FDI policy changes – The way forward

28 January 2020

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Recent amendments in FDI policy

Recent amendments in FDI policy – Retail and Contract Manufacturing

The Government has progressively relaxed Foreign Direct Investments (FDI) related conditions in select sectors to provide impetus to investments and growth

Single Brand Retail Trade (SBRT)
(Relaxation in local sourcing and online)

Relaxations provided:

- **5 year block:** All procurements made from India by the SBRT entity to be counted, irrespective of whether the goods procured are sold in India or exported
  (Erstwhile regulation provided for considering exports only for 5 years)
- **Self or supported global sourcing:** Sourcing of goods from India for global operations can now be done either directly by the SBRT entity or its group companies (resident or non-resident), or indirectly through a third party under a legally tenable contract
  (Erstwhile regulation provided for incremental self only)
- **Entire vs incremental:** Entire (not only incremental) sourcing from India for global operations to be considered
  (Erstwhile regulation provided for incremental)
- **Online:** Retail trading can be undertaken through e-commerce prior to opening of brick and mortar stores, subject to opening of store within 2 years from the date of start of online retail
  (Erstwhile regulation did not permit this)

Recent amendments in FDI policy – Retail and Contract Manufacturing

The Government has progressively relaxed Foreign Direct Investments (FDI) related conditions in select sectors to provide impetus to investments and growth

Contract Manufacturing
(FDI under automatic route)

Extant policy:

- A manufacturer with FDI was permitted to undertake wholesale and retail sale (including e-commerce) without having to comply with FDI trading conditions
- From June 2016, an Indian manufacturer (having FDI and sub-contracting more than 30% manufacturing) was additionally required to comply with trading conditions. This requirement was removed in 2018, however nothing was explicitly provided for contract manufacturing

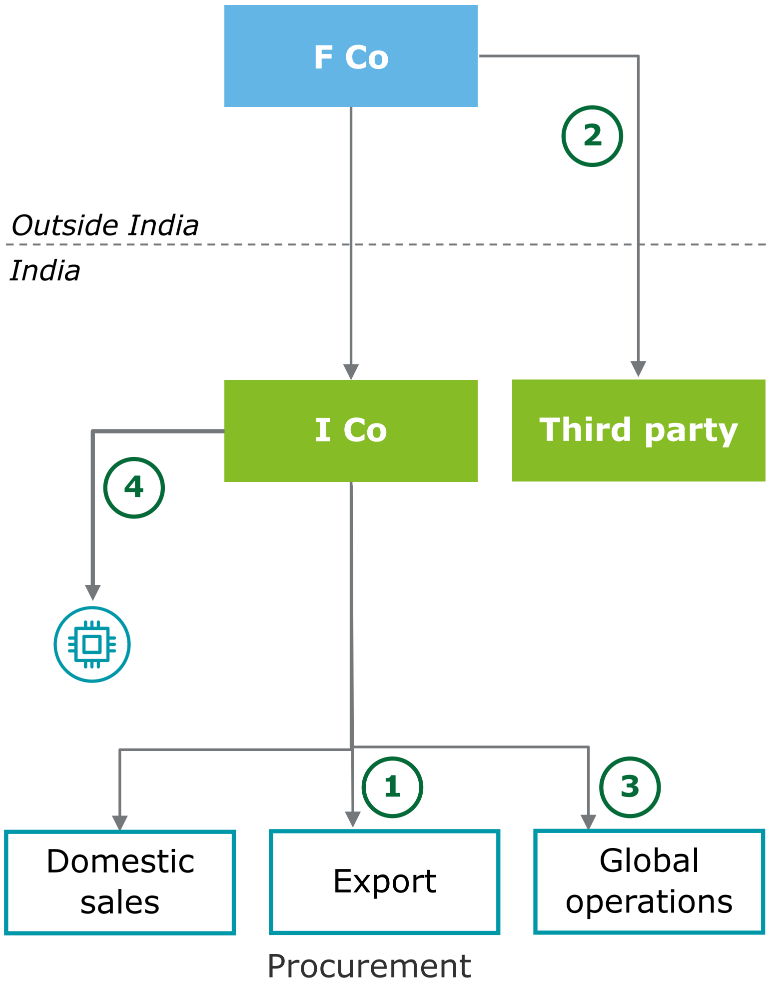
Change:

