employees, amount of salary/compensation, etc. Finally, it must be noted that under certain circumstances Indian states have the right to amend the labour laws enacted by the* *central (federal) government and accordingly it is important to check for any state-specific amendments that may be relevant to a central (federal) labour law.*

II. HR Documentation

While formal employment contracts are not mandatory, when employees are recruited in India, it is recommended that appropriate documentation be put in place to secure the company's workforce.

i. Employment Agreements

An employer typically provides a prospective new employee with an offer letter, which includes the basic terms of employment. Many employers seem to stop at this stage. However, this is often in ignorance of the fact that in the event that no subsequent employment agreement is signed, the offer letter becomes the only document governing the terms of employment. For certain types of business activities, a detailed employment agreement is generally recommended. The employment agreement lays out the terms of employment and provides suitable enforcement mechanisms as well as terms and conditions of termination.

Typically, employment agreements contain clauses in relation to:

- Term of employment and termination of employment;
- Compensation structure – Remuneration and bonuses;
- Duties and Responsibilities of the employee;
- Confidentiality and non-disclosure;
- Intellectual property;
- Non-compete and non-solicitation obligations; and
- Dispute Resolution.

ii. Confidentiality & Non-Disclosure

A confidentiality and non-disclosure agreement ("CNDA") is a contract between at least two parties that outlines confidential materials or knowledge, which the parties wish to share with one another for certain purposes, but wish to restrict access to or its disclosure. It is a contract through which a party agrees not to disclose information covered by the agreement. As such, a CNDA protects non-public business or the employer's proprietary information and trade secrets. Some common clauses in CNDAs include:

- The definition of what is confidential, i.e. the information to be held confidential.
- The exclusions from what must be kept confidential.
- The term, if any, for keeping the information confidential.
- The obligations regarding the use / disclosure of confidential information:
  - » To use the information only for restricted purposes.
  - » To disclose it only to persons with a need to know the information for the specified purposes.
  - » To adhere to a standard of care relating to confidential information.
  - » To ensure that anyone to whom the information is disclosed further abides by the recipient's obligations.

iii. Non-Compete & Non-Solicit

Companies may choose to enter into non-competition and non-solicitation agreements with their employees. These obligations may alternatively be included in the employment agreement. Non-solicit clauses prevent the employee from soliciting other employees or customers of the employer.

A post-termination non-compete clause is not enforceable in Indian courts as section 27 of the Indian Contract Act, 1872 ("ICA") declares any agreements in restraint of trade as void. However such clauses are retained for their deterrent effect.

iv. HR Policy

It is recommended that the company should clearly set out the various policies and procedures applicable to its employees. The policy manual or employee handbook assists in defining the role of the employees of the company and limits its liability in the event of breach. Many subjects covered in a company's HR policy handbook are governed by specific laws. Such laws may be specific to the state in which the workplace is located.

Aspects covered typically include (but is not limited to):

- Employee benefits
- Leave policies, including paid leave, casual leave, sick leave, maternity leave etc.
- Compensation policies
- Code of conduct and behaviour policies
- Anti-harassment policies (mandatory in the Indian context)
- Immigration law policies
- Complaint procedures and resolution of internal disputes
- Internet, email and computer use policies
- Accident and emergency policies
- Prohibition from insider trading (mandatory for listed companies)

v. Structuring of Compensation

With compensation packages paid to employees ever on the increase, it becomes important to structure the package in a tax effective and efficient manner. The ITA provides for certain deductions and allowances that may be considered. Some of the allowances/perquisites include house rent allowance, medical reimbursement, leave travel allowance, conveyance allowance, child education allowance, etc.

III. Stock Options[8]

Employee stock option plans ("ESOPs") are designed to give an employee participation in the equity of the company. ESOPs may be granted upon joining the company or thereafter, and continue to be an important tool for attracting and retaining talent. This is a popular strategy with companies that may not be able to afford larger or more competitive compensation packages.

An ESOP is a right but not an obligation of an employee to apply for the shares in the company in the future at a predetermined price. These options may be converted into shares upon fulfillment of certain conditions. Such conditions are usually performance-based or time-based. All plans or schemes introduced by listed companies are required to comply with the guidelines issued by SEBI.

8. Companies Act, 2013 has proposed several changes with respect to stock options, but the relevant sections are yet to be notified by the Central Government.

Further, foreign companies can also grant ESOPs to employees of Indian subsidiaries subject to the guidelines stipulated in FEMA. Therefore, the company would have to structure its ESOP in a manner that complies within the regulatory environment.

ESOPs are taxable as perquisites in the hands of the recipient employee. The value of the taxable perquisite is the difference between the fair market value of an equivalent share of the company and the exercise price of the option. When the employee sells the shares, such sale would attract capital gains tax at the applicable rate.

8. Intellectual Property

With the advent of the knowledge and information technology era, intellectual capital has gained substantial importance. Consequently, Intellectual Property and the Rights attached thereto ("IPRs") have become precious commodities and are being fiercely protected. Well-established statutory, administrative, and judicial frameworks for safeguarding IPRs exist in India. It becomes pertinent to mention here that India has complied with its obligations under the Agreement on Trade Related Intellectual Property Rights ("TRIPS") by enacting the necessary statutes and amending its existing statues.

Well-known international trademarks have been afforded protection in India in the past by the Indian courts despite the fact that these trademarks were not registered in India. Computer databases and software programs have been protected under the copyright laws in India, thereby allowing software companies to successfully curtail piracy through police and judicial intervention. Although trade secrets and know-how are not protected by any specific statutory law in India, they are protected under the common law and through contractual obligations.

I. International Conventions

India is a signatory to the following international conventions:

Convention	Date
Berne Convention	April 1, 1928 (Party to convention)
Universal Copyright Convention	January 7,1988 (Ratification)
Paris Convention	December 7,1998 (Entry into force)
Convention on Biological Diversity	June 5,1992 (Signature and ratification)
Patent Cooperation Treaty	December 7,1998 (Entry into force)
Budapest Treaty on the International Recognition of Microorganisms for the Purposes of Patent Procedure 1977	December 17, 2001(Party to treaty)
Madrid Protocol	July 8, 2013 (Member to the treaty)

By virtue of such membership, convention applications for the registration of trademarks, patents, and designs are accepted with the priority date claim; copyright infringement suits can be instituted in India based on copyright created in the convention countries.

II. Patents

Patent rights protect workable ideas or creations known as inventions. A patent is a statutory right to exclude others, from making, using, selling, and importing a patented product or process without the consent of the patentee, for a limited period of time. Such rights are granted in exchange of full disclosure of an inventor's invention.

The term "invention" is defined under Section 2(1)(j) of the Patents Act as *"a new product or process involving an inventive step and capable of industrial application."* Thus, if the invention fulfills the requirements of novelty, non-obviousness (inventive steps), and utility then it would be considered a patentable invention.

India grants patent rights on a first-to-apply basis. The application can be made by either

(i) the inventor or (ii) the assignee or legal representative of the inventor.

The inventor, in order to obtain registration of a patent, has to file an application with the Patent Office in the prescribed form along with the necessary documents as required. A patent application usually contains the following documents: (a) an Application Form in Form 1 (b) a Provisional or Complete Specification in Form 2 (c) a Declaration as to Inventorship in Form 5 (d) Abstracts (e) Drawings, if any (f) Claims, (g) a Power of Attorney in Form 26, if a patent agent is appointed. Once the application has been filed, it will be published in the patent journal after 18 months of the priority date, and would then be examined by the patent office, upon the office receiving a request for such examination. After such examination and subject to any objections, the patent may be granted or refused by the patent office. Once a patent is granted, it is published in the patent journal. With enhanced fees the publication and examination of the application may be expedited.

Once a Patent is granted, it gives the inventor the exclusive right to exclude third parties from making, using, selling, and importing a patented product or process without the consent of the patentee. In the event someone uses a patented invention without the permission or consent of the patent owner, then the same would amount to patent infringement and the owner of the patent can approach the court of law for obtaining remedies not limited to injunctions, damages etc. For infringement of a patent, only civil remedies are available. Upon an application made by any person the Controller of Patents ("Controller") may grant a CL at any time after three years of the grant of a patent on the grounds that the reasonable requirements of the public with respect to the patented inventions have not been satisfied, or the patented invention is not available to the public at reasonably affordable prices, or the invention is not exploited commercially to the fullest extent within the territory of India.

III. Copyrights

The Copyright Act, 1957 ("Copyright Act"), supported by the Copyright Rules, 2013 ("Copyright Rules"), is the law governing copyright protection in India. The Copyright Act provides that a copyright subsists in an original literary, dramatic, musical or artistic work, cinematograph films, and sound recordings.

A copyright grants protection to the creator and his representatives to certain works and prevents such works from being copied or reproduced without his/their consent. The term of copyright in India is, in most cases, the lifetime of the creator plus 60 years thereafter.

Under Indian law, registration is not a prerequisite for acquiring a copyright in a work. A copyright in a work is vested when the work is created and given a material form, provided it is original. Unlike the U.S. law, the Indian law registration does not confer any special rights or privileges with respect to the registered copyrighted work. India is also a member to the Berne and Universal Copyright Convention, which protects copyrights beyond the territorial boundaries of a nation. Further, any work first published in any country - which is a member of any of the above conventions - is granted the same treatment as if it was first published in India.

Copyright Infringement and Remedies

A copyright is infringed if a person without an appropriate consent does anything that the owner of the copyright has an exclusive right to do. However, there are certain exceptions to the above rule (e.g., fair dealing). The Copyright Act provides for both civil and criminal remedies for copyright infringement.

In the event of infringement, the copyright owner is entitled to remedies by way of injunction, damages, and order for seizure and destruction of infringing articles.

IV. Trademarks

Trademarks are protected both under statutory law and common law. The Trade Marks Act, 1999 ("TM Act") along with the rules thereunder govern the law of trademarks in India.

Under the TM Act the term 'mark' is defined to include 'a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or, combination of colors, or any combination thereof.' Thus, the list of instances of marks is inclusive and not exhaustive. Any mark capable of being 'graphically represented' and indicative of a trade connection with the proprietor is entitled to registration under the Act. This interpretation opens the scope of trademark protection to unconventional trademarks like sound marks. India follows the NICE Classification of goods and services, which is incorporated in the Schedule to the rules under the TM Act. The flowchart below describes the method of obtaining a trademark in India:

V. Obtaining a Trademark in India

Selection of The Mark	Mark should be distinctive and not be in the prohibited category
Search Before Application	Carry out a search at the Trade Marks Registry, to find out if same or similar Marks are either registered or are pending registration. This is advisable although not compulsory.
Filing of The Application	Under the Trade Marks Act, a single application with respect to multiple classes can be filed.
Numbering of The Application	The application is dated and numbered, and a copy is returned to the applicant / attorney. Once the mark is registered, this number is deemed to be the Registration Number.
Meeting The Official Objections	The Trade Marks Registry sends the "Official Examination Report" asking for clarifications, if any, and also cites identical or deceptively similar marks already registered or pending registration.
Advertising of The Application	The application is there after published in the "Trade marks Journal," Which is a Government of India published by the Trade Marks Registry.

Recently, India's first "sound mark" registration was granted to Yahoo Inc.'s three-note Yahoo yodel.

I. Internet Domain Names

Indian courts have been proactive in granting orders against the use of infringing domain names. Some of the cases in which injunctions against the use of conflicting domain names have been granted are: www.yahoo.com vs. www.yahooindia.com and www.rediff.com vs. www.radiff.com. In the www.yahoo.com case it has been held that "the domain name serves the same function as a trademark, and is not a mere address or like finding number on the internet, and therefore, it is entitled to equal protection as a trademark".

ii. Assignment of Trademarks

A registered or unregistered trademark can be assigned or transmitted with or without the goodwill of the business concerned, and in respect of either or all of the goods or services in respect of which the trademark is registered. However, the assignment of trademarks (registered or unregistered) without goodwill requires the fulfillment of certain statutory procedures including publishing an advertisement of the proposed assignment in newspapers.

iii. Recognition of Foreign Well-Known Marks & Trans-Border Reputation

The courts in India have recognized the trans-border reputation of foreign trademarks and trade names and the importance of their protection. Thus, international trademarks, having no commercial presence in India could, be enforced in India if a trans-border reputation with respect to such trademarks can be shown to exist.

Well known Marks such as Whirlpool, Volvo, Caterpillar, and Ocuflox, have received protection through judicial decisions.

Further, infringement actions for a registered trademark along with the claims for passing off for an unregistered mark are recognized by Indian courts. The courts not only grant injunctions but also award damages or an order for account of profits. In addition to the civil remedies, the TM Act contains stringent criminal penalties.

iv. The Madrid Protocol

The Madrid System, administered by the International Bureau of World Intellectual Property Organization (WIPO), Geneva, permits the filing, registration and maintenance of trademark rights in more than one jurisdiction on a global basis. This system comprises two treaties; the Madrid Agreement concerning the International Registration of Marks, which was concluded in 1891 and came into force in 1892, and the Protocol relating to the Madrid Agreement, which came into operation on April 1, 1996. India acceded to the relevant treaties in 2005 and in 2007. The new Trademarks (Amendment) Bill was introduced in Parliament. In 2009, the same received the assent of the Lok Sabha (the Lower House). It came into force on July 8, 2013.

VI. Trade Secrets

It deals with rights on private knowledge that gives its owner a competitive business advantage. Confidential information and trade secrets are protected under common law and there are no statutes that specifically govern the protection of the same. In order to protect trade secrets and confidential information, watertight agreements should be agreed upon, and they should be supported by sound policies and procedures.

VII. Designs

Industrial designs in India are protected under the Designs Act, 2000 ("Designs Act"), which replaced the Designs Act, 1911. The Designs Act incorporates the minimum standards for the protection of industrial designs, in accordance with the TRIPS agreement. It also provides for the introduction of an international system of classification, as per the Locarno Classification.

As per the Designs Act, "design" means only the features of shape, configuration, pattern, ornament or composition of lines or colors applied to any *"article"* whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye.

The Designs Act provides for civil remedies in cases of infringement of copyright in a design, but does not provide for criminal actions. The civil remedies available in such cases are injunctions, damages, compensation, or delivery-up of the infringing articles.

A company in India needs to ensure that it fully leverages the intellectual property developed by it as this may often be the keystone of its valuation. Further, it needs to establish systems to ensure that such intellectual property is adequately recorded, registered, protected and enforced. It needs to conduct IPR audits to ensure that any intellectual property developed by the company is not going unnoticed or unprotected. The company also needs to ensure that its employees do not violate any third party's intellectual property rights knowingly or unknowingly. A company must ensure that its intellectual property is not only protected in India, but also in the country where it carries on its business, where its products are exported, or where it anticipates competition.

9. Mergers and Acquisitions

The year 2012 witnessed a slew of acquisitions across diverse sectors of the economy in India with deals valuing $ 41 billion taking place.[9] Whether a Merger or an Acquisition is that of an Indian entity or it is an Indian entity acquiring a foreign entity, such a transaction would be governed by Indian domestic law.

The term 'merger' is not defined under the Companies Act, the ITA or any other Indian law. In simple words merger means a combination of two or more entities into one. Sections 390 to 394 of the Companies Act deal with the analogous concept of schemes of arrangement or compromise between a company, its shareholders and/or its creditors.

An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offeror company's approach, and may be affected through agreements between the offeror and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree's shares to the entire body of shareholders. Acquisitions may be by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target.

I. Companies Act

Sections 390 to 394 (the "Merger Provisions") of the Companies Act govern a merger of two or more companies under Indian law.[10]

i. Procedure under the Merger Provisions

Since a merger essentially involves an arrangement between the merging companies and their respective shareholders, each of the companies involved in a merger, must make an application to the High Court (the "Court") having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors The Court may then order a meeting of the creditors/shareholders of the company. If the majority in number representing 3/4th in value of the creditors and shareholders present and voting at such meeting agree to the merger, then the merger, if sanctioned by the Court, is binding on all creditors and shareholders of the company. The Court will not approve a merger or any other corporate restructuring, unless it is satisfied that all material facts have been disclosed by the company. The order of the Court approving a merger does not take effect until a certified copy of the same is filed by the company with the RoC. Merger Provisions recognize and permit a merger/reconstruction where a foreign company merges into an Indian company. But the reverse is not permitted, and at present an Indian company cannot merge into a foreign company.

