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International tax

India Highlights 2015

Investment basics:

Currency – Indian Rupee (INR)

Foreign exchange control – There is a simplified regulatory regime for foreign exchange transactions and liberalized capital account transactions. Current account transactions are permitted unless specifically prohibited and are monitored by the central bank. Full foreign investment is permitted in most industries, although sector-specific caps have been set for foreign investment in certain industries, such as defense, civil aviation, telecommunications, banking, insurance, retail trade, etc.

Foreign direct investment (FDI) in limited liability partnerships (LLPs) is allowed with specific government approval for LLPs operating in sectors/activities where 100% FDI is otherwise allowed under the "automatic route" and subject to other specified conditions. FDI up to 49% by one or more nonresident entities is permitted in single-brand product retail trading under the automatic route and FDI exceeding 49% is allowed under the approval route, subject to the fulfillment of certain conditions. FDI up to 51% is permitted in multi-brand product retail trading under the approval route and FDI up to 100% is permitted in specified railway infrastructure activities under the automatic route.

Accounting principles/financial statements – Accounting standards issued by the Institute of Chartered Accountants of India apply, which are largely based on IAS. Indian accounting standards are to be converged with IFRS from the 2016-17 financial year with the figures of the previous year, 2015-16, made comparable. Financial statements must be prepared annually.

Principal business entities – Various forms of business entity are permitted. These include the public/private limited liability company, one person company (owned by a resident individual), partnership firm, limited liability partnership, sole proprietorship, branch office, liaison office, project office or site office of a foreign corporation.

Corporate taxation:

Residence – A corporation is resident if it is incorporated in India or wholly managed and controlled in India.

Basis – Residents are taxed on worldwide income; nonresidents are taxed on Indian-source income only. Indian-source income may include capital gains arising from the transfer of any share or interest in a company or entity registered or incorporated outside India if the share or interest directly or indirectly derives its substantial value from assets located in India. Foreign-source income derived by a resident company is subject to corporation tax in the same way as Indian income. A branch of a foreign corporation is taxed as a foreign corporation.

Taxable income – Tax is imposed on a company's profits, which consist of business/trading income, passive income and capital gains. Income resulting from the indirect transfer of assets located in India is included. Normal business expenses, as well as other specified items, may be deducted in computing taxable income.

Taxation of dividends – Dividends paid by a domestic company are subject to dividend distribution tax (DDT) at an effective rate of 16.995%. Since 1 October 2014, the DDT payable is grossed up and calculated as 15% of the aggregate dividend declared, distributed or paid including the DDT. This results in an effective rate of 19.9941%, including a 10% surcharge and 3% education cess. Dividends subject to DDT are exempt from tax in the hands of the recipient.

Dividends received from a foreign company are generally subject to corporation tax, with a credit for any for foreign tax paid. However, dividends received by an Indian company from a foreign company in which the Indian company holds at least 26% of the equity shares, are subject to tax at a reduced base rate of 15% on the gross income. A surcharge and cess are also imposed.

Dividends paid by a domestic company that are liable to DDT may be reduced by: (1) the amount of dividends received from a domestic subsidiary company during the financial year, if the subsidiary has paid DDT and (2) dividends received from a foreign subsidiary company, provided tax is payable on such dividend income by the domestic company at the reduced base rate of 15%.

Capital gains – The tax treatment depends on whether gains are long or short term. Gains are long term if the asset is held for more than three years (one year in the case of listed shares and specified securities). For transfers on or after 11 July 2014, the minimum holding period for long-term capital gains in respect of shares in a company which is not listed on a recognized stock exchange or units in a mutual fund, is more than 36 months. Long-term gains on listed shares and specified securities are exempt if the transaction is subject to securities transaction tax (STT). Where such gains are not subject to STT, a 10% tax applies (without the benefit of an inflation adjustment). The applicable tax rate on long-term capital gains derived by a nonresident from the sale of unlisted securities is 10% (without the benefit of foreign currency conversion or an inflation adjustment). Gains on other long-term assets are taxed at 20% but with the benefit of an inflation adjustment.

Short-term gains on listed shares and specified securities which are subject to STT are taxed at 15%; gains from other short-term assets are taxed at the normal tax rates. A surcharge and cess are also imposed.