- 100% FDI in contract manufacturing (through legally tenable contract, whether on Principal to Principal or Principal to Agent basis) allowed under the automatic route

CASE STUDY 1

SBRT Changes

Case Study 1: Impact Analysis



Illustrative numbers:

Domestic procurement / Year	For Domestic sales (A)	For Export (B)	For Global Operations		Total
			Via I Co (C)	Via 3P (D)	
Year 1-5 (avg)	110	60	40*	30	240
Year 6	150	85	70	40	345

Maximum value of procurement (whether domestic or outside) for trading in India:

Year	Erstwhile Policy	Revised Policy
Year 1-5 (average)	600 [=(A+B+ΔC*)/30%]	800 [=(A+B+C+D)/30%]
Year 6	500 [=(A)/30%]	1150 [=(A+B+C+D)/30%]

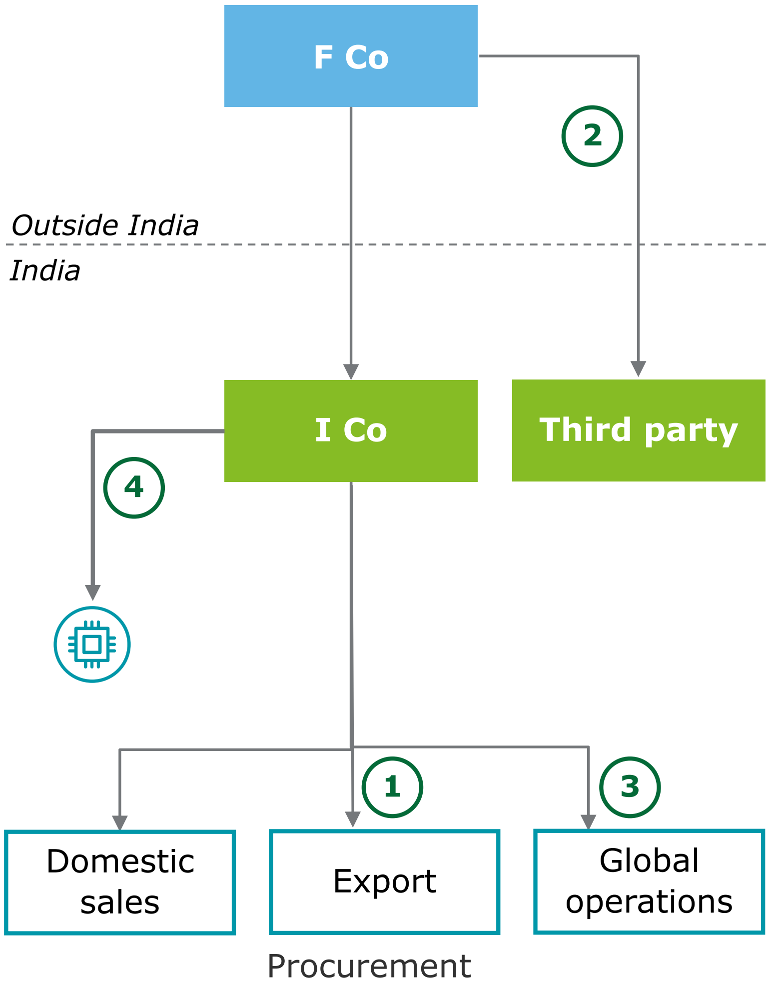
Conclusion: The quantum of retail trading in India available may be increased because of the changes. There may also be tax incentives on increased capacity in India – refer next slide

*Break-up for each year:

Year / Procurement	1	2	3	4	5
Per year	30	30	50	50	40
Incremental	30	-	20	-	-

SBRT Changes

Case Study 1: Potential Tax Incentives / Issues

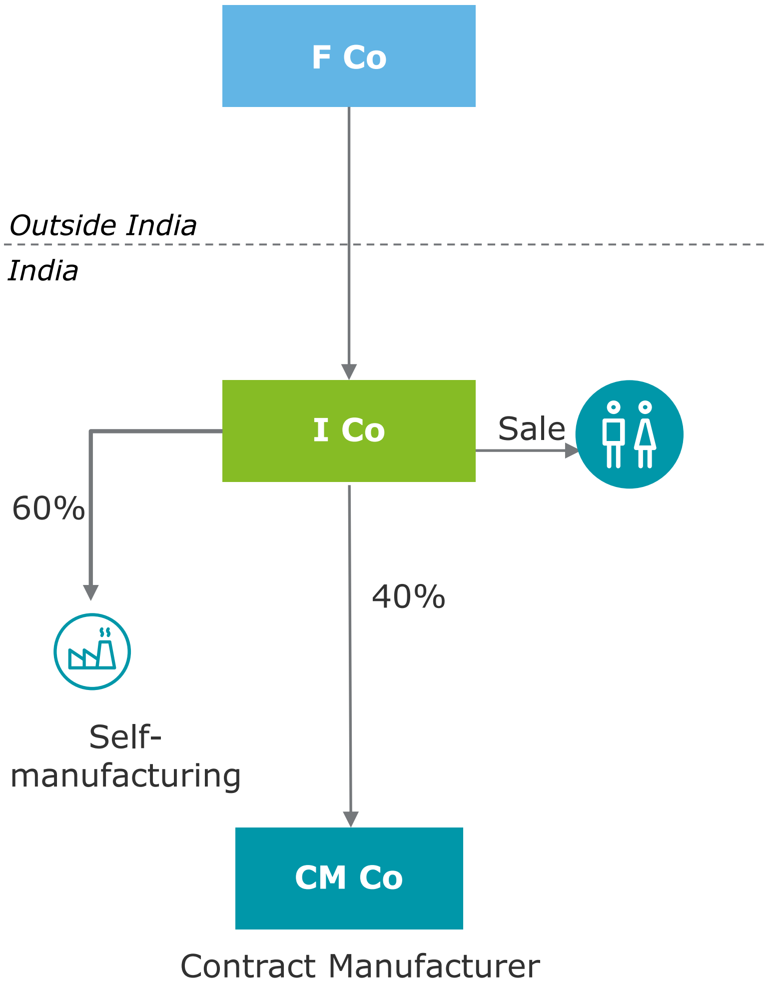


- Possibility of setting up a new **manufacturing company** to avail lower base corporate tax rate of 15%
- Tax holiday for **export oriented undertakings** set up in SEZ – sunset clause 31 March 2020
- In both cases above – commercial rationale and conditions specified in those sections – no splitting up or reconstruction of the existing business, no old asset use above 20%, etc would need to be satisfied

CASE STUDY 2

SBRT Changes

Case Study 2: Key Changes



- 100% FDI in contract manufacturing (through legally tenable contract, whether on Principal to Principal or Principal to Agent basis) allowed under automatic route
- Under the income tax law, the term 'manufacture' is defined as under:

  "'manufacture', with its grammatical variations, means a change in a non-living physical object or article or thing,—

  (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

  (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure"
- While the definition of manufacture under the FDI Policy is the same, FDI relaxation may not have any bearing on the treatment for income tax purposes
- Where CM Co bears all risks and acts in a principal capacity, I Co may not be considered as a manufacturer **[UOI vs Cibatul Limited 1985 (22) ELT 302 (SC)]**
- Transactions between CM Co and I Co are subject to transfer pricing regulations