II. Securities and Exchange Board of India

1. **Takeover Code:** In pursuance of the powers conferred by the Securities and Exchange Board of India Act, 1992 , SEBI had formulated the SEBI(Substantial Acquisition of Shares and Takeovers) Regulations 1997 which has been replaced with new takeover regulations, namely the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Code").

9. http://businesstoday.intoday.in/story/india-inc-manda-deal-tally-touches-$41-bn-grant-thornton/1/190405.html
10. Companies Act, 2013 has proposed several changes with respect to mergers and acquisitions, but the relevant sections are yet to be notified by the Central Government.

2. The Takeover Code will be applicable only in respect of the acquisition of shares in a public listed company. The main objective of the Takeover Code is to provide greater transparency in the acquisition of shares and takeovers of companies through a system of disclosure of information and procedures to be followed for such takeovers. The Takeover Code requires an acquirer to disclose his/her aggregate shareholding to the company and the stock exchanges whenever he/she becomes entitled to more than 5 per cent of the shares or voting rights in a company.

3. The initial threshold limit provided for open offer obligations is 25 per cent of the voting rights of the target company under the Takeover Code with a requirement to make an open offer up to 26 per cent.

4. **Pricing of the offer:** The merchant banker appointed by the acquirer will determine the price for the offer on the basis of the parameters laid down in the Takeover Code. Further, Clause 40A of the listing agreement entered into by a company with the stock exchange on which its shares are listed, requires the company to maintain a public shareholding of at least 25 per cent or 10 per cent, as the case may be, on a continuous basis.

5. **Listing Agreement:** The listing agreement is entered into by a company with a stock exchange for the purpose of listing its shares with the stock exchange. The listing agreement requires that a scheme of merger / amalgamation / reconstruction must be filed with the stock exchange at least one month prior to filing with the Court. The scheme cannot violate or override the provisions of any securities law / stock exchange requirements. Additionally the pre and post merger shareholding must be disclosed to the shareholders.

III. Legal Requirements

i. Companies Act

The Companies Act does not make a reference to the term 'acquisition' per se. The modes most commonly adopted are a share acquisition or an asset purchase.

1) Acquisition of Shares

A share acquisition may take place by purchase of all existing shares of the target by the acquirer, or by way of subscription to new shares in the target so as to acquire a controlling stake in the target. If the acquisition of a public company involves the issue of new shares or securities to the acquirer, then it would be necessary for the shareholders of the company to pass a special resolution under the provisions of Section 81(1A) of the Companies Act. A special resolution is one that is passed by at least 3/4ths of the shareholders present and voting at a meeting of the shareholders. A private company is not required to pass a special resolution for the issue of shares, and a simple resolution of the board of directors should suffice.

2) Asset Purchase

An asset purchase involves the sale of the whole or part of the assets of the target to the acquirer. The board of directors of a public company or a private company which is a subsidiary of a public company, cannot sell, lease or dispose all, substantially all, or any undertaking of the company without the approval of the shareholders in a shareholders meeting.

3) Insider Trading Regulations

Securities and Exchange Board of India (Insider Trading) Regulations, 1992 regulates insider trading and a person in violation of these regulations is punishable under Section 24 and Section 15G of the SEBI Act, 1992. These regulations were considerably amended in 2002 and renamed as SEBI (Prohibition of Insider Trading) Regulations, 1992 (hereinafter referred to as the "SEBI Insider Regulations"). The SEBI Insider Regulations are intended to prevent insider trading in securities of Indian listed company.

4) Continual Disclosures

Any person holding more than 5 per cent shares or voting rights in any listed company is required to disclose to the company within two (2) working days from receipt of intimation of allotment of shares; or acquisition or sale of shares or voting rights in Form C40, - the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5 per cent; if there has been any change in such holdings from the last disclosure made under Regulation 13(1) of SEBI Insider Regulations and such change exceeds 2 per cent of total shareholding or voting rights in the company. Any person, who is a director or officer of a listed company, shall disclose to the company in Form D41, the change in shareholding or voting rights held by him and his dependents, if the change exceeds INR 500,000 in value or 25,000 shares or 1 per cent to total shareholding or voting rights, whichever is lower.

IV. Competition Law

The Government of India enacted the Competition Act, 2002 ("Competition Act") to replace the Monopolies and Restrictive Trade Practices Act, 1969. The Competition Act takes a new look at competition altogether and contains specific provisions on anti-competition agreements, abuse of dominance, mergers, amalgamations and takeovers and competition advocacy. The Competition Commission of India ("CCI") has been established to control anti-competitive agreements, abuse of dominant position by an enterprise and for regulating certain combinations.

Transactions, the size of which meets certain threshold have to be filed under the Competition Act. The Competition Act requires mandatory pre-transaction notification to the CCI of all domestic and international acquisitions, mergers and amalgamations ('combinations') that exceed any of the asset or turnover thresholds which apply to either the acquirer or the target or both; or to the group to which the target/ merged entity would belong post acquisition or merger. For the purposes of the Competition Act, 'acquisitions' would mean direct or indirect acquisition of any shares, voting rights or assets of any enterprise, or control over management or assets of an enterprise. A filing/ notification will be required if the merger/acquisition satisfies the following criteria and does not fall within one of the specified exceptions.

	Total of Acquirer and Target		Total of Acquirer and Target	
	Assets	Assets	Assets	Assets
India	INR 15 billion	INR 45 billion	INR 60 billion	INR 180 billion
World-wide	SD 750 million (with at least INR 7.5 billion in India)	USD 2,250 million (with at least INR 22.5 billion in India)	USD 3 billion (with at least INR 7.5 billion in India)	USD 9 billion (with at least INR 22.5 billion in India)

However, for a period of 5 years, enterprises that have assets of not more than INR 2.5 billion or turnover of not more than INR 7.5 billion will be exempt from application of the regulation.

V. Exchange Control

i. Foreign Direct Investment

Investments in, and acquisitions (complete and partial) of, Indian companies by foreign entities, are governed by the terms of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (the "FDI Regulations") and the provisions of the Industrial Policy and Procedures issued by the Secretariat for Industrial Assistance (SIA) in the Ministry of Commerce and Industry, Government of India.

1) Indirect Foreign Investment

Foreign direct investment may be direct or indirect. If an Indian investing company is "owned" or "controlled" by "non-resident entities", then the entire investment by the investing company into the subject downstream Indian investee company would be considered as indirect foreign investment. Provided that, as an exception, the indirect foreign investment in wholly owned subsidiaries of operating-cum-investing / investing companies will be limited to the foreign investment in the operating-cum-investing / investing company.

2) Foreign Technology Collaborations

Payments for foreign technology collaboration by Indian companies are allowed under the automatic route, subject to compliance, without any limits. An Indian company importing any technology or knowhow is, however, required to pay a research and development cess of about 5 per cent under the Research and Development Cess Act, 1986.

ii. Overseas Direct Investment

An Indian company that wishes to acquire or invest in a foreign company outside India must comply with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (the "ODI Regulations"). Such an investment can be made by Indian Companies in overseas joint ventures/ wholly owned subsidiaries, with an investment of up to 400 per cent of the net worth of the Indian company, which is calculated as per the latest audited balance sheet of the Indian company.

VI. Taxes and Duties

i. Income Tax

A number of acquisition and restructuring options are recognized under Indian tax law, each with different set of considerations:

- Amalgamation (i.e. a merger which satisfies the conditions mentioned below)
- Slump sale / asset sale;
- Transfer of shares; and
- Demerger or spin-off.

Mergers and spin-offs may be structured as tax neutral transfers provided certain conditions are met with respect to transfer of assets / liabilities and continuity of shareholding. There are also provisions for carry forward of losses to the resulting entity.

Share transfers may give rise to capital gains tax at rates which depend on holding period of the securities (rates mentioned in Chapter 5 of this report). Capital gains income is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset. Cost of acquisition of shares of an amalgamated company, is deemed to be the cost of acquisition of the shares of the amalgamating company.

Transfer of foreign securities may be taxed if the securities substantially derive value from assets situated in India. This adds an additional element of complication in cross-border M&A with underlying assets or subsidiaries in India. Transfer pricing rules also have to be considered in relation of share transfers as part of a group re-structuring exercise.

Persons acquiring shares of unlisted companies in India may be subject to tax if the consideration paid for the shares is lower than the fair market value of the shares computed using a prescribed formula.

Additional tax considerations arise when the deal consideration is structured as earn-outs. Further, withholding tax obligations also create challenges especially in a cross-border context.

As an alternative to a share transfer, acquisitions may be structured in the form of an asset sale or slump sale.

A slump sale is a transaction where the seller transfers one or more of its undertakings on a going concern basis for a lump sum consideration, without assigning values to the individual assets and liabilities of the undertaking. The capital gains tax liability will be determined having regard to the net worth of the undertaking.

In an asset sale, the acquirer only purchases specific assets or liabilities of the seller. It does not involve a transfer of the business as a whole. The capital gains tax payable by the seller will depend on the period that the seller has held each of the assets that are transferred.

In light of the uncertainties in the tax environment, negotiation of tax indemnities has become a vital component in most M&A deals. Cross-border movement of intangibles may also give rise to potential tax exposures which have to be carefully considered and structured.

ii. Value Added Tax/Sales Tax

Value added tax ("**VAT**") or sales tax, as the case may be, may be payable on purchase of movable assets or goods of the target by the acquirer. VAT is a state level legislation and is payable by the seller of goods.

iii. Stamp Duty

Stamp duty is a duty payable on certain specified instruments / documents. An insufficiently stamped document is not enforceable in a Court of law of India. When there is a conveyance or transfer of any movable or immovable property, the instrument or document effecting the transfer is liable to payment of stamp duty.

1) Stamp Duty on Court Order for Mergers / Demergers

Since the order of the Court merging two or more companies, or approving a demerger, has the effect of transferring property to the surviving /resulting company, the order of the Court may be required to be stamped. The stamp laws of most states require the stamping of such orders. The amount of the stamp duty payable would depend on the state specific stamp law.

2) Stamp Duty on Share Transfers

The stamp duty payable on a share transfer form executed in connection with a transfer of shares is 0.25 per cent of the value of, or the consideration paid for, the shares. Stamp duty on shareholder agreements will be payable as per the state specific stamp law. Additional stamp duty may be payable on an agreement that records the purchase of shares/debentures of a company.

iv. Other Taxes

Other taxes that may have to be considered in structuring M&As include potential service tax obligations. For instance, this could be an issue in cases where the seller procures that its employees accept offers of employment with the acquirer. A question may arise as to whether this may be viewed as manpower recruitment services which could be subject to service tax.

While structuring any investment it is necessary to adopt a holistic approach and integrate all possible legal and tax considerations in a manner that best achieves the strategic and business objectives.

10. Dispute Resolution

I. Courts and Tribunals

The Supreme Court of India is the apex judicial authority in India. The Supreme Court generally receives appeals from the High Courts that occupy the tier below it. Most States have a High Court which has jurisdiction in the state in which it is situated, with a few exceptions such as Bombay and Guwahati. Beneath the High Courts are the subordinate civil and criminal courts that are classified according to whether they are located in rural or urban areas and by the value of disputes such courts have jurisdiction to adjudicate upon.

Certain important areas of law have dedicated tribunals in order to facilitate the speedy dissemination of justice by individuals qualified in the specific fields. These include the Company Law Board, the Income Tax Appellate Tribunal, the Labour Appellate Tribunal, the Copyright Board, Securities Appellate Tribunal, National Green Tribunal and others.

Certain disputes may be referred to in-house dispute redressal systems within certain government bodies and government companies.

II. Jurisdiction

Jurisdiction may be defined as the power or authority of a court to hear and determine a cause, to adjudicate and exercise any judicial power in relation to it. The jurisdiction of a court, tribunal or authority may depend upon fulfillment of certain conditions or upon the existence of a particular fact. If such a condition is satisfied, only then does the authority or Court, as the case may be, have the jurisdiction to entertain and try the matter. Jurisdiction of the courts may be classified under the following categories:

i. Territorial or Local Jurisdiction

Every court has its own local or territorial limits beyond which it cannot exercise its jurisdiction. The Government fixes these limits.

ii. Pecuniary Jurisdiction

The Code of Civil Procedure provides that a court will have jurisdiction only over those suits the amount or value of the subject matter of which does not exceed the pecuniary limits of its jurisdiction. Some courts have unlimited pecuniary jurisdiction i.e. High Courts and District Courts in certain states have no pecuniary limitations.

iii. Jurisdiction as to Subject Matter

Different courts have been empowered to decide different types of suits. Certain courts are precluded from entertaining certain suits. For example, the Presidency Small Causes Courts has no jurisdiction to try suits for specific performance of contract, partition of immovable property etc. Similarly, matters pertaining to the laws relating to tenancy are assigned to the Presidency Small Causes Court and therefore, no other Court would have jurisdiction to entertain and try such matters.

iv. Original and Appellate Jurisdiction

The jurisdiction of a court may be classified as original and appellate. In the exercise of original jurisdiction, a court acts as the court of first instance and in exercise of its appellate jurisdiction, the court entertains and decides appeals from orders or judgments of the lower courts. Munsiff's Courts, Courts of Civil Judge and Small Cause Courts possess original jurisdiction only, while District Courts and High Courts have original as well as appellate jurisdictions, subject to certain exceptions.

In addition to the above, the High Courts and the Supreme Court also have writ jurisdiction by virtue of Articles 32, 226 and 227 of the Constitution of India.

Indian courts generally have jurisdiction over a specific suit in the following circumstances:

- Where the whole or part of the cause of action (the facts that have happened on account of which a person gets a right to file a suit for a relief) arose in the territorial jurisdiction of the court.
- Where the defendant resides or carries on business for gain within the territorial jurisdiction of the court.
- Where the subject of the suit is immovable property (real property and items permanently affixed thereto), where such immovable property is situated within the jurisdiction of the court.

III. Interim Relief

Due to heavy case load and other factors, legal proceedings initiated before Indian courts can often take inordinate amounts of time. Thus, it is common for the plaintiff to apply for urgent interim reliefs such as to seek an injunction restraining the opposite party from disturbing the status quo. Interim orders are those orders passed by the court during the pendency of a suit or proceeding which do not determine finally the substantive rights and liabilities of the parties in respect of the subject matter of the suit or proceeding. Interim orders are necessary to deal with and protect rights of the parties in the interval between the commencement of the proceedings and final adjudication. They enable the court to grant such relief or pass such order as may be necessary, just or equitable. Hence, interim proceedings play a crucial role in the conduct of litigation between the parties.

Injunctions are a popular form of interim relief. The grant of injunction is a discretionary remedy and in the exercise of judicial discretion in granting or refusing to grant, the court will take into consideration the following guidelines:

i. Prima Facie Case

The applicant must make out a prima facie case in support of the right claimed by him and should be able to convince the court that there is a bonafide dispute raised by the applicant - that there is a strong case for trial which needs investigation and a decision on merits and on the facts before the court there is a probability of the applicant being entitled to the relief claimed by him.

ii. Irreparable Injury

The applicant must further satisfy the court that he will suffer irreparable injury if the injunction as prayed is not granted such as no monetary damages at a later stage could repair the injury done, and that there is no other remedy open to him by which he can be protected from the consequences of apprehended injury.

iii. Balance of Convenience

In addition to the above two conditions, the court must also be satisfied that the balance of convenience must be in favor of the applicant. In order to determine the same the court needs to look into the factors such as

- whether it could cause greater inconvenience to the plaintiff if the injunction was not granted.
- whether the party seeking injunction could

be adequately compensated by awarding damages and the defendant would be in a financial position to pay them.

IV. Specific Relief

The Specific Relief Act, 1963 provides for specific relief for the purpose of enforcing individual civil rights and not for the mere purpose of enforcing civil law and includes all the cases where the Court can order specific performance of an enforceable contract.

Specific performance is an order of the court which requires a party to perform a specific act, usually what is stated in a contract. While specific performance can be in the form of any type of forced action, it is usually used to complete a previously established transaction, thus being the most effective remedy in protecting the expectation interest of the innocent party to a contract. The aggrieved party may approach a Court for specific performance of a contract. The Court will direct the offender party to fulfill his part of obligations as per the enforceable contract.

V. Damages

Under the common law, the primary remedy upon breach of contract is that of damages. The goal of damages in tort actions is to make the injured party whole through the remedy of money to compensate for tangible and intangible losses caused by the tort.