An unlisted domestic company is liable to pay an additional tax of 20% on income distributed to a shareholder on account of a buyback of the company's shares. The distributed income is the amount of consideration paid by the company on the buyback, reduced by the amount received by the company on account of the issue of the shares. The shareholders will not be charged to tax on any income arising from the buyback of shares.

Losses – Business losses and capital losses may be carried forward for eight years, with short-term losses offsetting capital gains on both long and short-term assets, and long-term losses offsetting only long-term gains. Other than unabsorbed depreciation (which may be carried forward indefinitely), losses may be carried forward only if the tax return is filed by the due date. Unabsorbed depreciation may be offset against any income, whereas business losses may be offset only against business profits in subsequent years.

Rate – The rate is 30% for domestic companies and 40% for foreign companies and branches of foreign companies. Taking into account the surcharge and cess, the highest effective rate is 33.99% for domestic companies and 43.26% for foreign companies.

Surtax – A 5% surcharge applies to domestic companies if income exceeds INR 10 million (2% for foreign companies) and a 10% surcharge if income exceeds INR 100 million (5% for foreign companies). An additional 3% cess is payable in all cases.

Alternative minimum tax – A Minimum Alternative Tax (MAT) is imposed at 18.5% (plus any applicable surcharge and cess) on the adjusted book profits of corporations whose tax liability is less than 18.5% of their book profits. A credit is available for MAT paid against tax payable on normal income, which may be carried forward for offset against income tax payable in the following 10 years.

Any person other than a corporation (including an LLP) is liable to an alternative minimum tax (AMT) at 18.5% (plus any applicable surcharge and cess) of the adjusted total income where the normal income tax payable is less than the AMT. From 1 April 2014, AMT has also been imposed on a person eligible for investment-linked incentives. The adjusted total income is the total income before giving effect to the AMT provisions, as increased by certain deductions claimed in computing the total income, including the tax holiday claimed by units in a Special Economic Zone (SEZ). The base for computation of AMT for noncorporate taxpayers therefore differs from that for computing MAT in the case of corporations. A tax credit is allowed for the AMT paid against tax payable on normal income. The tax credit may be carried forward up to 10 years.

Foreign tax credit – Foreign tax paid may be credited against Indian tax on the same profits but the credit is limited to the amount of Indian tax payable on the foreign income.

Participation exemption – No, except for DDT in some cases.

Holding company regime – No

Incentives – A deduction of up to 200% is available in respect of capital and revenue expenditure on scientific research conducted in-house by specified industries and for payments made to specified organizations for scientific research.

A deduction is available for 15% of the cost of new plant or machinery acquired and installed from 1 April 2013 to 31 March 2015, if the aggregate cost exceeds INR 1 billion, in addition to the normal depreciation allowance. A similar deduction is also available from 1 April 2014 until 31 March 2017 where the cost of plant or machinery acquired and installed in a year exceeds INR 250 million.

A deduction of 150% is available for expenditure incurred on a notified agricultural extension or skill development project.

A deduction of 100% is available for capital expenditure (other than expenditure incurred on the acquisition of land, goodwill or financial instruments) incurred by specified businesses, including laying and operating cross-country natural gas or crude or petroleum oil pipeline networks for distribution, including integral storage facilities; setting up and operating an inland container depot or freight station; housing projects under a slum redevelopment scheme; building and operating a two-star hotel; bee-keeping and associated activities; setting up and operating a warehousing facility for storage of sugar; laying and operating a slurry pipeline for the transportation of iron ore; and setting up and operating a semi-conductor wafer fabrication manufacturing unit.

A deduction of 150% is available for capital expenditure (other than expenditure incurred on the acquisition of land, goodwill or financial instruments) incurred by businesses on setting up and operating cold chain facilities or warehousing facilities, building and operating a hospital with 100 beds, investing in housing projects under a scheme for affordable housing or producing fertilizers in India.

Undertakings set up in SEZs are exempt from tax on their export profits subject to compliance with other conditions. Other tax holidays are available based on industry and region.

Withholding tax:

Dividends – Dividends are not subject to withholding tax. However, the company paying the dividends is subject to DDT.