Topical corporate tax issues

Consumer & Retail

Topical corporate tax issues

Business Tax

Impact of BEPS – Digital tax, GLoBE Proposal

MLI to amend certain tax treaties effective 1 April 2020

Taxation of dividends

New E-assessment scheme

Concessional tax rate regime for **new** manufacturing companies

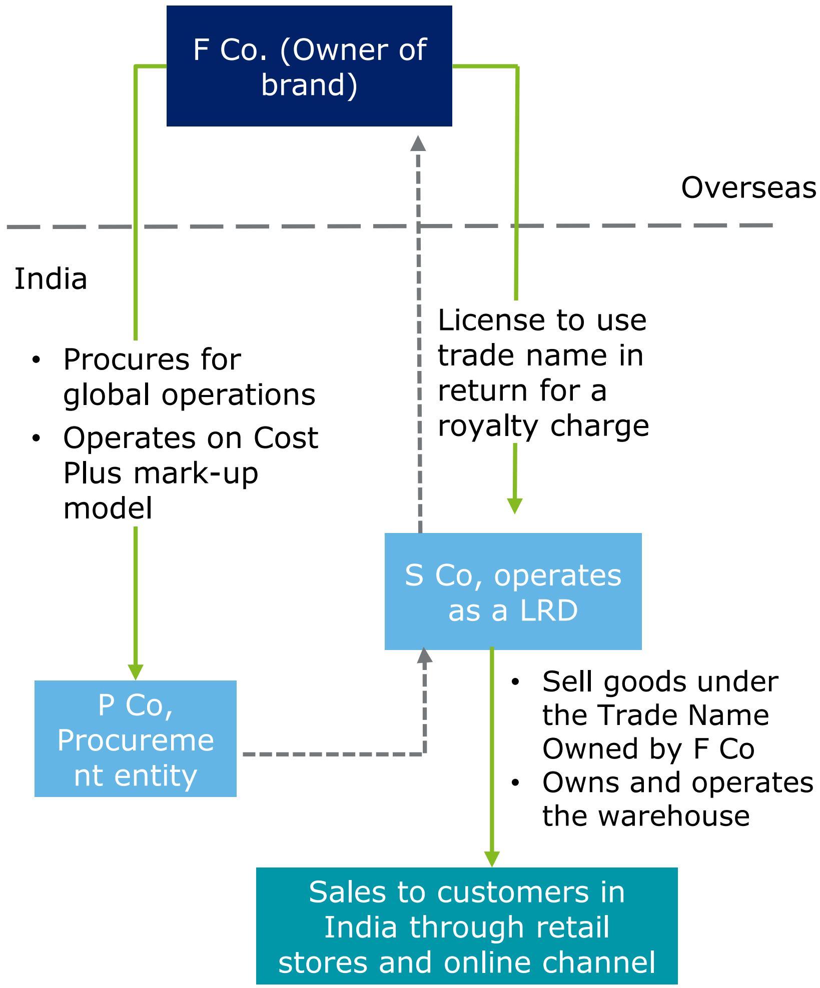
Rollback of enhanced surcharge

Non-applicability of MAT

CASE STUDY 3

SBRT Changes

Case Study 3: TP Impact Analysis



Facts

- F Co. is the owner of the brand and carries on business in India via its subsidiary by way of setting up retail stores
- S Co. functions as a LRD for its retail operations in India
- P Co. is responsible for sourcing from India for global operations and is remunerated on a cost plus model

Impact analysis

- As per the erstwhile policy, S Co. was mandatorily required to meet the 30% domestic sourcing requirement individually
- To meet this requirement, a part of sourcing was routed through S Co. (atleast for first five years)
- In such a scenario, S Co. was remunerated on a minimum cost plus mark-up for sourcing activities (only value added cost)
- IRA alleged that S.Co. needs to earn a mark-up on its entire cost including the cost of goods and not just the value added cost since S Co. is a retail entity and title of goods was recorded in the books of S Co.
- The new rules provides twofold relief :
  - a) Sourcing can be done through any other third party or any other related party
  - b) Value of exports is counted towards the value of local sourcing requirement even after first five years
- P Co.'s sourcing operations can suffice S Co.'s domestic sourcing requirement in purview of the revised policy