Under the ICA, the remedy of damages is laid down in Section 73 and 74. Section 73 states that where a contract is broken, the party suffering from the breach of contract is entitled to receive compensation from the party who has broken the contract. However, no compensation is payable for any remote or indirect loss or damage.

Section 74 deals with liquidated damages and provides for the measure of damages in two classes: (i) where the contract names a sum to be paid in case of breach; and (ii) where the contract contains any other stipulation by way of penalty. In both classes, the measure of damages is as per Section 74, reasonable compensation not exceeding the amount or penalty stipulated for.

VI. Arbitration

Due to the huge pendency of cases in courts in India, there was a dire need for effective means of alternative dispute resolution. India's first arbitration enactment was The Arbitration Act, 1940. Other complementary legislations were formed in the Arbitration (Protocol and Convention) Act of 1937 and the Foreign Awards Act of 1961. Arbitration under these laws was not effective and led to further litigation as a result of the rampant challenge of arbitral awards. The legislature enacted the current Arbitration & Conciliation Act, 1996 (the "A&C Act") to make arbitration, domestic and international, more effective in India. The A&C Act is based on the UNCITRAL Model Law (as recommended by the U.N. General Assembly) and facilitates International Commercial Arbitration as well as domestic arbitration and conciliation. Under the A&C Act, an arbitral award can be challenged only on limited grounds and in the manner prescribed. India is party to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. As the name of the A&C Act suggests, it also covers conciliation, which is a form of mediation.

The A&C Act covers the following recognized forms of arbitration:

i. Ad-hoc Arbitration

Ad-hoc arbitration is where no institution administers the arbitration. The parties agree to appoint the arbitrators and either set out the rules which will govern the arbitration or leave it to the arbitrators to frame the rules. Ad-hoc arbitration is quite common in domestic arbitration in India. The absence of any reputed arbitral institution in India has allowed ad-hoc arbitration to continue to be popular. In cross border transactions it is quite common for parties to spend time negotiating the arbitration clause, since the Indian party would be more comfortable with ad-hoc arbitration whereas foreign parties tend to be more comfortable with institutional arbitration. However, with ad-hoc arbitrations also being seen as a lengthy process and with various arbitral institutions coming up in India such as LCIA India, the preference seems to be now shifting to institutional arbitration.

ii. Institutional Arbitration

As stated above, institutional arbitration refers to arbitrations administered by an arbitral institution. Institutions such as the International Court of Arbitration attached to the International Chamber of Commerce in Paris ("ICC"), the London Court of International Arbitration ("LCIA") and the American Arbitration Association ("AAA") are well known world over and often selected as institutions by parties from various countries. Within Asia, greater role is played by institutions such as the Singapore International Arbitration Centre ("SIAC"), the Hong Kong International Arbitration Centre ("HKIAC") and China International Economic and Trade Arbitration Commission ("CIETAC"). The Dubai International Arbitration Centre is also evolving into a good center for arbitration. While Indian institutions such as the Indian Council of Arbitration attached to the Federation of Indian Chambers of Commerce and Industry ("FICCI"), the International Centre for Alternative Dispute Resolution under the Ministry of Law & Justice ("ICADR"), and the Court of Arbitration attached to the Indian Merchants' Chamber ("IMC") are in the process of spreading awareness and encouraging institutional arbitration, it would still take time for them to achieve the popularity enjoyed by international institutions.

iii. Statutory Arbitration

Statutory arbitration refers to scenarios where the law mandates arbitration. In such cases the parties have no option but to abide by the law of land. It is apparent that statutory arbitration differs from the above types of arbitration because (i) the consent of parties is not required; (ii) arbitration is the compulsory mode of dispute resolution; and (iii) it is binding on the Parties as the law of land. Sections 24, 31 and 32 of the Defence of India Act, 1971, Section 43(c) of The Indian Trusts Act, 1882 and Section 7B of the Indian Telegraph Act, 1885 are certain statutory provisions which deal with statutory arbitration.

iv. Foreign Arbitration

When arbitration proceedings are seated in a place outside India and the award is required to be enforced in India, such a proceeding is termed as a Foreign Arbitration. The seminal judgment of the Supreme Court of India in *BALCO vs. Kaiser,* has altered the landscape of arbitration in India and *has overturned the law laid down in Bhatia Inter- national vs. Bulk Trading.* According to the *BALCO judgment,* provisions of part I of the A&C Act are not applicable to foreign awards and foreign seated arbitrations where such arbitration agreement was entered into on or after September 6, 2012. This has considerably reduced the level of interference by Indian courts in foreign arbitrations. However, another consequence of the judgment is that parties to a foreign seated arbitration cannot seek interim reliefs in aid of arbitration from the Indian courts. Also as interim awards passed by a foreign seated arbitral tribunal cannot be enforced in India, in a foreign seated arbitration no interim reliefs are available in India. A Foreign award can be enforced either under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 ("New York Convention") or under the Convention on the Execution of Foreign Awards, 1923 ("Geneva Convention") provided such award is made in one of such territories which has been notified by the Central Government as a territory to which the convention applies. Reciprocity is only in relation to the place where the award is made and does not bear any real relation to the nationality of the parties or whether the nations to which each of the parties belong have signed or ratified the Conventions.

VII. Enforcement of Arbitral Awards

A Foreign Award is defined in Section 44 and Section 53 of the A&C Act, 1996. India is a signatory to the New York Convention as well the Geneva Convention. Thus, if a party receives a binding award from another country which is a signatory to the New York Convention or the Geneva Convention and the award is made in a territory which has been notified as a convention country by India, the award would then be enforceable in India. There are about 47 countries which have been notified by the Central Government as reciprocating convention countries, with the most recent addition being China. Section 48 of the A&C Act deals with the conditions to be met for the enforcement of foreign awards made in countries party to the New York Convention. It stipulates that the only cases where enforcement can be refused are when one party is able to show that:

- the parties were under some incapacity as per the applicable law or that the agreement was not valid under the law of the country where the award was made or the law which the parties have elected;
- that the party against whom the award has been made was not given adequate notice of appointment of arbitrators, arbitration proceedings or was otherwise unable to present his case;
- the award addresses issues outside the scope of the arbitration agreement, and if separable, any issue which is within the ambit of the agreement would remain to be enforceable;
- the composition of the tribunal or the procedure were not in accordance with the agreement of the parties or if there was no such agreement with the law of the country where the arbitration took place; and
- lastly, the award has been set aside or suspended by a competent authority in the country in which it was made or has otherwise not yet become binding on the parties.

Additionally, enforcement may also be refused if the subject matter of the award is not capable of settlement by arbitration under the laws of India or if the enforcement of the award would be contrary to the public policy of India. Most of the protections afforded to awards which are made in countries that are party to the New York Convention are also applicable to those made in countries party to the Geneva Convention. The A&C Act also provides one appeal from any decision where a court has refused to enforce an award, and while no provision for second appeal has been provided, a party retains the right to approach the Supreme Court.

VIII. Enforcement of Foreign Judgments

The definition of judgment as given in Section 2(9) of the Code of Civil Procedure, 1908 ("CPC") is inapplicable to foreign judgments'.

A foreign judgment must be understood to mean "an adjudication by a foreign court upon a matter before it" and not the reasons for the order made by it. The foreign Court must be competent to try the suit, not only with respect to pecuniary limits of its jurisdiction and the subject matter of the suit, but also with reference to its territorial jurisdiction. In addition, the competency of the jurisdiction of the foreign court is not be judged by the territorial law of the foreign state, but rater, by the rule of Private International Law.

A foreign judgment may be enforced by filing a suit upon judgment under Section 13 of CPC or if the judgment is rendered by a court in a "reciprocating territory", by proceedings in execution under Section 44A of the CPC. A "reciprocating territory" is one, which is notified by the Government of India as a "reciprocating territory" under Section 44A of the CPC. For instance, U.K. has been notified by the Government of India as a "reciprocating territory" but the U.S. has not. The judgment of a foreign court is enforced on the principal that where a court of competent jurisdiction has adjudicated upon a claim, a legal obligation arises to satisfy the claim. Judgments of specified courts in reciprocating countries can be enforced directly by execution proceedings as if these foreign judgments are decrees of the Indian courts. Foreign judgments of non-reciprocating countries can be enforced in India only by filing a suit based on the judgment. A foreign judgment is usually recognized by Indian courts unless it is proved that:

- it was pronounced by a court which did not have jurisdiction over the matter;
- it was not given on the merits of the case;
- it appeared on the face of the proceeding to be founded on an incorrect view of international law or a refusal to recognize Indian law (where applicable);
- principles of natural justice were ignored by the foreign court;
- the judgment was obtained by fraud; or
- the judgment sustained a claim founded on a breach of Indian law.

The jurisdiction of foreign courts is decided by applying rules of conflict of laws. Even if the court did not have jurisdiction over the defendant, its judgment can be enforced if the defendant has appeared before the foreign court and not disputed its jurisdiction. While a decision of a foreign court must be based on the merits of a case, the mere fact that it was *ex-parte* (in the absence of a party) does not preclude enforcement. The test is whether it was passed as a mere formality or penalty or whether it was based on a consideration of the truth and of the parties' claim and defense. For applying the third exception, the mistake or incorrectness must be apparent on the face of the proceedings. Merely because a particular judgment does not conform to Indian law when it is under no obligation to take cognizance of the same does not preclude enforcement. The term 'natural justice' in the fourth exception to enforcement refers to the procedure rather than to the merits of the case. There must be something which is repugnant to natural justice in the procedure prior to the judgment. The fifth exception of a judgment being obtained by fraud applies as much to domestic judgments as to foreign judgments. The last exception for instance would ensure that a judgment regarding a gambling debt cannot be enforced in India.

Where any judgment from a 'reciprocating' territory is in question, a party may directly apply for execution under Section 44A. A judgment from a non-reciprocating country cannot be enforced under this section. A party approaching the Indian court must supply a certified copy of the decree together with a certificate from the foreign court stating the extent to which the decree has been satisfied or adjusted, this being treated as conclusive proof of the satisfaction or adjustment. Execution of the foreign judgment is then treated as if it was passed by a District Court in India. However, the parties may still challenge the enforcement under the provisions of Section 13 of the CPC.

The courts may refuse enforcement of a foreign award in India on the grounds mentioned above. Further the claims may be barred under the Limitation Act, 1963, if the suit is instituted after the expiry of the limitation period, which is, in general, a period of 3 years. The Limitation Act will be applicable if the suit is instituted in India on the contracts entered in a foreign country.

11. Conclusion

Historically, India has had a poor track record with its 'Hindu' rate of growth subsisting through much of the period from independence until 1991. For decades, India was a semi-socialist state. Various restrictions were placed on internal production under the 'permit-license-quota raj.' Many industrial sectors were put under unwieldy and unproductive public sector undertakings, which effectively had a monopoly over their respective sectors. Bureaucracy was rampant and the polity highly corrupt; even the private sector was largely subject to their whims and vagaries causing huge inefficiencies in business operations.

Furthermore, some aspects of the legal system in India are archaic. For example, Indian labour laws find their origin in the British laws of the early 20th century and have undergone only minor amendments since, even though the same laws in Britain have changed significantly. As a result, sectors such as manufacturing have been dogged by strikes and lock outs. Additionally, it is very difficult to terminate an employee in India due to extensive protections under various laws. These laws are unlikely to change soon as the country's political class still originates from labour and other unions. India's import policies, while relaxed a bit recently, continue to remain unfriendly with very high duties charged on many imported goods. India's tax and corporate laws are complex and outdated, though both are proposed to be amended in the near future with the new Companies Bill (has received assent in the Lower House of the Parliament and is awaiting approval of the Upper House) and Direct Taxes Code having been introduced in Parliament.

India liberalized its economy in 1991 with a sweep of reforms to the country's financial and trade policies. These changes have had a positive impact on the sizable Indian populace. India's middle class, its prime consumer market and responsible for over half the Indian economy's GDP in the form of private spending, has been estimated to have crossed 400 million in number, more than the population of the United States. Furthermore, India's population remains largely of working age and relatively young, unlike China, who's 'one-child' policy has resulted in a smaller working population supporting a growing mass of retirees.

The entrepreneurial spirit of India's people has found a new lease of life after years of being stifled. For instance, the IT/ITES field is one of few which find a large number of friendly policies that have permitted the sector to grow by leaps and bounds in the last two decades and made India a global hub for both front and back-end operations in the sector.

While corruption still exists, the computerization of numerous public bodies has led to an increased level of efficiency and institutions such as the RBI and SEBI have become increasingly proactive and professional in dealing with foreign investment into India. Furthermore, some state governments have taken proactive steps at their level to improve efficiency in public offices such as the RoC. While caution exercised by them may seem draconian; it has helped India tremendously in avoiding any major internal impact of the ongoing financial crisis. Despite the recessionary global economic state, India posted a growth rate of close to 7 per cent in the third quarter of 2011 while most developed nations have faced negative or severely limited growth patterns

To conclude, while it is apparent that India still needs to clean up its act, it is and will continue to be an attractive destination for investment and trade. Its expanding level of intellectual capital and large English-speaking population are likely to make it a global hub for services. And its significant internal market makes it an attractive destination for investments in services and manufacturing.

Investing into India: Considerations from a German-India Legal & Tax Perspective

I. German-India Relations: Background

India and Germany have enjoyed long-standing historic and cultural ties due to strong shared values of democracy, rule of law, pluralism, tradition and culture. Germany is India's biggest trading partner in Europe and the second largest technology partner.[1]

The relations between India and Germany date back to the early 16th century when German trading companies from Augsburg and Nuremberg started operating in India.[2] The depth of the Indo-German relations is reflected in the fact that Werner Von Siemens, founder of Siemens, personally supervised the laying of telegraph line between Kolkata and London, which was completed in 1870.[3] Further, the first wholly - owned subsidiary of Bayer in Asia "Farbenfabriken Bayer and Co. Ltd." was set-up in Mumbai as far back as 1896.[4] Since then, there has been a continuous advancement in trade and investment flow between the two countries.

Foreign direct investment (FDI) from Germany into India has significantly increased since 2005. The cumulative FDI inflows from Germany into India in the period from April 2000 to April 2013 has been USD 5.5 billion.[5] Industries which have attracted the highest inflow from Germany include services, IT & telecommunications, real estate, automobile, energy & chemicals. A cross section of German investors regularly invest in India, recent being the acquistion of 30% stake by KfW Bankengruppe (a German-state owned development bank) in Invest India Micro Pension Services Private Limited, a company operating in the micro-finance space. Major German automobile giants such as BMW, Mercedes, Daimler, Audi, Volkswagen and Porsche have set up manufacturing and assembly units in India. Other German companies that have made significant investments into India include Siemens, Bosch, Bayer, SAP, Deutsche Bank, Kion Group, Rheinmetall AG and others.

Similarly, Indian companies too have been making significant investments in Germany. The cumulative investment by Indian companies in Germany stood at about €4.7 billion until September, 2012.[6] Some well-known Indian family run companies such as Ranbaxy, Hinduja Group, Biocon, Hexaware Technologies, Dr. Reddy's Laboratories, Suzlon, Reliance, Kalyani Steels, Endurance Technologies, Bharat Forge, Mahindra & Mahindra etc. have established presence in Germany. There are more than 1600 Indo-German collaborations and over 600 Indo-German joint ventures in operation, and about 215 Indian companies operate in Germany.[7]

The German economy's success is largely defined by the role played by the *Mittlestandt* companies, which specialize in their niche product offering, invests into research and development, and are family owned. This last characteristic of *Mittlestandt* companies is

1. Reference to Ministry of External Affairs briefing note, available at: http://www.mea.gov.in/Portal/ForeignRelation/Germany-January-2012.pdf
2. India-Germany bilateral relations, available at: http://www.ficci.com/international/75179/Project_docs/India-Germany-Bilateral-Relations-21-12-12.pdf.
3. India-Germany Relations, Ministry of External Affairs, Government of India available at: http://www.mea.gov.in/Portal/ForeignRelation/Germany.pdf
4. Ibid
5. Cumulative FDI inflows in India since April 2000, available at: http://dipp.nic.in/English/Publications/FDI_Statistics/2013/india_FDI_April2013.pdf
6. Supra 2
7. Ibid

what strikes a common chord with Indian companies who are family owned deeply valuing the culture and traditions along with their conservative approach towards borrowing. Thus, the commonality of philosophy and the complementary nature of offerings which *Mittlestandt* and the Indian companies share, such as *Mittlestandt* companies bring in their specialized technology and Indian companies bring in their local market expertise to provide for a great opportunity for mutual co-operation. A number of bilateral agreements and institutional arrangements have been executed between India and Germany. Listed below are some of the key agreements:

- Income and Capital Tax treaty entered on June 19, 1995 which became effective on January 01 1997 (for Germany) and on April 01, 1997 (for India);

- Bilateral Investment Promotion and Protection Agreement entered on July 10, 1995 and became effective on July 13, 1998;

- Social Security treaty entered on October 08, 2008, became effective on October 08, 2008.