Interest – Interest paid to a nonresident on a foreign currency borrowing or debt is generally subject to a 20% withholding tax, plus the applicable surcharge and cess. The rate may be reduced under a tax treaty.

Interest paid to a nonresident on an infrastructure debt fund set up in accordance with guidelines prescribed by the government is subject to a 5% withholding tax, plus the applicable surcharge and cess.

Interest paid to a nonresident on debt incurred under a loan agreement or through the issue of long-term bonds including long-term infrastructure bonds issued by an Indian company in foreign currency, is subject to a 5% withholding tax, plus the applicable surcharge and cess, if the loan agreement is approved by the central government and the funds are borrowed between 1 July 2012 and 30 June 2017. The 5% withholding tax (plus applicable surcharge and cess) is also applicable to interest paid between 1 June 2013 and 31 May 2015 on a rupee-denominated bond of an Indian company, or a government security subscribed for by a foreign institutional investor or a qualified foreign investor.

If the nonresident does not have a Permanent Account Number (PAN), i.e. a tax registration number, tax must be withheld at the applicable tax treaty rate or 20%, whichever is higher.

Royalties – Royalties paid to a nonresident are subject to a 25% withholding tax, plus the applicable surcharge and cess. The rate may be reduced under a tax treaty.

If a treaty applies, but the nonresident does not have a PAN, tax must be withheld at the applicable tax treaty rate or 20%, whichever is higher.

Technical service fees – Technical services fees paid to a nonresident are subject to a 25% withholding tax, plus the applicable surcharge and cess. The rate may be reduced under a tax treaty.

If a treaty applies, but the nonresident does not have a PAN, tax must be withheld at the applicable tax treaty rate or 20%, whichever is higher.

Branch remittance tax – No

Other taxes on corporations:

Capital duty – No

Payroll tax – The employer is responsible for withholding tax on salary income.

Real property tax – Each state levies property tax, with rates varying from state to state.

Social security – The employer generally contributes 12% of eligible wages per month to the Provident Fund. From that contribution, 8.33% of the wages (up to INR 15,000) are applied to the pension fund, with the balance paid to the Provident Fund. The employer also must pay a gratuity to workers who have rendered continuous service for at least five years at the time of retirement, resignation, superannuation, etc., at the rate of 15 days' wages for every completed year of service (up to a maximum of INR 1 million).

Stamp duty – Financial instruments, real property and other specified transactions in India attract stamp duties that are levied under the Indian Stamp Act and the stamp acts of the various states (with rates varying significantly between states).

Transfer tax – Securities transaction tax is levied on the purchase or sale of equity shares, derivatives or units in an equity-oriented fund listed on a recognized stock exchange in India.

Other – A 1% wealth tax applies on the aggregate value exceeding INR 3 million of nonproductive assets such as land; buildings not used as factories; commercial property not used for a business or a profession; offices or residential accommodation for employees earning over INR 500,000 per annum; certain precious metals; cars, aircraft and yachts; and cash exceeding INR 50,000.

Anti-avoidance rules:

Transfer pricing – The transfer pricing regime is influenced by OECD norms, although the penalty provisions in India are stringent compared to those in other countries. The definition of "associated enterprise" extends beyond a shareholding or management relationship, as it includes some deeming clauses. The taxpayer is required to maintain certain information and documents and to provide a certificate (in a prescribed format) from a practicing chartered accountant that sets out the details of associated enterprises, international transactions, etc., along with the methods used to determine an arm's length price. The certificate must be submitted by the due date for filing the annual tax return for companies required to submit such a certificate, i.e. 30 November.

Where the application of the arm's length price would reduce the income chargeable to tax in India or increase a loss, no adjustment will be made to the income or loss. If a taxpayer who benefits from a tax holiday is subject to a transfer pricing adjustment, the benefit will be denied to the extent of the adjustment. The allowable variation in computing the arm's length price will be as notified by the government. (See "Other" below, for application of the transfer pricing rules to transactions involving jurisdictions that do not effectively exchange information with India and for application of the general anti-avoidance rule).

The scope of the transfer pricing provisions covers "specified domestic transactions" if the aggregate value of those transactions exceeds INR 50 million in one year. Specified domestic transactions include payments to related parties, the inter-unit transfer of goods or services, transactions of profit-linked tax holiday units with other parties and any other transaction that may be notified. The pricing of these transactions must be determined with regard to arm's length principles using methods prescribed under India's transfer pricing rules.