Topical transfer pricing issues

Consumer & Retail

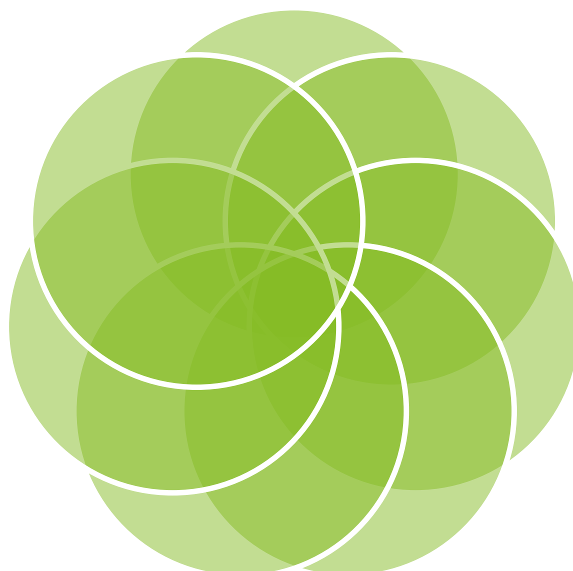
Topical transfer pricing issues

Transfer Pricing

Marketing intangibles–
AMP issue

Attribution of profits
to PE

Royalty paid for
licensing distribution
rights, use of brand
name etc.
aggressively
scrutinized



Alignment with
master file and group
policies

Payment of
intragroup services–
Need test, Benefit
test, Rendition test

Interplay between
Customs and TP

Marketing service
provider considered as
distributor

Manufacturing In India
Central And State Policies

Fiscal and non-fiscal incentives for “Make in India”

The Central and State Governments offer a host of incentives for manufacture of consumer oriented products ranging from cellular phones to electric vehicles. We have discussed few key policies below:

Incentive Policy	Brief of Benefit
National Policy on Electronics – Announced in February 2012	Provided a road map for the development of electronics sector in the country and introduced schemes such as • Modified Special Incentive Package Scheme (M-SIPS) to provide financial incentives across the Electronics System Design and Manufacturing (ESDM) value chain to compensate for cost disability in manufacturing – capital subsidy of 25% for electronics industry located in non-SEZ areas and 20% for those in SEZ areas • Electronics Manufacturing Clusters (EMC) for providing world-class infrastructure and logistics - 50% of the project cost for Greenfield EMC and 75% for Brownfield EMC is given as grant • Phased Manufacturing Programme (PMP) announced in April 2017 to be implemented by April 2020 (earlier March 31, 2019 - recommendation to defer the PMP accepted), for mobile handsets and related sub-assemblies/ components manufacturing - The PMP has been rolled out with a four year timeline for increasing value addition in the cellular mobile phone manufacturing eco-system - Customs duty exemptions on parts and sub-assemblies for manufacture of mobile phones

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The Central and State Governments offer a host of incentives for manufacture of consumer oriented products ranging from cellular phones to electric vehicles. We have discussed few key policies below:

Incentive Policy	Brief of Benefit
National Policy on Electronics – Announced in February 2019	To position India as a global hub for Electronics System Design and Manufacturing (ESDM) for developing core components, including chipsets, and creating an enabling environment for the industry to compete globally • Customs duty exemptions announced for identified capital equipment for manufacturing of mobile phone parts • Customs duty exemptions announced in last budget for manufacturing of core electronic components, lithium-ion cells for electronics/ EV applications, fuel cells, preform of silica, optical fibre, solar cells, raw materials for electronic components, etc., and ATMP of semiconductors • Special packages for mega projects • PMP for electric vehicles announced in April 2019
Faster Adoption and Manufacturing of Electric Vehicles in India Phase II (FAME India Phase II) – for 2019-20 to 2021-2022	• Objective is to encourage Faster adoption of Electric and hybrid vehicle by way of offering upfront Incentive on purchase of Electric vehicles and also by way of establishing a necessary charging Infrastructure for electric vehicles • Demand incentives will be availed by buyers (end users/consumers) upfront at the point of purchase and the same will be reimbursed by the manufacturers from Department of Heavy Industries, on a monthly basis • Applicable in selected areas notified separately such as smart cities • Two-wheelers will get subsidy of Rs 20,000 each while fully electric cars can avail benefit of Rs 1.5 lakh each

Possible incentives under State Industrial Policies

01 Interest free loan on Net State Tax for a period ranging between 7-14 years subject to industries providing minimum number of direct employment and investment in fixed assets

02 Reimbursement of land conversion fee for converting the land from agricultural use to industrial use including for development of industrial areas by private investors

03 One time 100% stamp duty exemption for purchase / lease of land

04 Electricity Duty exemption upto 100% for specified period and concessional electricity tariffs

05 Financial assistance in setting up of Effluent Treatment Plants

06 Uninterrupted water and power supply

The benefits are basis the various state specific policies and linked to the quantum of investment