II. German-India Tax Treaty: Special Considerations

i. Residency of partnerships and hybrid entities

Issues have arisen when tax treaty benefits are claimed by hybrid entities.

Benefits under the German-India tax treaty are available to residents liable to tax in Germany. The tax authorities sought to deny treaty benefits to a German *Kommanditgesellschaft* (KG) or limited partnership on the basis that it was a transparent entity. However in *DIT v. Chiron Bhering*[8], the Bombay High Court noted that although a German limited general partnership does not pay income tax, it is subject to *Gewerbesteuer* or trade tax which is specifically covered under the German-India treaty. On this basis, it was held that the German KG cannot be denied treaty benefits.

In contrast, the Authority for Advance Ruling held that a Swiss general partnership (*Schellenberg Wittmer*[9]) is not entitled to treaty benefits since it is a fiscally transparent entity. It was further held that the Swiss resident partners of the partnership could also not take advantage of the treaty since they were not direct recipients of the income, and because the Swiss-India treaty does not recognize partnerships.

ii. Permanent Establishment (PE) Risks

German companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the German-India context.

A PE may be constituted if a German enterprise has a fixed base, office, branch, factory, workshop, etc. in India. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 6 months. A German enterprise is also deemed to have a PE in India if it provides services or facilities in connection with, or supplies plant and machinery on hire used for or to be used in the prospecting for or extraction or exploitation of mineral oils in India.

In the early case of *CIT v. Visakhapatnam Port Trust*[10], the Andhra Pradesh High Court held that mere supply of a plant by a German

8. TS-12-HC-2013 (BOM)

9. [2012] 210 TAXMAN 319 (AAR).
10. 1983 144 ITR 146 AP

company whose assembly and erection are undertaken by purchaser under supervision of engineer deputed by supplier does not result in a PE in India. However, the Delhi Tribunal in the case of *Steel Authority of India Ltd. v. ACIT*[11] held that a building site or construction, installation or assembly project need not be that of the taxpayer and supervisory activities carried out in connection therewith becomes a PE of the taxpayer if they continue for a period exceeding 6 months. Therefore, even if the installation or assembly project does not belong to the taxpayer, the fact that he has been providing supervisory services for installation purposes for a period exceeding six months would make it a PE.

A dependent agent in India of the German enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders on behalf of the German enterprise.

The Protocol to the treaty clarifies that any direct and independent supply of equipment or machinery from the German head office should not be attributable to profits arising from the building site, construction, assembly or installation project in India. Income derived by a German enterprise from planning, project, construction or research activities as well as income from technical services exercised in India in connection with a PE situated in India, shall not be attributed to that PE.

iii. Taxation of Capital Gains

Gains arising to a German resident from the sale of shares of an Indian company would be taxable in India. The treaty does not provide any relief in this regard.

Capital gains are categorized as short term and long term depending upon the time for which they are held. Gains from shares which are held for a period of more than twelve months are categorized as long term. If the holding period is lesser than 12 months, then it is in the nature of short term gains. Long term capital gains arising out sale of listed shares on the stock exchange are tax exempt (but subject to a nominal securities transaction tax). Long term gains arising from the sale of unlisted shares are taxed at the rate of 20% (or 10% in certain cases). Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares is 40%.

In this context, it is interesting to note that the Authority for Advance Ruling in the case of *RST, In Re*[12] held that even in a case where a German company was holding 99.99% of the shares of a subsidiary in India, the Indian company could not be regarded as a wholly-owned subsidiary of the German company and therefore the capital gains tax relief which was allowed under Section 47(iv) (for parent-subsidiary transfers) of the Income Tax Act, 1961 (ITA) could not be applied.

iv. Taxation of Interest, Royalty and Fees for Technical Services (FTS)

Interest, royalties and FTS arising in India and paid to a Germany resident may be taxed in Germany. However, if the German resident is the beneficial owner of the royalties or FTS, the tax so charged shall not exceed 10% of the gross amount that is paid. The domestic withholding tax rate on interest can be as high as 42% and around 27% for royalties and FTS.

Interest covers income from debt-claims of every kind. Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of,

11. (2006) 10 SOT 351 (Del).

12. [2012] 348 ITR 368 (AAR)

or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments. FTS refers to payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel respectively.

The Mumbai Tribunal in the case of *Siemens Ltd. v CIT*[13] held that payments made to laboratories, for conducting certain tests by using highly sophisticated technology without using human intervention for the purpose of certification does not fall within the meaning of FTS under Section 9(1)(vii) of the ITA.

v. Relief from Double Taxation

Under the German-India treaty, an exemption should be allowed in Germany for any income that arises in India which may be taxed in India in accordance with the treaty. With respect to dividends, the exemption applies only if the German company holds at least 10% of the share capital of the Indian company. Other income not covered by the exemption is subject to available foreign tax credit with respect to taxes paid in India.

vi. Exchange of Information

With a view to curb tax evasion and money laundering, India has been actively entering into arrangements for exchange of information with other countries. The German -India treaty also provides a framework for exchange of information between the two Governments. In *Ram Jethmalani & Ors. vs Union of India*[14] the Indian Supreme Court noted that while there is a requirement for confidentiality, the German -India treaty permitted disclosure of information in Court proceedings. The Government was accordingly directed to reveal details of accused individuals with Liechtenstein bank accounts, the details of which were shared by the German Government.

III. German-India: Bilateral Investment Promotion and Protection Agreement

Bilateral investment promotion and protection agreements (BIPAs) are agreements between two States for the reciprocal encouragement, promotion and protection of investments in each other's territories by individuals and companies situated in either State.

India entered into a BIPA with Germany on July 10, 1995 which came into force July 13, 1998. The India-Germany BIPA states that investments and investors would be provided "all times fair and equitable treatment and full protection and security". BIPA provides legal basis for enforcing the rights of the investors of both the countries and provides for fair and equitable treatment, full and constant legal security and dispute resolution through international mechanism.

13. [2013] 30 taxmann.com 200 (Mum)

14. [2011] 339 ITR 107 (SC)

Investing into India: Considerations from a Japan-India Tax Perspective

I. Japan-India Relations: BackGround

India and Japan share a common vision of global peace, stability and shared prosperity, based on sustainable development. India and Japan have taken major strides in developing strategic, defence, economic and cultural relations.

During the period between April 2000 and March 2013, India has received USD 14.55 billion foreign direct investment (**"FDI"**) from Japan[1] making Japan the fourth largest source of investment into India after Mauritius, Singapore and the United Kingdom. The bilateral commerce between the countries have increased by six times since 2002 and currently stands at USD 18.77 billion and it is expected that it will touch US$ 25 billion by 2014. India has also been one of the largest recipients of the Japanese Official Development Assistance loans in recent times, which have been utilized to stimulate several upcoming Indian infrastructure projects in India, some notable examples being the Mumbai Metro Line-III project; the Campus Development Project of Indian Institute of Technology; Hyderabad (Phase 2); Delhi–Mumbai Industrial Corridor Project and the Chennai–Bengaluru Industrial Corridor Project[2].

1. Fact Sheet On Foreign Direct Investment (FDI) From April, 2000 to March, 2013 available at http://dipp.nic.in/English/Publications/FDI_Statistics/2013/india_FDI_March2013.pdf (last visited on August 18, 2013).
2. Joint Statement on Prime Minister's visit to Japan: Strengthening the Strategic and Global Partnership between India and Japan beyond the 6oth Anniversary of Diplomatic Relations, May 29, 2013, available at http://www.mea.gov.in/bilateral-documents.htm?dtl/21755/Joint+Statement+on+Prime+Ministers+visit+to+Japan+Strengthening+the+Strategic+and+Global+Partnership+between+India+and+Japan+beyond+the+6oth+Anniversary+of+Diplomatic+Relations (last visited on August 18, 2013).

Significantly, two bilateral agreements have been entered into between Japan and India that might have a tremendous impact on economic relations between Japan and India:

i. Comprehensive Economic Partnership Agreement (**"CEPA"**) between Japan and the Republic of India (2011); and

ii. Agreement Between Japan And The Republic Of India On Social Security (2012) (**"Social Security Agreement"**)

While Indian exports to Japan primarily include mineral fuels, mineral oils, pearls and other precious and semi-precious stones, iron and steel, sea food and fodder, Japan primarily exports machinery, optical, medical and surgical instruments and articles of iron and steel to India. Under the Japan-India CEPA, India has committed to reduce or eliminate tariffs from 87% of its tariff lines, whereas Japan has committed to reduce or eliminate tariffs from 92% of its tariff lines with fifteen years.[3] India offered 17.4% of the tariff-lines to be reduced to zero with immediate effect. Tariffs on 66.32% of tariff lines are likely to be brought down to zero in the next ten years.

Further, the Japan-India Social Security Agreement exempts employees posted to the host country under short term contracts (upto five years) from making social security payments in such host country insofar as social security contributions have been made in the home country and certificate of coverage in respect of the same has been obtained. This is an important step in furthering economic

3. 'India japan CEPA comes into force Commerce Secretary calls it a Major Step for a larger East Asian Partnership', Ministry of Commerce and Industry Press Release August 1, 2011, available at http://pib.nic.in/newsite/erelease.aspx?relid=73596 (last visited on August 18, 2013).

interactions and facilitating movement of talent and knowhow between the two countries.

II. Japan-India Tax Treaty: Special Considerations

i. Residency of Partnerships and Hybrid Entities

Companies or individuals that are resident in Japan, in that, they are liable to tax in Japan therein by reason of their domicile, residence, place of head or main office or any other criterion of a similar nature, can avail of relief under of the Japan-India Double Taxation Avoidance Agreement (“**DTAA**”).

Relief therefore may be claimed by Japanese corporations and entities that are liable to tax as residents of Japan. With respect to partnerships limited by shares (*gomei kaisha or goshi kaisha*) or special types of trusts, treaty relief may be available if these entities are taxed as a regular corporate taxpayer. However, certain fiscally transparent entities may have difficulties in obtaining treaty relief. For instance issues faced by entities such as general or limited partnerships (*kumiai*) or silent partnerships (*tokumei kumiai*).

Unlike most treaties signed by India, the Japan-India DTAA does not have a tie-breaker clause to deal with situations where a person may be treated as resident of both India and Japan. In such a case then tax authorities of both States will have to discuss the issue by way of mutual agreement. In a dual-residence scenario, treaties usually specify certain factors that will determine the residence of an individual or company. For a dual-resident company, residence is normally determined based on the place of effective management. The treaty with Japan does not provide such clarification.

ii. Permanent Establishment (PE) Issues

The Japan-India DTAA has a more expansive definition of PE than prescribed under the OECD Model Convention. A Japanese resident may have a PE in India if it has a ‘fixed place of business’ in India through which a part or the whole of its business is carried on. Such fixed place may be constituted through a branch, an office, factory, workshop, warehouses, constructions, place of effective management, or structure for exploration of natural resources (for a period exceeding 6 months) in India. Further, a building site, construction, installation or assembly project, or supervisory services in connection therewith may give rise to a PE if the project or activity exceeds a period of 6 months. A PE may also be constituted if a Japanese resident dependent agent in India concluding contracts, maintaining a stock of goods in India for making deliveries, or securing orders in India on behalf of the foreign enterprise.

In many cases activities that are preparatory or auxiliary to the main business activities should not create a PE even if these are carried out in India. Therefore in the cases of *Mitsui & Co.*[4], Sumitomo Corporation[5] and Metal One Corporation[6] it was held that a liaison office in India would not be treated as a PE since they only carried out ancillary activities such as collection of information, submission of bids and served as a mere communication channel.

All profits attributable to a PE will be taxable in India. In *Ishikawajima Harima Heavy Indus. Company Limited v. DIT*[7] it was held that for attribution of profits to a PE of a Japanese company in India, it is necessary to consider the activities actually carried out by the PE. It was also held that activities carried outside India could not be attributed to the PE. In

4. [2008] 114 TTJ 903(DELHI)
5. [2007] 110 TTJ 302 (DELHI)
6. [2012] 22 TAXMAN 77 (Delhi)
7. 288 ITR 408

Nippon Kaiji Kyokoi v. ITO[8] it was further held that fees for inspection and survey services provided by a Japanese company would be taxable in India to the extent attributable to its PE in India. It was further held that services not connected to the PE could not be separately taxed as fees for technical services. The Protocol to the treaty however clarifies that attribution shall be made with respect to the PE's activities even if the order for purchase is placed directly with the head office.

iii. Taxation of Interest, Royalties and Fees for Technical Services (FTS):

Interest, royalties and FTS earned by resident of Japan from sources in India would be subject to a lower withholding tax rate of 10%. The domestic withholding tax rate on interest can be as high as around 43% and around 27% for royalties and FTS. The treaty therefore provides significant relief with respect to interest, royalties and FTS.

Interest covers income from debt-claims of every kind. Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments. FTS refers to payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel respectively.

In *Uniflex Cables Ltd. v. DCIT*[9], a Mumbai tribunal held that "usance interest" paid by the Indian company to Japanese vendors (among vendors from other jurisdictions) on letters of credit furnished to them for purchase of raw materials amount to interest under the DTAA and was hence taxable in India.

In *Dassault Systems K.K. v. Director of Income-tax (International Taxation)-I*[10] the company marketed licensed software products through independent agents with whom it entered into a general value added reseller agreement ("**GVA**") that merely allowed them to receive and subsequently sell the software products to the end users at a price independently determined by them and upon such purchase from the independent intermediary, the end users were required to enter into a tri-partite end-user license agreement ("**EULA**") with the Japanese company and the intermediary, which enabled them to use a license key (which could function only on the end user's designated machine) to activate the software and register the license, the Indian Authority for Advance Rulings ("**AAR**"), New Delhi held that the income derived by the company did not amount to royalty under the ITA or the DTAA because the copyright continued to vest in the Japanese company.

However, in *Acclerys K K v. DIT*[11] the AAR on similar facts held that since the company had specifically granted a right to use the copyright in the software to the customers through the vendor license key, the income from such software supply transaction amounted to royalty and was hence taxable in India.

The Supreme Court of India, in *Ishikawajima Harima Heavy Indus. Company Limited v. DIT*[12] held that offshore services may not be taxed in India unless they are rendered and utilized in India. Subsequently, the Indian Income Tax Act was amended to reflect that

8. [2011] 12 TAXMAN 477 (Mum)
9. [2012] 136 ITD 374 (Mum)
10. [2010] 322 ITR 125 (AAR)
11. [2012] 343 ITR 304 (AAR)
12. 288 ITR 408

even if services are rendered outside India, insofar as they are utilized in India, they may be taxed in India. However, when the issue was referred to a Tribunal for a decision in light of this amendment in *IHI Corporation v. ADIT (IT)-3*[13], the Tribunal noted that while the position had changed with respect to the domestic law, there had been no change in the position of law under the Japan-India DTAA. Therefore, income from offshore services not being attributable to Indian PE cannot be taxed in India under the Japan-India DTAA. Applying the principle that in case of inconsistency in the position under the domestic law and Treaty law, whichever is more beneficial to the taxpayer shall apply, the Tribunal ruled that income from services rendered offshore may not be taxable in India.

iv. Taxation of Capital Gains

Gains arising to a Japanese resident from the sale of shares of an Indian company would be taxable in India. The treaty does not provide any relief in this regard.

Capital gains are categorized as short term and long term depending upon the time for which they are held. Gains from shares which are held for a period of more than twelve months are categorized as long term. If the holding period is lesser than 12 months, then it is in the nature of short term gains. Long term capital gains arising out sale of listed shares on the stock exchange are tax exempt (but subject to a nominal securities transaction tax). Long term gains arising from the sale of unlisted shares are taxed at the rate of 20% (or 10% in certain cases). Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares is 40%. These rates are exclusive of applicable surcharge and education cess.

13. [2013] 32 TAXMAN 132

Investing into India: Considerations from a Mauritius-India Tax Perspective

I. India-Mauritius Relations: Background

India and Mauritius have shared close economic, political and cultural ties for more than a century. There has been close cooperation between the two countries on various issues including trade, investment, education, security and defense.