Advance pricing agreements are possible.

Thin capitalization – No

Controlled foreign companies – No

Other – To discourage transactions with persons located in jurisdictions that do not effectively exchange information with India, transactions with persons situated in certain jurisdictions designated by the government will be subject to the Indian transfer pricing rules and income paid to persons in those jurisdictions will be subject to a minimum withholding tax of 30%.

A general anti-avoidance rule will apply from the 2015-16 financial year. Under this rule, an arrangement entered into by a taxpayer may be declared as an impermissible avoidance arrangement if its main purpose is to obtain a tax benefit and other prescribed conditions (e.g. lack of commercial substance, etc.) are satisfied.

Disclosure requirements – A nonresident with a liaison office in India is required to prepare financial statements, annual activity certificates, etc. on its activities and submit this information to the Indian tax officer within 60 days from the end of the financial year.

Compliance for corporations:

Tax year – The tax year is the fiscal year (1 April to 31 March).

Consolidated returns – Consolidated returns are not permitted; each company must file a separate return.

Filing requirements – Taxes on income in a fiscal year usually are paid in the next fiscal year ("assessment" year). Companies must submit a final return by 30 September (30 November for companies required to file a certificate on international transactions (see "Transfer pricing" above)) of the assessment year, stating income, expenses, taxes paid and taxes due for the preceding tax year. Returns for noncorporate taxpayers that are required by law to have their accounts audited are also due on 30 September. All other taxpayers must submit a return by 31 July. Taxpayers claiming tax holidays or carrying forward tax losses must file their returns on or before the due date.

Companies must make four advance payments of their income tax liabilities during the accounting year on: 15 June (15% of total tax payable), 15 September (30% of total tax payable, cumulative amount 45% of total tax payable), 15 December (30% of total tax payable, cumulative amount 75% of total tax payable) and 15 March (25% of total tax payable, cumulative amount 100% of total tax payable).

Penalties – Penalties apply for failure to file a return and certificate of international transactions, failure to comply with withholding tax obligations and concealment of income.

Rulings – The Authority for Advance Rulings issues rulings on the tax consequences of transactions or proposed transactions with nonresidents. Since 1 October 2014, it has also been able to issue rulings in relation to tax liability of residents in prescribed cases. From 1 April 2015, the Authority for Advance Rulings is able to issue rulings on whether an arrangement is an impermissible avoidance arrangement. Rulings are binding on the applicant and the tax authorities for the specific transaction(s). Advance pricing agreements are also possible.

Personal taxation:

Basis – An individual who is resident and ordinarily resident in India is normally taxed on worldwide income subject to the provisions of a relevant tax treaty. A person who is not ordinarily resident does not generally pay tax on income earned outside India unless it is derived from a business or profession controlled or established in India, or the income is accrued or received in India or deemed to have accrued or been received in India. A nonresident is subject to tax on Indian-source income only.

Residence – An individual is resident in India if he/she spends at least 182 days in the country in a given year, or at least 60 days if the individual has spent at least 365 days in India in the preceding four years. For an Indian citizen leaving India for the purpose of employment or as a member of the crew of an Indian ship, and for an Indian citizen/person of Indian origin working abroad who visits India while on vacation, the threshold is 182 days in the given year instead of 60 days. An individual is "not ordinarily resident" if he/she has not been a resident in nine out of the 10 preceding years or has been in India for less than 730 days during the preceding seven years.

Filing status – Each taxpayer must file a return; the concept of joint filing does not exist in India.

Taxable income – Income from employment, including most employment benefits, is fully taxable. Profits derived by an individual from the carrying on of a trade or profession are generally taxed in the hands of the individual after applying available tax exemptions and tax-free thresholds (see "Rates" below).

Capital gains – See "Corporate taxation."

Deductions and allowances – Deductions are available in respect of certain payments and investments such as contributions to the Provident Fund, pension funds, medical insurance or life assurance policies, and some savings schemes, etc. subject to applicable limits.