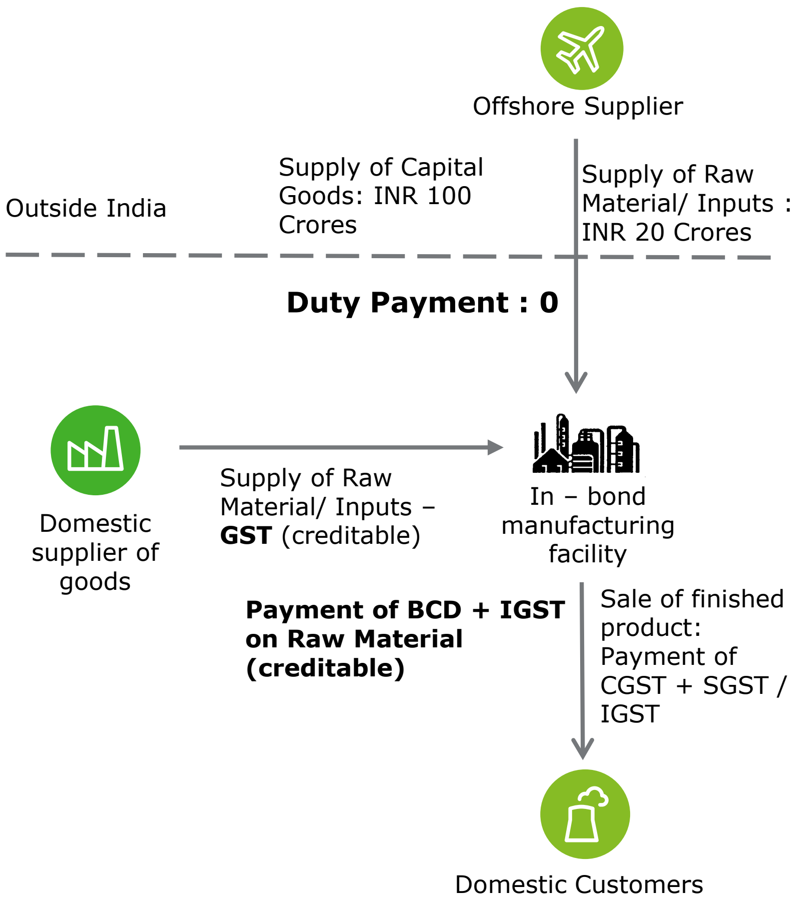
Benefits for exporters
Customs, Foreign Trade Policy (FTP) and GST

Scheme	Nature of benefit	Clubbing with other schemes
CUSTOMS		
Bonded Warehouse	• No customs duty payment while bonding of imported goods. No duty payment on imported goods required in case of exports of finished goods • GST payment on supply of finished goods in DTA along with customs duty on raw material (discussed in detail later)	• MEIS • Refund of input GST on Export of goods
Foreign Trade Policy Certificates		
Advance Authorization scheme (AAS)	• Zero Custom duty on imported raw material which are incorporated in export product • Minimum value of export to be 15% of value of raw material imported	• Refund of input GST on Export of goods • MEIS • EPCG
Export Promotion Capital Goods (EPCG)	• Exemption from payment of Customs duty • Exports of 6 times of duty saved in 6 years to be made	• Refund of input GST on Export of goods • MEIS • AAS
Merchandise Export incentive scheme (MEIS)	Obtain duty credit scrips on export of notified goods on FOB value	• Refund of input GST on Export of goods • EPCG & AAS
Scheme for Remission of Duties and Taxes on Exported products (RoDTEP)	• Future incentive scheme for export of goods. To replace MEIS • Data gathering started	
Duty Drawback scheme	Rebate of basic customs duty cost on imported materials used for manufacture of export goods	• MEIS • Refund of input GST on Export of goods
GST		
Zero Rated Supplies	Avail refund of input GST on goods exported	EPCG & AAS, MEIS
Exports on Payment of GST	Claim Rebate of GST paid on Goods exported	EPCG, MEIS