Bilateral investment between the two countries has continued to strengthen the ties between the two nations. As of March 2013, the cumulative FDI inflows from Mauritius to India was around USD 73 Billion amounting to 38% of the total FDI inflows, making it India's largest source of FDI.[1] Several global funds and strategic investors have invested into India from Mauritius due to various commercial, strategic and tax related advantages offered by the country. Mauritius has also emerged as an important gateway for investments into Africa. Indian companies have made significant investments in Mauritius with over USD 500 million having been invested in the last 5 years alone.

India is also Mauritius's most important trading partner and the largest exporter of goods and services into Mauritius. The combined trade between the two countries stood at USD 1.6 Billion.[2]

The major bilateral agreements between the two nations cover several areas not just restricted to finance, trade and commerce but also including intelligence, cultural ties, environmental protection etc. Some of the key bilateral treaties and institutional agreements between India and Mauritius include:

1. The Double Taxation Avoidance Agreement, 1982
2. Bilateral Investment Promotion and Protection Agreement, 1998
3. MOU on Cooperation in Biotechnology, 2002
4. MOU on Cooperation in the Field of Environment, 2005
5. MOU Concerning Cooperation in the Exchange of Finance Intelligence Related to Money Laundering & Financing of Terrorism, 2008
6. Supply Contract for the Coastal Radar Surveillance System, 2009
7. MOU on Science and Technology Cooperation, 2012
8. MOU on Textiles, 2012

II. India-Mauritius Tax Treaty: Special Considerations

i. Residence and Entitlement to Treaty Relief

A person is considered a resident of Mauritius for relief under the tax treaty, as long as it is liable to tax in Mauritius by reason of domicile, residence or place of management. The Indian tax authorities issued a Circular (789 of 2000) stating that a tax residency certificate

1. FDI Synopsis on Country: Mauritius, as accessible at http://www.dipp.nic.in/English/Publications/SIA_NewsLetter/AnnualReport2010/Chapter6.1.A.i.pdf.
2. Release by the Ministry of External Affairs on India-Mauritius Relations, as accessed *http://mea.gov.in/Portal/ForeignRelation/India-Mauritius_Relations.pdf.*

(TRC) issued by the Mauritius tax authorities constitutes sufficient proof of residence in Mauritius and entitlement to treaty relief.

This Circular was upheld by the Indian Supreme Court in the landmark *Mauritius Case (Union of India v. Aazadi Bachao Aandolan*[3]*)* where it was held in the absence of a 'limitation of benefits' or anti-abuse clause within the treaty, there was nothing illegal about 'treaty shopping' and legitimate tax planning using low tax jurisdictions. The Supreme Court affirmed the time tested principle laid down by the UK House of Lords in *Duke of Westminster Case*[4] *where it was held* ***"every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be".*** Therefore, based on this judgment and the Circular, any Mauritius based investor with holding a valid TRC should be entitled to treaty relief.

Following this case, a number of cases have confirmed treaty benefits for Mauritius based investors including: *Dynamic India Fund I*[5]*; DDIT v. Saraswati Holdings Corporation*[6]*; E*Trade; In Re:Castleton*[7] *and D.B.Zwirn Mauritius Trading*[8]*.*

Certain proposals in the 2013 Budget, gave rise to doubts on the continued validity of the Circular and availability of relief under the Mauritius treaty. Immediately after the Budget, the Government issued a press release clarifying that the Circular is still valid and that, at the moment, a TRC obtained by a Mauritius company would not be questioned for proof of residence. It is understood that India and Mauritius are in the process of renegotiating the tax treaty and criteria for obtaining relief under the treaty.

3. [2003] 263 ITR 706 (SC).
4. (1936) 19 TC 490, [1936] AC 1.
5. AAR 1016/2010 dated 18th July, 2012.
6. [2009] 111 TTJ 334.
7. [2010] 324 ITR 1 (AAR).
8. [2011] 333 ITR 32 (AAR).

ii. Permanent Establishment (PE) Risks

Mauritius companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Mauritius-India context.

A PE of a Mauritius based entity may be constituted in India if such entity has a 'fixed place of business' in India through which a part or the whole of its business here is carried on. Such fixed place may be constituted through a branch, an office, factory, workshop, warehouses, constructions or place of effective management in India. A PE may also be constituted if a Mauritius resident has a building, construction or assembly project in India for a period exceeding 9 months. In *GIL Mauritius Holdings Ltd. v. ADIT*[9] the Delhi Tribunal held that presence in India for installation of a pipeline may not per se be a PE but would give rise to a PE only if it extends for a period beyond 9 months. A PE may be constituted if a Mauritius entity has a dependent agent in India concluding contracts or maintaining a stock of goods in India for making deliveries on behalf of the foreign enterprise.

The Mumbai tribunal in *DDIT v. B4U International Holdings Limited*[10] held that an Indian entity that did not have the power to conclude contracts on behalf of a Mauritius enterprise would not be treated as a dependent agent. It also held that even if there is a PE, as long as the Indian entity was compensated at arm's length, no further profits could be attributed to the Mauritius based taxpayer.[11]

iii. Taxation of Interest and Royalty

The India-Mauritius treaty reduces the

9. [2012] 348 ITR 491 (Del).
10. [2012] 18 ITR 62 (Mumbai).
11. Based on the decision in *DIT International Taxation Mumbai Vs M/S Morgan Stanley & Co. [2007] 292 ITR 416.*

Indian withholding tax rate on cross-border royalties to 10% from around 27% applicable under domestic law. Royalty is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The definition of royalty is more restricted than under Indian domestic law, which has been recently subject to certain retroactive amendments.

The treaty does not have a specific provision dealing with fees for technical services. Such income would be treated as business profits taxable in India only if the Mauritius enterprise carries on business in India through a fixed base or PE.[12]

There is no relief for withholding tax on interest under the treaty and the domestic rates will apply. The domestic withholding tax rate on interest ranges between 5% (introduced recently for certain specific bonds) to around 42%.

iv. Taxation of Capital Gains

Capital gains (whether long term or short term) earned by a Mauritius resident from the transfer of securities in India would not be subject to tax in India. Under Indian domestic law, capital gains tax can range from around 12% to 42% depending on the period of holding and type of transaction.

The relief from capital gains tax provides significant advantage for Mauritius based funds and other investors. This is particularly beneficial for US investors investing via Mauritius as they are able to avoid double taxation of capital gains income which could have potentially arisen because of conflict in source rules (for capital gains tax) under US and Indian domestic law.

From the Supreme Court decision in *Azadi Bachao Andolan* to the various advance rulings referred to above, Courts have generally held that a Mauritius resident holding a TRC would not be taxable on gains earned from transfer of Indian securities.

There has been some challenge from revenue authorities or entitlement to relief on the basis that the Mauritius entity was not the real beneficial owner of the Indian investments.[13] However, the position of law laid down by the Supreme Court in favor of Mauritius based investors has not changed till date.

One may also note that in the case of Re: Castleton Investments , it was held that although the Mauritius investor may not be liable to capital gains tax, the gains may still be subjected to minimum alternate tax at the rate of 18.5%. It is understood that this matter currently is being examined by the higher Judiciary.

It is expected that the ongoing renegotiation of the Mauritius tax treaty will provide further clarity and certainty as to the circumstances for entitlement of the capital gains tax relief under the treaty.

v. Exchange of Information

The India-Mauritius tax treaty has the older provisions for exchange of information. However recently India and Mauritius are reported to be entering into a specific Tax Information Exchange Agreement containing more elaborate provisions for exchange of information.

12. Spice Telecom v. ITO, (2008) 113 TTJ Bang. 502.

13. Aditya Birla Nuvo Ltd. v. DDIT, [2011] 242 CTR 561.

vi. India-Mauritius Bilateral Investment Promotion and Protection Agreement

Bilateral Investment Promotion and Protection Agreements (BIPAs) are agreements between two States for the reciprocal encouragement, promotion and protection of investments in each other's territories by individuals and companies situated in either State.

The India-Mauritius BIPA is comprehensive and provides several reliefs to investors from Mauritius including fair and equitable treatment, protection against expropriation, repatriability of capital, an efficient dispute resolution framework and other rights and reliefs. Taking advantage of the BIPA is an important strategic reason for investors to invest from Mauritius.[14] It should be noted that India does not have a BIPA with the US and hence, typically US investors investing from Mauritius seek to take advantage of the India-Mauritius BIPA.

14. [2010] 324 ITR 1 (AAR).

Investing into India: Considerations from a Netherlands-India Tax Perspective

I. Netherlands-India Relations: Background

India and Netherlands have historically enjoyed strong commercial ties which have been nurtured by the shared values of democracy, multiculturalism and the rule of law and which have intensified with economic liberalization in India and the recognition of India as an attractive investment destination.

Trade relations between India and Netherlands have continued to remain robust despite the slowdown in the Euro zone economy. In 2011, two-way trade between India and the Netherlands reached Euro 5.287 billion. This increased by 9.45% in the first seven months of 2012. Further, the cumulative FDI inflows into India from the Netherlands in the period between April 2000 and April 2013 have been $9.1 billion. Many well-known Dutch multinationals like Phillips, KLM, Shell and Unilever have established massive operations in India. Likewise, more than 150 Indian companies are based out of the Netherlands, attracted by the stability of the Dutch tax system and the competitive corporate tax rate of 20 – 25%.[1]

A number of bilateral agreements and institutional arrangements have been executed between India and Netherlands. Listed below are some of the important agreements on commercial and economic cooperation:

- India and Netherlands Income and Capital Treaty (1988) which became effective on Income and Capital Tax treaty entered on June 19, 1995 which became effective on January 01 1989 (for the Netherlands) and on April 01, 1989 (for India);

- India and Netherlands Bilateral Investment Promotion and Protection Agreement (1995) which came into force on December 01, 1996;

- Agreement on Social Security between the Kingdom of Netherlands and the Republic of India (2009) which came into force and became effective on December 01, 2011.

1. India-Netherlands Relations, Ministry of External Affairs, Government of India available at: http://www.mea.gov.in/Portal/ForeignRelation/India-Netherlands_Relations.pdf

II. Netherlands-India Tax Treaty: Special Considerations

i. Residency of Partnerships and Hybrid Entities

For a Dutch entity to be entitled to relief under the Netherlands-India tax treaty, it has to be liable to tax in the Netherlands. This may not be an issue for entities such as Dutch BVs, NVs or Cooperatives investing or doing business in India.

In the case of *KSPG Netherlands*[2] it was held that sale of shares of an Indian company by a Dutch holding company to a non-resident would not be taxable in India under the India-Netherlands tax treaty. It was further held that the Dutch entity was a resident of the Netherlands and could not be treated as a conduit that lacked beneficial ownership over the Indian investments. The mere fact that the Dutch holding company was set up by its German parent company did not imply that it was not eligible to benefits under the Netherlands-India tax treaty.

2. [2010] 322 ITR 696 (AAR)

It may be noted that difficulties with respect to treaty relief may be faced in certain situations, especially in the case of general partnerships (VOF) and hybrid entities such as closed limited partnerships, European economic interest groupings (EEIG) and other fiscally transparent entities.

ii. Permanent Establishment (PE) Issues

Dutch companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Netherlands-India context.

A PE may be constituted if a Dutch enterprise has a fixed base, office, branch, factory, workshop, sales outlet, warehouse etc. in India. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 183 days. A dependent agent in India of the Dutch enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders on behalf of the Dutch enterprise.

In the case of *DDIT v Dharti Dredging and Infrastructure Ltd.*[3] the Hyderabad tax Tribunal held that a PE was not constituted where a dredger was leased by a Dutch company to an Indian company and was operated under the direction, control and supervision of the Indian company. In the case of *Van Oord Atlanta B.V. v ADIT,*[4] the Kolkata bench of the Income Tax Appellate Tribunal held that since the Dutch enterprise's dredger was in India for a period much shorter than the 6 month requirement under the Netherlands-India tax treaty, the dredger could not constitute a PE of the Dutch enterprise.

The Protocol to the treaty clarifies that only income that is 'actually attributable' to the activities of a PE shall be considered for the purpose of taxation at source. With respect to contracts for the survey, supply, installation or construction of industrial, commercial or scientific equipment or premises, or of public works, it is clarified that the profits of a PE shall not be determined on the basis of the total amount of the contract, but only on the basis of that part of the contract which is effectively carried out by the PE. Further, no profits shall be attributed to a PE by reason of the facilitation of the conclusion of foreign trade or loan agreements or mere signing there of.

iii. Taxation of Capital Gains

In certain situation, the Netherlands-India treaty provides relief against capital gains tax in India. Normally under Indian domestic law capital gains tax can range between 10% to around 42% depending on the period of holding and type of transaction.

Gains arising to a Dutch resident arising from the sale of shares of an Indian company to non-resident buyer would not be taxable in India. Such gains would be taxable if the Dutch resident holds more than 10% of the shares of the Indian company and a sale is made to a resident of India.

The gains however would not be taxable in India if they arise in the course of a corporate organisation, reorganization, amalgamation, division or similar transaction and the buyer or seller owns at least 10% of the capital of the other.

In Re: *VNU International B.V.,*[5] the Authority for Advanced Rulings held that where a Dutch company transfers its holding in an Indian

3. (2010) 46 DTR 1.
4. (2007) 112 TTJ 229.
5. [2011] 334 ITR 56 (AAR)

company to a non-resident, the transaction would be eligible for relief against capital gains tax under the tax treaty but the Dutch company would still be required to file a tax return in India.

The case of *Vodafone International Holdings B.V. v Union of India,*[6] dealt with the acquisition of a Cayman Island based entity from a Cayman based seller by a Dutch subsidiary of Vodafone. The target entity held various subsidiaries which ultimately held an operating company in India. The Supreme Court of India held that Indian tax authorities did not have the jurisdiction to tax a sale of shares in a Cayman Islands company by a non-resident and hence the Dutch entity was not required to withhold tax on the purchase consideration.

iv. Taxation of Interest, Royalty and Fees for Technical Services

Interest, royalties and FTS arising in India and paid to a Dutch resident may be subject to a lower withholding tax of 10% under the Netherlands-India tax treaty. This is a significant relief from the withholding under Indian domestic law which can be as high as 42% for interest and around 27% for royalties and FTS.

Interest covers income from debt-claims of every kind. Royalties is defined to mean consideration for the use of or the right to use any copyright of literary, artistic or scientific work, including motion picture films or works on films or videotapes for use in connection with television, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

6. (2012) 6 SCC 757.

The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments. It also does not cover payment for use of equipment unlike in several tax treaties. On this basis, in *Nederlandsche Overzee Baggermaatschappij BV*[7], the Mumbai Tribunal held that payment to a Dutch firm for use of certain dredging equipment on dry lease was held not to be in the nature of taxable royalties.

The definition of FTS in the treaty is also more restricted than the definition under Indian domestic law. Under the treaty, FTS only covers payments for services that are ancillary to license that may give rise to royalties, or if the service involves making available or transfer of knowledge, skill, know how or a technical plan or design. If there is no such technology or knowledge transfer, the fees may not be taxable unless the Dutch resident has a PE in India.

In the case of Re: *Shell Technology India,*[8] the Authority for Advance Ruling held that payment for support services rendered by a Dutch affiliate to an Indian company did not qualify as taxable fees for technical services under the treaty since the services did not make available any technical knowledge or skill. Likewise in *De Beers India Minerals*[9] the Karnataka High Court held that fees paid to a Dutch service provider for conducting geophysical surveys could not be taxed as fees for technical services in the absence of knowledge transfer.

The India-Netherlands treaty also has a most favoured nation requirement providing that if India (post 1989) enters into a treaty with an OECD member country which provides lower scope of taxation of dividends, interest, royalties or FTS, then the same relief may be

7. [2010] 39 SOT 556
8. 246 CTR 158.
9. [2012] 346 ITR 467 (Kar)

available under the India-Netherlands tax treaty.

v. Exchange of Information

The Netherlands - India tax treaty was amended in 2012 to provide a more comprehensive framework for exchange of information between the two countries.