Rates – Rates are progressive up to 30%, plus the applicable cess. A 10% surcharge applies if income exceeds INR 10 million, subject to applicable marginal relief. The first INR 300,000 is exempt for resident senior citizens (aged 60 years or over, but under 80 years) and INR 500,000 is exempt for very senior citizens (at least 80 years of age); for all others, the first INR 250,000 is exempt. A tax rebate up to INR 2,000 is allowed for individuals with taxable income of up to INR 500,000.

Alternative minimum tax – See "Corporate taxation." AMT is not applicable to individuals, associations of persons and bodies of individuals if their adjusted total income does not exceed INR 2 million.

Other taxes on individuals:

Capital duty – No

Stamp duty – Financial instruments and transactions in India attract stamp duties that are levied under the Indian Stamp Act and the stamp acts of the various states (with rates varying significantly between states).

Capital acquisitions tax – No

Real property tax – Each state levies property tax, with rates varying between states.

Inheritance/estate tax – No

Net wealth/net worth tax – A 1% wealth tax applies on the aggregate value exceeding INR 3 million of nonproductive assets such as land; residential accommodation for employees earning over INR 1 million per annum; jewelry, bullion metals; cars, aircraft and yachts and cash exceeding INR 50,000.

Social security – All employees (including "international workers" but not "excluded employees" as defined in the Provident Fund Act) contribute 12% of eligible wages per month to the Provident Fund, with a matching 12% contribution by the employer. However, where India has entered into Social Security Agreement (SSA) with the relevant overseas country, the international worker (subject to certain conditions) is not liable to contribute to the Provident Fund in India. An international worker may be either: (1) a foreign employee working for an establishment in India to which the Provident Fund Act applies; or (2) an Indian employee seconded to a country with which India has entered into an SSA and who has not obtained a "certificate of coverage."

Compliance for individuals:

Tax year – The tax year is the fiscal year (1 April to 31 March).

Filing and payment – The employer withholds tax on salary income. All individual taxpayers are required to file an individual tax return. Individuals must prepay 100% of the final tax due by the end of the fiscal year either via withholding at source or by making advance payments (with interest payable on underpayments). Returns are due by 31 July (30 September for specified individuals) of the assessment year. Electronic filing of tax returns is mandatory if: (1) taxable income exceeds INR 500,000; (2) the individual has foreign assets (including a financial interest in any entity or signing authority for any account); or (3) the individual is claiming any relief for foreign taxes.

Penalties – Penalties apply for failure to file a return, failure to comply with withholding tax obligations and concealment of income.

Value added tax:

Taxable transactions – All Indian states impose a "consumption-type destination-based VAT," driven by the invoice tax credit method, on the sale of most types of movable goods and specified intangible goods (barring a few exempt goods), the list of which varies from state to state.

Sales involving the movement of goods from one state to another are governed by the Central Sales Tax (CST).

Rates – The standard VAT rate in the various states ranges from 12.5% to 15%, depending on the state, with reduced rates of 1% and 5% in most states. Commodities like liquor and petroleum products attract a higher rate in the range of 20% to 30%.

The CST rate is 2% against the submission of specified forms or the applicable local VAT rate.

Registration – The turnover limit for compulsory registration for businesses is INR 500,000, although this may vary by state. State VAT laws also specify monetary amounts of sales and/or purchases required for registration.

Filing and payment – VAT returns must be filed and payments made monthly, quarterly or half yearly, based on the tax liability. The filing and payment deadlines may vary from state to state.

Other – A central excise duty is levied on the manufacture of excisable goods in India. The peak rate of central excise duty, including the education cess and the secondary and higher education cess is 12.36%.

Service tax is payable at 12.36%, including the education cess and the secondary and higher education cess, on the provision of all taxable services that are not included on the negative list of services. No service tax is payable on services that are specifically exempted (nontaxable services) by notifications issued by the tax authorities.

Source of tax law: Income-tax Act; Annual Finance Acts; Customs Act; Central Excise Act; Finance Act, 1994; State VAT and Central Sales Tax laws

Tax treaties: India has comprehensive tax treaties with more than 94 countries.

Tax authorities: Income Tax Department, Authority for Advance Rulings

International organizations: WTO, ADB (Asian Development Bank), G20, SAARC (South Asian Association for Regional Cooperation)