CASE STUDY 4

Bonded Manufacturing

Case Study: Overview

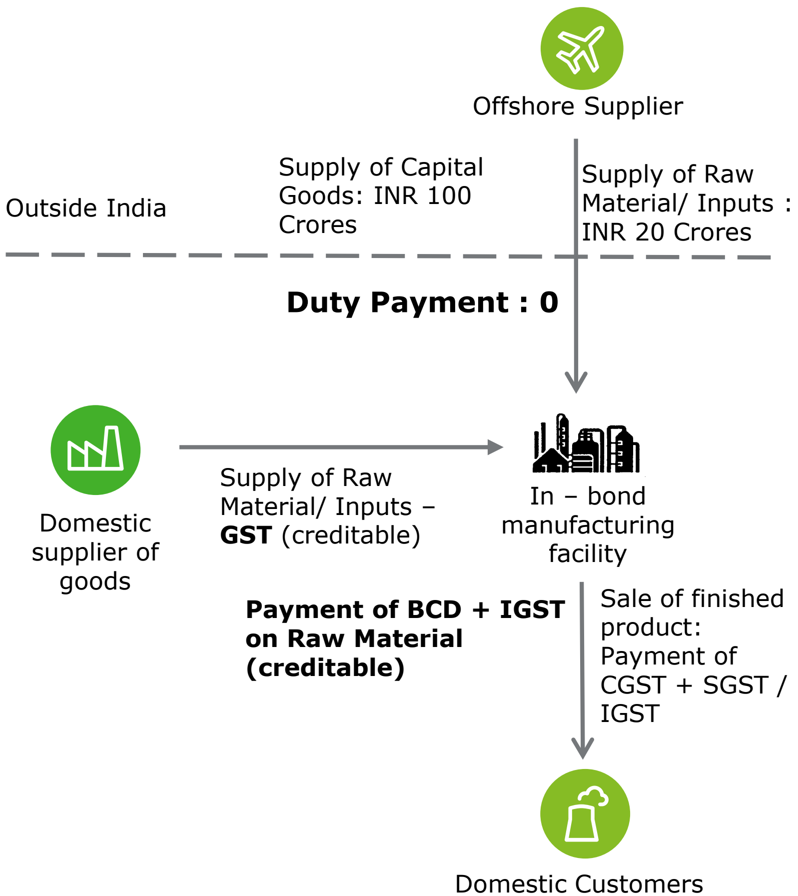


Company can file an application for licensing a facility and setup a manufacturing plant in such facility

- Import of raw materials and capital goods is allowed without payment of duty for manufacturing and other operations in a bonded manufacturing facility
- Highlights of in-bond manufacturing are:
  - Deferred duty on capital goods and raw materials – payable only if cleared to DTA
  - Seamless transfers between warehouses
  - No fixed export obligation
  - Ease of bonded manufacturing
  - Single point of approval
  - Common application form
  - Unlimited period of warehousing
  - No geographical restriction - New manufacturing facility can be set up or an existing facility can be converted into a bonded manufacturing facility irrespective of its location in India
  - Easy compliance
- Also avail reduced base corporate tax rate of 15% and state incentives basis quantum of investment

Bonded Manufacturing

Case Study: Overview



Computation	Amount in INR Cr	
	Capital Goods	Raw Material
Cost of Raw Material (A)	100	20
BCD	-	
Surcharge	-	
IGST	-	
Cash Outflow at the time of Import (C)	**100**	**20**
Duty Payment on imported raw material at the time of **<u>removal</u>** of manufactured Finished Goods:		
BCD (D=A*10%)		2
Surcharge (E=D*10%)		0.20
IGST [F=(A+D+E)*18%]		4
Credit Available		(4)
Savings:		
Tax Cost Saving - Duty on Imported Capital Goods* (BCD + Surcharge)	**11**	
Interest cost on Duty Deferment on Imported Raw Material (Assuming interest cost @ 10% and imported goods are sold within 3 months of import)		**0.06 (Approx. 3% of the customs duty)**

- Import of Capital Goods*/ RM … deferment of taxes/duty
- Reduced working capital blockages

* Customs duty implication in case of Capital goods disposal to be analyzed