The amended provisions clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

Investing into India: Considerations from a Singapore-India Tax Perspective

I. Singapore-India Relations: Background

Building on their centuries-old historical and cultural linkages, Singapore and India have, over the years, developed a very strong strategic partnership, which covers a whole gamut of areas of co-operation including trade, tourism, security and defence. Singapore is an important partner for India, owing to its strategic location, stable government, competitive work-force and a pro-business environment. It is ranked #1 in World Bank's ease of doing business index. Singapore has a mature and developed financial market with an important stock exchange to facilitate the raising of capital and improve stock liquidity. Singapore also has good connectivity to the rest of Asia, Europe and the United States, thereby making it very convenient for prospective clients to invest there. Several multinational corporations including Indian companies are actively considering setting up regional or international headquarters in Singapore.

Singapore has always been an important strategic trading post, giving India trade access to the Malay Archipelago and the Far East. For India, Singapore has also played an important role with respect to India's "Look East" Policy for expanding its economic, cultural and strategic ties in Southeast Asia.

FDI of around USD 97.214 billion has been received from Singapore from April 2000 to April 2013, making it the second largest investor in India after Mauritius accounting for 11% of total FDI received by India.[1] The investments from India to Singapore have been equally forthcoming.[2] Singapore has become a preferred centre of operations for Indian companies active in the Asia Pacific region. Thanks to its enabling environment, access to low cost finance, strong air connectivity, availability of skilled resources and the presence of a large Indian community, Singapore has emerged as a key offshore logistics and financial hub for many Indian corporate/houses.

In 2005, India and Singapore signed the Comprehensive Economic Cooperation Agreement (CECA) to promote trade, economic development and partnerships which integrates agreements on trade in goods and services, investment protection, and economic cooperation in fields like education, intellectual property and science & technology.

The CECA eliminated tariff barriers, double taxation, duplicate processes and regulations and provided unhindered access and collaboration between the financial institutions of Singapore and India.

A number of bilateral agreements and institutional arrangements have been executed between Singapore and India. Listed below are some of the key agreements:

- Establishment of Diplomatic Relations (1965);
- Bilateral Air Services Agreement (1968);
- Defence Cooperation Agreement (2003);

1. http://dipp.nic.in/English/Publications/FDI_Statistics/2013/india_FDI_January2013.pdf

2. http://www.hcisingapore.gov.in/business/investment/

India and Singapore are poised to see enhanced economic cooperation as well as an increase in trade and investment flows.

II. Singapore-India Tax Treaty: Special Considerations

i. Residency of Partnerships and Hybrid Entities

Tax treaty relief may only be claimed by persons who are residents in accordance with the taxation laws of India or Singapore, as the case may be. Singapore based limited liability partnerships (LLPs) may face difficulties in claiming treaty relief in view of the *Schellenberg Wittmer*[3] case wherein a Swiss general partnership was held not to be entitled to treaty benefits since it is a fiscally transparent entity and Swiss resident partners of the partnership could also not take advantage of the treaty since they were not direct recipients of the income. Although these entities are body corporates, and may be viewed as a company from an Indian tax perspective, they are not liable to taxation as they are fiscally transparent entities where the income is taxed at level of the partners of the LLP. The treaty in this regard needs to be revised.

ii. Permanent Establishment (PE) Risks

Singapore residents having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Singapore India context.

A PE may be constituted if a Singapore based enterprise has a fixed base, office, branch, factory, workshop, etc. in India. The enterprise is deemed to have a PE in India if it has an installation or structure which is used for the extraction or exploitation of natural resources in India and such installation or structure is used for more than 120 days in a fiscal year. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 183 days in a fiscal year. A Singapore enterprise shall also be deemed to have a PE in India if it provides services or facilities in relation to exploration, exploitation or extraction of mineral oils in India for a period of more than 183 days in a fiscal year.

The Singapore treaty is also one of the few tax treaties signed by India which have a service PE clause. A service PE may be constituted if a Singapore enterprise provides services through its employees who spend more than 90 days in India in any fiscal year (or 30 days if the services are provided to a related enterprise).

A dependent agent in India of the Singapore enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders wholly or almost wholly on behalf of the Singapore enterprise.

The Delhi High Court in *Rolls Royce Singapore Pvt. Ltd. v. ADIT*[4] held that a sales agent in India providing services to a Singapore company would be treated as giving rise to a dependent agent PE in India. The Court noted that the Indian entity was prohibited from promoting products of competitors, and that the Singapore company exercised extensive control over the Indian entity whose activities were wholly or almost wholly devoted to the Singapore company. However, the Court also accepted the established principle that if the agent is compensated the agent (PE) at arm's length, there can be no further attribution of taxable income. In *WSA Shipping (Bombay) Pvt Ltd. v. ADIT*[5] the Mumbai Tribunal held

3. [2012] 210 TAXMAN 319 (AAR).

4. [2012] 347 ITR 192 (Delhi)
5. [2012] 53 SOT 306 (Mum)

that an Indian service provider which acted on behalf of a Singapore company could not be treated as an agency PE in India since the Indian entity was an independent agent that provided services to multiple clients.

iii. Exemption for Capital Gains Tax on Sale of Shares

Gains arising to a Singapore resident from the sale of shares of an Indian company would be taxable in Singapore. However, in this context, it is essential to note that the capital gains tax benefit available under the Singapore India tax treaty may be denied if the Singapore resident does not satisfy conditions laid down under the Limitation of Benefits (LoB) clause in the treaty. As per the LoB clause (contained in Article 3 of the Singapore India treaty protocol), a Singapore resident will be entitled to the capital gains tax exemption on sale of shares of an Indian company only if the following criteria is satisfied:

- *Purpose not to be primarily tax driven* (Article 3.1 of Singapore India treaty protocol): The affairs of the Singapore enterprise are not arranged with the primary purpose of taking benefit of the capital gains tax relief.

- *The Singapore resident is not a shell or conduit* (Article 3.2-3.4 of Singapore treaty protocol): A shell / conduit entity is one with negligible or nil business operations or with no real and continuous business activities carried out in Singapore.

A Singapore resident is deemed not to be a shell or conduit if its annual operational expenditure in Singapore is at least SGD 200,000 per year in the two years preceding the transfer of shares giving rise to capital gains.

The Singapore India treaty protocol is a broad anti-avoidance provision within the treaty itself. A Singapore entity will not be entitled to the capital gains tax relief if its affairs are arranged with the primary purpose of taking benefit of such relief. If this is the case, the benefit may be denied even if the Singapore entity incurs annual operational expenditure of SGD 200,000.

The Singapore treaty protocol also clarifies that the capital gains tax exemption shall be applicable only to the extent a similar exemption continues to be available under the Mauritius-India tax treaty.

vi. Taxation of Royalty and Fees for Technical Services (FTS)

Interest, royalties and FTS arising in India and paid to a Singapore resident may be taxed in Singapore. However, if the Singapore resident is the beneficial owner of the royalties or FTS, the tax so charged shall not exceed 10% of the gross amount that is paid. The domestic withholding tax rate on royalty and FTS can be as high as around 27%.

Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information or for the use of, or the right to use, any industrial, commercial or scientific equipment, other than payments derived by an enterprise from (i) the incidental lease of ships or aircraft used in such transportation; or (ii) the use, maintenance or rental or containers (including trailers and related equipment for the transport of containers) in connection with such transportation. The definition of royalty is more restricted than under Indian domestic law which has been recently subject to certain retroactive amendments.

The Mumbai Tribunal in *Standard Chartered Bank v. DCIT*[6] held that payment for data processing services provided by a Singapore based company cannot be treated as taxable royalty income since the Indian client did not have possession or control over the mainframe computer in Singapore and could only transmit the data and receive back processed information from the server. This case may be contrasted with In Re: Cargo Community Network Pte. Ltd.[7] where it was held that payment to a Singapore based service provider for access to an internet based air cargo portal would be characterized as taxable royalty payments.

The scope of FTS in the Singapore treaty is more restrictive than most treaties signed by India. FTS refers to payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel if such services :

a. are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment is in the nature of royalties ; or

b. make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein ; or

c. consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein.

The case of *Bharati AXA General Insurance Co.Ltd v. Director of Income Tax*[8] dealt with the taxability of payments made by an Indian entity for support services provided by a Singapore company, which included strategic advice, marketing support, IT services, choosing re-insurance partners, review of actuarial methodologies, etc. in line with the global practices. The Authority of Advance Ruling (AAR) held that such payments are not FTS as the services do not "make available" available any technical knowledge, know-how or skill to the Indian company. However, in *Organisation Development Pte. Ltd. v. DDIT*[9], the Chennai Tribunal held that payments made to a a Singapore based service provider for license to a specialized software to enable management based on 'balanced score card' techniques and transfer of knowledge and skill would be treated as fees for technical services subject to withholding tax in India.

v. Exchange of Information

The Singapore India tax treaty was amended in 2011 to strengthen the exchange of information framework in line with internationally prescribed norms.

The amended treaty clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person. However, there are safeguards in relation to supply of information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

---

6. 2011 TPI 728 (ITAT-Mumbai)
7. [2007] 289 ITR 355 (AAR)
8. (2010) 326 ITR 477 (AAR)
9. [2012] 50 SOT 421 (Chen)

Investing into India: Considerations from a Swiss-India Tax Perspective

I. Swiss-India Relations: Background

India's traditional policy of non-alignment and the Swiss policy of neutrality, coupled with shared values of democracy and rule of law have forged close ties between the two countries. Swiss-India economic relationship dates back to the 1850s, when Volkart Trading Co set up offices in Basel and Bombay. Since then, there has been a continuous rise in trade and investment flow between the two countries.

Foreign direct investment (FDI) from Switzerland into India is estimated to be in excess of USD 5 billion. In around 5 years (2007-2012) trade between the two countries tripled from around USD 10 billion to USD 34 billion. Popular sectors of economic cooperation between India and Switzerland include banking & finance, biotechnology, education, clean-tech, infrastructure, research & development, science & technology, engineering, precision instruments, entertainment, tourism and others.

A number of bilateral agreements and institutional arrangements have been executed between India and Switzerland including:

- Swiss-India Joint Economic Commission (1959)
- Swiss-India Collaboration in Biotechnology (1974)
- Agreement for Avoidance of Double Taxation (1994, amended in 2012)
- Agreement for Promotion and Protection of Investments (1997)
- Agreement on Social Security (2009)
- Swiss-India Joint Committee on Science & Technology (2011)
- Swiss-India Financial Dialogue (2011)
- MoU on Mutual Cooperation in Local Governance (2011)
- MoU for Development Cooperation (2011)

India and Switzerland are poised to see enhanced economic cooperation as well as an increase in trade and investment flows.

II. Swiss-India Tax Treaty: Special Considerations

i. Residency of Partnerships and Hybrid Entities

Difficulties may arise when treaty benefits are claimed by partnerships and hybrid entities. Benefits under the Swiss-India tax treaty are available to **residents liable to tax** in Switzerland.

In *Schellenberg Wittmer*[1], a Swiss general partnership was held not to be entitled to treaty benefits since it is a fiscally transparent entity. It was further held that the Swiss resident partners of the partnership could also not take advantage of the treaty since they were not direct recipients of the income. In contrast, the Bombay High Court confirmed that a German partnership (*DIT v. Chiron Bhering*[2]) should be eligible for German-India treaty benefits since the partnership (though

1. [2012] 210 TAXMAN 319 (AAR).
2. TS-12-HC-2013 (BOM).

fiscally transparent) was subject to a German trade tax, which was listed as a covered tax under the treaty.

By virtue of a Protocol to the Swiss-India treaty (effective from April 1, 2012), Swiss pension funds or schemes would be treated as residents entitled to treaty benefits even if they are generally exempt from tax in Switzerland. This specific clarification provides some relief, considering that in the US-India context, a US pension fund (in the case of *Re: General Electric Pension Trust*[3]) was held not to be entitled to treaty benefits.[4]

ii. Permanent Establishment (PE) Risks

Swiss companies having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Swiss-India context.

In addition to the standard PE threshold in most treaties (eg: fixed base, office, branch, construction site), the Swiss-India treaty also has a **service PE** clause. A service PE may be constituted if services are provided by the Swiss enterprise's employees who spend more than 90 days (in a 12 month period) in India or 30 days if the services are provided to a related enterprise in India.

A dependent agent in India of the Swiss enterprise that negotiates and concludes contracts on its behalf would be treated as a PE. Unlike in most Indian treaties, an agent in India which manufactures or processes goods belonging to the Swiss enterprise would also be treated as a PE. This could create tax exposure for enterprises having contract research and manufacturing arrangements in India.

3. (2006)200CTR(AAR)121.
4. Although the US-India treaty unlike most treaties recognizes trusts, in this case it was not possible to establish that all beneficiaries of the trust (policy holders) were resident in the US.

In eBay International *AG v. ADIT*[5]*,* the Tax Tribunal held that Indian company which entered into an exclusive marketing services arrangement with its Swiss parent should not be viewed as a PE. The Tribunal also held that fees received by the Swiss entity from Indian customers who used the online e-commerce platform is not in the nature of technical service fees and hence, not taxable in India in the absence of a PE.

iii. Lower Withholding Tax Rate not Available to 'Conduits'

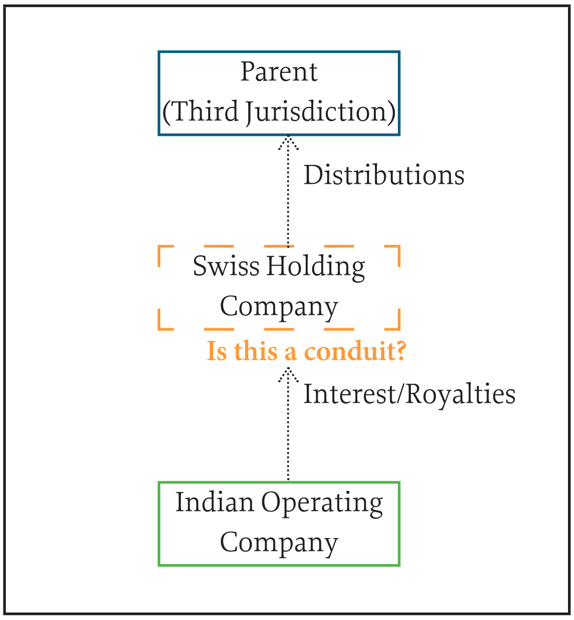
The Swiss-India tax treaty provides some relief for financing arrangements, IP licensing and technology collaborations. Swiss residents should be able to take advantage of the **lower withholding tax rate of 10% for interest, royalties and technical service fees** available under the tax treaty. Ordinarily, India's domestic withholding tax rate on interest can be as high as around 40% and around 25% for fees for technical services and royalty.[6]

The lower withholding tax rate is available only to Swiss residents that are **beneficial owners** of interest, royalties or technical service fees. Such relief would therefore not be available to **conduit companies** in Switzerland.

The Protocol to the Swiss-India tax treaty defines '**conduit arrangement**' as one where the Swiss resident *"pays, directly or indirectly, all or substantially all"* of its income *"at any time or in any form"* to another person who is resident in a third State, and where the main purpose of the structure was to take advantage of the lower withholding tax rate.

Since the treaty relief is critical in light of the higher domestic withholding tax rates, it is important to consider the 'conduit' limitation while setting up Swiss structures.

5. [2013] 140 ITD 20 (Mum).
6. All domestic tax rates specified herein are exclusive of applicable education cess and surcharge.



iv. Taxation of Capital Gains

Gains arising to a Swiss resident from the sale of shares of an Indian company would be taxable in India. The treaty does not provide any relief in this regard.

Capital gains are categorized as short term and long term depending upon the time for which they are held. Gains from shares which are held for a period of more than twelve months are categorized as long term. If the holding period is lesser than 12 months, then it is in the nature of short term gains. Long term capital gains arising out sale of listed shares on the stock exchange are tax exempt (but subject to a nominal securities transaction tax). Long term gains arising from the sale of unlisted shares are taxed at the rate of 20% (or 10% in certain cases). Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares is 40%.

Transfer of shares of an Indian company in the course of a merger between 2 non-resident enterprises should not be taxable in India subject to certain conditions being satisfied. In *Credit Suisse (International) Holding AG v. DIT*[7], the Authority for Advance Rulings held that merger of a Swiss company (having an Indian subsidiary) into its Swiss parent could not be taxable in India on the basis that the merger was sanctioned under Swiss law, the transferor ceased to exist and no gains arose from the merger.

v. Exchange of Information

The Swiss-India tax treaty was amended in 2011 to strengthen the exchange of information framework in line with internationally prescribed norms.

The amended treaty clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

The 2011 Protocol adds some safeguards by clarifying that 'fishing expeditions' would not be permitted and hence complete details including identity of the person and nature of information and purpose should be provided. It also clarifies that the provisions do not envisage automatic or spontaneous exchange of information. Interestingly, the exchange of information clause also recognizes the administrative rules regarding taxpayer's rights before any information is transmitted.

7. [2012] 349 ITR 161 (AAR).

Investing into India: Considerations from a India-UK Tax Perspective

I. UK - India Relations: BackGround

Bilateral relations between the UK and India, "the world's oldest and the world's largest democracies"[1] have shaped up significantly in not just commercial or trade relations but also in social and cultural ties owing to the shared colonial past. It would be difficult to outline here the numerous historical records that underscore the importance of India-UK bilateral relations. To avoid reaching too far back into the past, we may reset the clock to September 2004, when a joint declaration titled 'India-UK: towards a new and dynamic partnership' was signed. This envisaged annual summits and regular meetings between Foreign Ministers and identified certain areas for future cooperation, such as civil nuclear energy, space, defence, combating terrorism, economic ties, science & technology, education and culture.[2]

Bilateral trade grew in 2008-09 by 7.4% to $12.5 billion. In the year 2009-10 total trade declined by 14.68 % as a result of financial / economic crisis, but in 2010 volume of US$ 12.5 billion (+17.36% growth) was registered. In the first two quarters of year 2012-2013 trade of 7.4 billion was registered. Although trade has increased in absolute terms, there has been a gradual decrease in UK's share in India's global bilateral trade, both in exports and imports during the last five years.[3] The recent visits by British Prime Minister Cameron and Indian Finance Minister Chidambaram have underscored the continuing importance of India-UK ties with both nations keen to reach a shared goal of doubling bilateral trade by 2015.

UK contributes 9% of the total FDI into India. The FDI inflow during 2010-11 was US$ 2.7 billion. However, the FDI inflow from UK registered a record US$ 7.87 billion during the year of 2011-12. The cumulative FDI inflows from UK into India in the period from April 2000 to April 2013 have been US$17,558 million, making it 3rd largest investor in India since then. For the financial year 2012-13 investment of US$ 615 million has been registered in first three quarters.[4]

India-UK ties have been strengthened through the execution of a number of agreements and establishment of institutions, such as:

- The India-UK Joint Economic and Trade Committee (JETCO); and
- The UK-India Business Council (UKIBC);
- Bilateral Investment Protection Agreement
- Civil Nuclear Co-operation Declaration
- MOUs for collaboration in Chemical Biological, Radiological and Nuclear Defence; on Skills and Development; collaboration in Community Colleges and School Leadership Programmes[5]
- India-UK Double Taxation Avoidance Agreement ("**India-UK tax treaty**") recently amended as to significant aspects by

---

1. http://articles.economictimes.indiatimes.com/2013-08-14/news/41410130_1_great-indian-pm-david-cameron-golden-temple
2. http://www.mea.gov.in/Portal/ForeignRelation/United-Kingdom-February-2012.pdf
3. Data in this paragraph has been sourced from http://www.ficci.com/international.asp?cdid=54525
4. Data in this paragraph has been sourced from 'Cumulative FDI inflows in India since April 2000,' available at: http://dipp.nic.in/English/Publications/FDI_Statistics/2013/india_FDI_April2013.pdf
5. http://www.hcilondon.in/indiaukbilateral.html

an amending protocol concluded on 30 October 2012 (“**Protocol**”);

- India-UK Inheritance Tax Treaty[6]

II. India-UK DTAA: Special Considerations

i. Residence of Partnerships, Estates and Trusts

Tax treaty relief may only be claimed by persons who are residents of either India or the UK (or both) in accordance with the taxation laws of the respective countries. Until recently, the India-UK DTAA specifically excluded certain partnerships from the definition of a person (and consequently from being a resident) under the treaty. Only such partnerships which were treated as a taxable unit under the Indian Income Tax Act, 1961 were included within the term ‘person’. Unlike India, in the UK, partnerships are considered fiscally transparent and the income of the partnership is directly taxed in the hands of its partners. Consequently, a UK partnership earning Indian-sourced income was ineligible to claim tax treaty relief.

However, in *Linklaters LLP vs. ITO*[7] and *Clifford Chance vs. DCIT*[8] it was held that a UK partnership was eligible to claim benefits of the tax treaty.[9] While the cases do not analyze the issue of residence of partnerships, the recent Protocol settles the uncertainty by clearly specifying provisions for taxation of partnerships (along similar lines as in the India-US tax treaty).

The protocol provides that the definition of person be amended to include *“...a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force”* of India and the UK. Further, the term ‘resident of a Contracting State’ has been amended to provide that for entities such as a partnership, estate or trust, the term ‘resident of a contracting State’ applies only to the extent that the income derived by such entity is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries. The amending protocol has also deleted Article 25 (*Partnerships*) of the India-UK tax treaty which addressed the issue of eligibility to tax credits by Indian partnerships.

As regards trusts and estates, prior to the Protocol, such entities were ineligible to claim tax treaty relief unless they were considered separate taxable entities. Following the Protocol, income of a trust or an estate to the extent taxable in the hands of resident beneficiaries would be eligible to benefit from tax treaty relief.

The UK treaty is one of the few treaties signed by India (along with the US treaty) which specially recognizes partnerships and trusts. This provides significant relief to UK firms doing business in India. However, challenges may still arise if a UK based partnership admits partners who are residents of a third country. Treaty relief may not be available to this extent.

ii. Permanent Establishment (PE) Issues

In general, business profits of an enterprise are taxable only in its state of residence unless it

---

6. Please note that the inheritance tax treaty has not been examined in detail here since India does not currently impose inheritance tax. However, there has been discussion in the ruling political circles to re-introduce estate duty in India (in some form). If that were to become a reality the provisions of this treaty would then assume significance.
7. (132 TTJ 20)
8. (82 ITD 106)
9. In *Linklaters LLP,* the tax tribunal extended the benefits under the treaty to a UK Limited Liability Partnership (‘LLP’) and observed that where a partnership is taxable in respect of its profits in the hands of partners, as long as the entire income of the partnership firm is taxed in the country of residence (i.e. UK), treaty benefits could not be denied. In *Clifford Chance,* the tax tribunal granted benefits of the treaty to a UK partnership firm comprising lawyers but the issue whether a partnership was entitled to treaty benefits was not discussed at length.

earns such income through a PE in the source state. Thus, a UK entity earning business profits from India would be taxable in India only if such profits are earned through a PE in India. The India-UK tax treaty provides for a PE by way of a fixed place of business, a dependent agent in India entering into contracts or securing orders on behalf of the UK entity or a PE by way of an installation or an assembly project or due to the provision of services beyond a specified number of days.

In *Airlines Rotables Limited, UK v. Joint Director of Income Tax*[10], the Mumbai Tribunal observed that in order to constitute a fixed PE under Article 5(1), three conditions needed to be satisfied: physical criterion, i.e. existence of physical location; subjective criterion, i.e. right to use that place; and function criterion, i.e. carrying out business from that place. The Tribunal further held that the onus was on the tax authorities to show that the taxpayer had a PE in India.

In *Rolls Royce Plc v. Director of Income Tax*[11] the Delhi High Court (affirming a ruling of the Delhi Tribunal)[12] held that the Indian entity was not merely a post office as argued by the taxpayer but it was a PE for the following reasons:

i. it was a fixed place of business[13] in India at the disposal of the UK entity and group companies through which their business was carried on;

ii. the activity of that place was not preparatory or auxiliary. Instead it was a core activity of marketing, negotiating, selling of the product and the court called it a "virtual extension/projection of its customer facing business unit, who has the responsibility to sell the products belonging to the group";

iii. The Indian entity acted almost like a sales office of the UK entity and its group companies.

iv. Not only did the Indian entity and its employees work wholly and exclusively for the UK entity and the group, they also solicited and received orders wholly and exclusively on behalf of these entities.

v. Group employees were present in various locations in India and they reported to the Director of the Indian entity in India.

Like the 'fixed place of business' PE, an agency PE clause is also commonplace in treaties. In general, a source State considers that a PE is constituted by the offshore enterprise's dependent agent who has authority to habitually conclude contracts or secure orders on behalf of the offshore enterprise in the source State. Article 5(4) of the India-UK tax treaty provides, among others, that an agency PE may arise if the dependent agent has, and habitually exercises in the source State an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.[14] An exchange of notes in 1993 between the UK and Indian Government authorities has clarified the method of income attribution for an agency PE. This is discussed further below.

In contrast to the above PE clauses, the service PE clause is found in very few tax treaties

10. [2011]44SOT368(Mum)
11. [2011]339ITR147(Delhi),
12. (2008) 113 TTJ Delhi 446
13. The Tribunal in its decision had observed that " 'place of business' covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not exclusively used for that purpose. A "place of business" can also exist where no premises are available or are required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is not relevant whether the premises, facilities or installations are owned or rented by or is otherwise at the disposal of the concerned enterprise."

14. Please note the actual text is in greater detail and for that reason has not been reproduced here. The summary principle described here and the clarification given by the exchange of notes must be read against the backdrop of the actual text of the provision.

and was given impetus by the UN Model Convention. The OECD Model Convention does not have a specific provision for a service PE. A service PE is created when the foreign entity deputes its employees to India to perform services on its behalf and those activities are performed in the source State for a number of days (usually prescribed in the relevant treaty).

Under Article 5(2)(k) of the India-UK tax treaty, provision of services (including managerial services) within the source State by the employees or other personnel of the offshore enterprise will amount to a service PE only if activities are performed for a period aggregating more than 90 days within any twelve-month period.

However, the service PE provision provides for a different rule when the offshore entity deputes employees to an associated enterprise. In such a case, the day count is reduced to a period aggregating more than 30 days in a twelve-month period. This day count threshold, similar to the India-Singapore treaty, is liberal compared to the India-US tax treaty (which is triggered immediately). Most service PE clauses also exclude specified types of services. The India-UK tax treaty excludes services where consideration is taxable as royalty or fees for technical services under the separate provision applicable to such consideration.

In *Linklaters LLP, UK v. ITO,*[15] a dispute on whether legal services provided by a UK law firm employees for an Indian project gave rise to a service PE, the Mumbai Tribunal rejected the contentions of the taxpayer that: (i) in order for a PE to arise under Article 5(2) of the treaty, the basic condition of Article 5(1) (i.e. existence of a fixed place of business) must first be satisfied; and (ii) that Article 5(2) merely provided an illustrative list which could only be applied if there was a fixed place of business.

15. (2010) 132 TTJ 20

The Tribunal held that while some of the items listed under Article 5(2) were illustrative of Article 5(1), the others, notably a PE due to building site or construction installation under Article 5(2)(j) or a service PE under Article 5(2)(k) were on a stand-alone basis, and they did not require a fixed place of business to exist for a PE to be created, provided the threshold time period prescribed was met.

Article 5(2)(j) of the India-UK tax treaty refers to another PE form, the 'installation PE'. This Article provides that a PE would include a building site or construction, installation or assembly project or connected supervisory activities, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10% of the sale price of the machinery and equipment. The 1993 exchange of notes provided further clarity on the factors to be considered for determining when an installation/assembly project would come into existence. It has been clarified that that for the purpose of determining whether the site, project, activity etc. has continued for a period of more than six months, the source State shall not take into account time previously spent by employees of the enterprise on other sites or projects which have no connection with the site or project in question. Further the 'more than six months test' must be applied separately based on whether other sites or projects are connected or not. That is to say, the test must be applied separately to each site or project which has no connection with any other site or project and to each group of connected sites or projects.

Article 7 of the India-UK tax treaty provides that if the enterprise carries on business through a PE, the profits of the enterprise may be taxed in the source State but only so much of them as is directly or indirectly attributable to that PE. In general, only as much income as is attributable to the activities carried out by that PE should be taxable in the source State. Indian Revenue authorities have taken the view that the term 'indirectly attributable' is understood as embodying the 'force of attraction' principle, that is to say, where the foreign enterprise provides goods or services directly to customers in the source State and its PE in that State is also in the same line of business, then the source State can tax the entire profits that the foreign enterprise derives there regardless of whether the PE had a role in carrying out the profit-generating transactions. This view was affirmed by a decision of an Mumbai Tribunal in *Linklaters LLP v ITO.*[16] The Tribunal held that relying on Article 7(1) of the UN Model Convention commentary on this issue, a view could be taken that the connotation of "profits indirectly attributable to permanent establishments" extended to incorporation of the 'force of attraction' rule being embedded in Article 7(1).[17]

In the June 2013 decision of *ADIT v Clifford Chance,*[18] the Mumbai Tribunal[19] has been held that the India-UK tax treaty does not embody the force of attraction principle. In this dispute, Indian Revenue authorities sought to tax the entire legal fee received by a UK LLP for legal services rendered from within and outside India for the reason that these legal services were in relation to a project being carried out in India. The Tribunal (a Special Bench whose decision would be binding on all other Tribunals) held that the language of the UK-India tax treaty was very clear in its import. There was no necessity to therefore relate the provision to Article 7(1) of the UN Model Convention to understand it as authorizing attribution by way of 'force of attraction'.

While the decision of the Special Bench would provide clarity on this aspect, the Indian Revenue authorities still have the scope to obtain a favorable judgment in appeal. Considering that India has recently amended treaties with some other nations to remove the force of attraction principle from those treaties, it might be helpful to carry through this change to the India-UK treaty as well for the sake of complete clarity on this issue.

In relation to income attribution for agency PEs, Article 7(3) of the India-UK tax treaty provides that where a permanent establishment takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, regardless of the fact that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the PE to those transactions bears to that of the enterprise as a whole shall be treated as being the profits indirectly attributable to that permanent establishment. In this context, the 1993 exchange of notes has clarified that in applying Article 7(3), for the purpose of determining whether a PE has taken such an active part, the States must take into consideration all relevant circumstances. In particular, the fact that a contract or order contract or order relating to the purchase or provision of goods or services was negotiated or placed with the head office of the enterprise, rather than with the PE, should not preclude the States from determining that the PE did take an active part in negotiating, concluding or fulfilling that contract

---

16. [2010] 40 SOT 51 (Mum).
17. A Miscellaneous Application by the aggrieved taxpayer requesting a re-look of the decision on this ground was rejected, Linklaters & Pines v ITO 56 SOT 116 (Mum).
18. [2013] 33 taxmann.com 200 (Mumbai - Trib.) (SB)
19. The Tribunal also relied on a decision of the Bombay High Court in a previous case involving the same tax-payer whose decision was made ineffective following a legislative amendment. The Bombay High Court had held that, to be taxable, services had to be rendered within India. This decision led to a retrospective amendment in the tax legislation which brought within the tax net even those services rendered from outside India.

iii. Fee for Technical Services (FTS)

The scope of taxation of FTS is more restricted than under Indian domestic law. The India-UK tax treaty defines FTS to mean payments of any kind in consideration for the rendering of any technical or consultancy services which are ancillary and subsidiary to the application or enjoyment of the right, property or information related to royalty; make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

The interpretation of 'make available' has a been a source of dispute. In a recent Tribunal ruling, *ITO v Veeda Clinical Research Pvt. Ltd.*[20] the Tribunal has upheld the principle that 'make available' requires that the services must enable the recipient of the service to be able to apply the technology directly without further assistance. In this matter, Indian Revenue authorities sought to bring to tax payments made by an Indian company to a UK Company for provision of 'in-house training of IT Staff and medical staff' and 'market awareness training'. The Revenue argued these were taxable since services were made accessible to recipients for a fee and that it would be absurd to keep the 'make available' standard such that a service provider would have to make the recipient an expert in its own area of core competence. If that would be the case, then the expert would be rendered redundant once training was imparted. The Tribunal rejected this contention, relied on previous High Court decisions[21] to hold that general training services would not result in transfer of technology. There must be a transfer such that the recipient is enabled to apply the technology itself.

20. ITA No.1406/Ahd/2009,taxsutra.com. Order pronounced on 28 June 2013.
21. CIT v. De Beers India Minerals (P.) Ltd (2012) 346 ITR 467 (Kar.). and CIT v. Guy Carpenter & Co Ltd. (2012) 346 ITR 504 (Del.).

iv. Limitation of Benefits

The Protocol has also introduced a Limitations of Benefits (LoB) clause. Treaty benefits may be denied if the main purpose or one of the main purposes of the creation or existence of such a resident or of the transaction undertaken by the resident, was to obtain benefits under the tax treaty. Unlike the India-Singapore or the India-US tax treaties, the LoB provision in this tax treaty does not go into further details. It would be pertinent to note that both the UK and India provide for a General Anti-Avoidance Rule (GAAR) in their domestic tax regimes. While the UK GAAR has become operational, the Indian GAAR is intended to take effect only from 1 April. 2016.

v. Enhanced Measures to Tackle Evasion

The Protocol also provides for a more robust clause on Exchange of Information and introduces two new clauses on Tax Examinations Abroad and Assistance in Collection of Taxes. It proposes to expand the scope of the provision on exchange of information currently existing in the treaty. The existing Article provides that a request for exchanging information would be entertained where 'necessary for carrying out the provisions of this Convention or of the domestic laws'. The Protocol extends the scope of the Article by allowing a request for the exchange of information which is 'foreseeably relevant' for carrying out the provisions of this Convention or of the domestic laws'.

The Article does not oblige the State to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or such information whose disclosure would be contrary to public policy. However, the Article further clarifies that a State could not refuse to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

The other two provisions were introduced with the aim of supporting the information gathering process thereby making tax collection effective. Subject to prescribed procedural safeguards being followed, representatives of the competent authority of the respective states are permitted to enter the other state's territory to interview persons and examine records. The respective competent authorities have been empowered to assist in the collection of revenue claims, i.e. amount owed in taxes, as per the mode of application which is mutually agreed between the authorities. Measures of conservancy including an interim measure of asset freezing has been provided for.

Investing into India: Considerations from a US-India Tax Perspective

I. US - India Relations: Background

The inception of market-oriented reforms in India has marked a new phase in the relationship between India and the United States of America ("**US**"). With the impending shifting of political and economic polarity in the globe to the Asian region, economic and strategic alliances between India and the US are stronger than ever before. Accelerating trade and exchange in technology and investment coupled with improved collaboration in the fields of energy, national security and environmental protection have laid down the foundations in this growing relationship.

India's flourishing market comprising of a highly educated and skilled populous has resulted in several US companies investing in the country. As per data collected by the Department of Industrial Policy and Promotion of the Government of India, cumulative Foreign Direct Investment ("**FDI**") into India from the US from April, 2000 to April, 2013 amounts to around USD 11 billion which would approximately be 5.7% of total FDI inflows into India. Moreover, the progressive rationalization of the investment regime in India has resulted in more comfort for US players to set up shop in India. Currently, India has become a market that is indispensable to the business plans of any multi-national corporation based in the US.

India's trade relations with the US have seen substantial improvement in the past decade as well. As reported by the Indian embassy in the US, bilateral trade between the two nations has as of 2012 was close to USD 63 billion, representing more than a 1000% increase post-liberalization in India.

In lieu of the continuing co-operation and strong diplomatic and economic relations between the two nations, a number of bilateral agreements and institutional arrangements have been executed between India and US. Listed below are some of the key agreements:

- India-US Double Taxation Avoidance Agreement ("**India-US DTAA**")
- US-India Civil Nuclear Agreement
- U.S.-India Science and Technology Cooperation Agreement
- Agreement for Cooperation on Joint Clean Energy Research And Development Center (JCERDC)
- The New Framework for India-US Defence Relationship

Going forward, with strengthening dialogue and a constant exchange of synergies in the form of diplomatic visits, the relations between India and the US are accelerating at an exponential pace.

II. US-India Tax Treaty: Special Considerations

i. Residency of Partnerships and Trusts

The India-US DTAA is an example of how a special provision is provided for in a DTAA to deal with availability of treaty benefits to partnerships and trusts. Under Article 3(e) of the India-US DTAA, partnerships, trusts and estates are specifically included in the definition of the term 'person'. Further, under Article 4 of that India-US DTAA, it is provided that for such entities, the term 'resident of a contracting State' applies only to the extent that the income derived by such entity is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries. In this regard, the technical explanation of the India-US DTAA on Article 4 provides that under US law, a partnership is never taxed and a trust and estate are often not taxed. Under the provision, income received by such an entity will be treated only to the extent such income is subject to tax in the US as income of a US resident. Thus, treaty benefits would only be given to such US entities only as far as income received by them is taxable either at the entity or the partner/beneficiary level in the US.

In *General Electric Pension Trust, In re:*[1], the Authority for Advance Rulings while analyzing this held that a pension trust established under US laws was not entitled to benefits of the India-US DTAA since it was exempt from tax liability in the US.

ii. Capital Gains

Article 13 of the India-US DTAA provides that each country may tax capital gains in accordance with the provisions of its own domestic law. While general international tax jurisprudence suggests that a DTAA must allocate taxability to one of the states involved in cases where there is a risk of double taxation, the India-US DTAA specifically opts for domestic law taxability presumably on the basis that differing rules for taxation of capital gains would not create a conflict.

The capital gains tax regime in India works in such a way that all Indian tax residents are taxable on their worldwide income, including income in the nature of capital gains arising from disposal of a foreign asset. However, all non-residents are taxed in India only on India-sourced income i.e. capital gains arising from the disposal of an Indian asset. Similarly, in the US, all US citizens and resident aliens for tax purposes are taxed on their worldwide income in form of capital gains (irrespective of situs of disposed asset). However, non-residents are not taxed in the US for disposal of all US-sourced assets. There is no US capital gains tax on a non-resident selling US securities.

Thus, in a case where a US citizen disposes of his/her Indian assets, he/she is liable to be taxed both in India (as the asset is India sourced) and in the US (since he/she is a US citizen) as there are no allocation rules provided for the same in the India-US DTAA. In *Trinity Corporation v. CIT*[2], the Authority for Advance Rulings held that the capital gains from the sale of shares in an Indian company by a US resident shareholder to a US resident company were taxable in India as the shares of the Indian company had to be regarded as a capital asset situated in India. Although Article 25 of the India-US DTAA provides for tax credit from the state of residence in case of double taxation, the availability of such credit in this case is not assured.

iii. Credit Rules

Double Taxation of the same income?

Article 25 of the India-US DTAA provides that the US shall allow its residents or citizens to claim a tax credit in the US on income tax paid in India by or on behalf of such residents or citizens. However, the provision also provides that the determination of the source of income for purposes of credit is subject to domestic laws of the US as applicable for the purpose of limiting foreign tax credit. According to the US Internal Revenue Code ("**IRC**"), in order to claim a tax credit for taxes paid in another country, the income must be 'foreign sourced'.

1. (2006) 280 ITR 425 (AAR).

2. [2007]165TAXMAN272(AAR)

However, the IRC also provides that all income earned by a US citizen or resident from disposal of assets (irrespective of situs) would be US sourced.

This means that the sale of assets, even in a foreign country by a US person would be treated as US sourced and therefore, foreign tax credit may not be available in such cases. Therefore, since the India-US DTAA does not provide specific allocations in the case of capital gains, there is a risk that a US citizen is subject to tax in both nations in respect of disposal of Indian assets. This uncertainty is the major reason why a large chunk of the investment into India by US entities comes through holding companies set-up in Mauritius.

Moreover, complications arise in case of credit claimed in relation to dividends as well since Article 25 is subject to limitations contained in the IRC. In India, dividend distribution tax is payable at the company's level on distribution and is exempt in the hands of the shareholder. However, the IRC taxes resident shareholders for dividends received by them. The IRC provides that foreign tax credit is generally available only in a case where tax is paid on the same income by the same taxpayer in a foreign country. Although the Indian company is to pay tax on the same distribution, since the tax is paid at the company level and since dividends received is exempt in the hands of the shareholder in India, claiming a tax credit for the shareholder becomes difficult. Thus, US credit rules consider only 'juridical double taxation' where the same entity is doubly taxed on account of the same income as opposed to 'economic double taxation' where the same income is doubly taxed in the hands of different entities. Such situations have created tax leakage.

However, Article 25 of the India-US DTAA also provides that if a US company owns at least 10% of the voting stock of its subsidiary in India, the US would grant underlying tax credit for tax paid in India for distributions made by the Indian company in the form of dividends. Thus, tax credit would be available in the US in cases where the shareholder is a US company and the holding in the Indian company is at least 10%. Nonetheless, the specific inclusion of underlying credit only for US company shareholders of Indian companies, owning at least 10% of the Indian company's shares might suggest that tax credit may not be available to any US shareholder which is not a company.

iv. Permanent Establishments

The concept of a Permanent Establishment (“**PE**”) is commonplace in almost all DTAAs. In general, business profits of an enterprise earning income are taxable only in its state of residence unless if it earns such income through a PE in the source state. Thus, a US entity earning business profits from India would be taxed in India for the same only if such profits are earned through a PE in India. As per Article 5 of the India-US DTAA, a PE can be anything from a fixed place of business, a dependent agent in India entering into contracts or securing orders on behalf of the US entity or a service PE.

Although all US DTAAs contain the PE clause, the service PE clause is found in very few DTAAs. The service PE clause is borrowed from the UN Model Convention and creates a PE when a US entity deputes its employees to India to perform services on its behalf. In general, a service PE is only created when the deputed employees spend a particular time period in the other State performing services on behalf of the foreign entity. The India-US DTAA has provided for a time period of 90 days to be spent in India for a US entity to create a service PE through deputation of employees performing services in India.

However, the service PE provision in the

India-US DTAA has carved out a different rule when a US entity deputes employees to an associated enterprise or related party. In such a case, irrespective of time spent, a service PE would be created if employees are deputed to the Indian entity to perform services on behalf of the foreign entity.[3] The Hon'ble Supreme Court of India in *DIT v. Morgan Stanley & Co*[4] has elaborated on the scope of this provision. The Court held that in case of stewardship activities performed by employees of the US company in India, since the activities could not be considered as provision of services by or on behalf of the US company, there would be no service PE implications. With respect to employees of the US company who were deputed to the Indian related party, a service PE was held to exist since the employees continued to be on the rolls of the US company and the US company had a lien on their employment.

Once a PE is created in India, taxation of business profits is determined as per rules contained in Article 7 of the India-US DTAA. Although the authorized OECD approach suggests that the source state must have the right to tax only those profits as are directly attributable to a PE in India, the India-US DTAA borrows the limited force of attraction rule as contained in the UN Model Convention. Thus, apart from profits directly attributable to the Indian PE, the US entity would also be taxed for profits from sales in India of similar goods as sold through the PE or profits from business activities in India similar to those undertaken through the PE.

v. Fee for Included Services

As per Article 12 of the India-US DTAA, 'fees for included services' means payments made to any person in consideration for the rendering of any technical or consultancy services if such services are incidental to the application or enjoyment of the right, property or information in relation to royalty payments or 'makes available' technical knowledge, experience, skill, know-how, or processes etc. Further, the India-US DTAA lays down a 15% withholding tax on such payments falling under this provision. This provision is generally not contained in most other US DTAAs and this provision is found mostly only in Indian DTAAs.

The Memorandum of Understanding annexed to the India-US DTAA explains the concept of the expression 'make available' used in Article 12 and clarifies that other than in cases where royalty payments are involved, Article 12 only covers services where there is transfer of some technology, knowledge or skill whereby the recipient is able to independently apply the same.

Thus, in cases where technical services are provided by US entities in India, payments for the same will not be subject to withholding tax under the India-US DTAA unless if such criteria are satisfied. The Karnataka High Court in the case of *CIT v. De Beers India Minerals (P.) Ltd.*[5] and the Delhi High Court in *CIT v. Guy Carpenter & Co Ltd.*[6] have upheld this principle.

vi. Limitation of Benefits

As is the general norm for US DTAAs, the India-US DTAA also contains a limitation on benefits clause. In this regard, Article 24 of the India-US DTAA provides for a limitation on benefits clause. As with its other treaties, the US has ensured that under the India-US DTAA, only 'qualified residents' of either treaty state are entitled to benefits of the treaty. With respect to corporate entities, the provision is intended to ensure that only companies that are resident in either state that

3. A similar provision can be found in India's DTAAs with Canada and Australia as well.
4. [2007] 162 TAXMAN 165 (SC).

5. (2012) 346 ITR 467 (Kar.).
6. (2012) 346 ITR 504 (Del.).

fulfill substantial substance requirements and strong business activities in such state may be entitled to treaty benefits.

In this regard, Article 24 lays down a two-fold ownership/base-erosion test for claiming treaty benefits by which more than 50% of each class of an entity's shares must be owned, directly or indirectly, by individual residents who are subject to tax in either state, or by the government or government bodies of either state and the entity's gross income must not be used in substantial part, directly or indirectly, to meet liabilities in form of deductible payments to persons, other than persons who are residents of either State, government or government bodies of either state or US citizens. However, benefits under the India-US DTAA may be claimed if the entity is engaged in active trade or business in respect of which the concerned income has been earned or if a principal class of its shares are actively traded in a recognized stock exchange in either state.

The following research papers and much more are available on our Knowledge Site: www.nishithdesai.com

Doing Business in India

October 2013

Mergers & Acquisitions in India

July 2013

Joint Ventures in India

May 2013

Globalizing India Inc.

April 2013

Competition Law in India

April 2013

Destination India-Welcome Retail

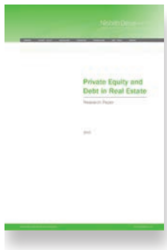
August 2013

E-Commerce in India

January 2013

Cloud Computing Risks/Challenges-Legal & Tax Issues

March 2013



Private Equity in Real Estate

February 2013

NDA Insights

TITLE	TYPE	DATE
File Foreign Application Prosecution History With Indian Patent Office	IP Lab	02 April 2013
Warburg - Future Capital - Deal Dissected	M&A Lab	01 January 2013
Public M&A's in India: Takeover Code Dissected	M&A Lab	26 November 2012
Copyright Amendment Bill 2012 receives Indian Parliament's assent	IP Lab	25 May 2012
Real Financing - Onshore and Offshore Debt Funding Realty in India	Realty Check	01 May 2012
Pharma Patent Case Study	IP Lab	21 March 2012
Patni plays to iGate's tunes	M&A Lab	04 January 2012
Vedanta Acquires Control Over Cairn India	M&A Lab	03 January 2012
Corporate Citizenry in the face of Corruption	Yes, Governance Matters!	15 September 2011
Funding Real Estate Projects - Exit Challenges	Realty Check	28 April 2011
Real Estate in India - A Practical Insight	Realty Check	22 March 2011
Hero to ride without its 'Pillion Rider'	M&A Lab	15 March 2011
Piramal - Abbott Deal: The Great Indian Pharma Story	M&A Lab	05 August 2010
Bharti connects with Zain after two missed calls with MTN	M&A Lab	17 May 2010
The Battle For Fame - Part I	M&A Lab	01 April 2010
Great Offshore Takeover Saga - Bharati Shipyard v/s ABG Shipyard	M&A Lab	16 December 2009
Second missed call: Bharti Airtel fails to reconnect with MTN	M&A Lab	09 October 2009

Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines".* These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our *ThinkTank* discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports. Please feel free to contact us at **research@nishithdesai.com**

Nishith Desai Associates

LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI

93 B, Mittal Court,
Nariman Point,
Mumbai 400 021 INDIA
Tel: +91 - 22 - 6669 5000
Fax: +91 - 22 - 6669 5001

SILICON VALLEY

220 S California Ave., Suite 201,
Palo Alto, CA 94306,
USA
Tel: +1 - 650 - 325 7100
Fax: +1 - 650 - 325 7300

BANGALORE

Prestige Loka, G01,
7/1 Brunton Rd,
Bangalore 560 025 INDIA
Tel: +91 - 80 - 6693 5000
Fax: +91 - 80 - 6693 5001

SINGAPORE

Level 30,
Six Battery Road,
SINGAPORE 049909
Tel: +65 - 6550 9855
Fax: +65 - 6550 9856

MUMBAI - BKC

3, North Avenue
Maker Maxity
Bandra – Kurla Complex,
Mumbai 400 051 INDIA
Tel: +91 - 22 - 6159 5000
Fax: +91 - 22 - 6159 5001

NEW DELHI

C-5, Defence Colony
New Delhi - 110024
INDIA
Tel: +91 - 11 - 4906 5000
Fax: +91 - 11- 4906 5001

MUNICH

Maximilianstraße 13
80539 Munich
GERMANY
Tel: +49 - 89 - 203006 - 268
Fax: +49 - 89 - 203006 - 450

For any help or assistance please email us on ndaconnect@nishithdesai.com or

visit us at www.nishithdesai.com