

KEY TAXATION ISSUES FOR SUBSIDIARIES IN INDIA

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presented by

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PRESENTATION OUTLINE

- ▲ Overview of Corporate Tax Provisions
- ▲ Key Issues
 - ▶ Management fee – *issues around it*
 - ▶ PAN for foreign companies – *a quick debate*
 - ▶ Deputation/ secondment – *how to structure*
 - ▶ EPC contracts – *basic rules*
- ▲ Key Provisions of the Direct Tax Code (DTC)
- ▲ About ASA/CCI

CORPORATE TAX PROVISIONS – AN OVERVIEW

CORPORATE TAX PROVISIONS

- ▲ Scope of taxability based on **residential status**. Residential status determined on the basis of place of control and management
- ▲ Resident companies taxed on **worldwide income** in India
- ▲ Non resident companies taxed on income **received, accruing or deemed** to be accruing in India
- ▲ **Rates of Tax**

Assessee	Effective Tax Rate (%)
Indian Incorporated Companies	32.445
Foreign Companies	42.024

- ▲ All business related expenses allowed as **tax deductible** against business receipts

CORPORATE TAX PROVISIONS

- ▲ Business losses allowed to be **carried forward** upto 8 years for set off against future business profits
- ▲ **Minimum Alternate Tax (MAT)** at **20.01%** is payable based on 'Book Profits'. Tax paid under MAT eligible for carry forward and set off against normal tax liability
- ▲ Industry/Sector/Area based tax **exemptions** available. SEZ are in focus
- ▲ Payment of dividend to parent company subject to **distribution tax** at **16.22%**
- ▲ **Royalty & Fee for technical services** payable to parent subject to 10% tax withholding (subject to PAN availability). Generally available as credit to parent company
- ▲ **Transfer pricing documentation necessary if quantum of transactions exceed INR 10million. Safe Harbor Rules and Advance Pricing Authorities non-existing.**
Key subject matter for litigation at all levels

KEY ISSUES FOR DISCUSSION

MANAGEMENT FEE

challenging best practices

MANAGEMENT FEE

FACTS/ BACKGROUND

- ▲ Management Fee paid by Subsidiary Company (Sub Co) to its Parent Company ('P Co') for support on internal management functions viz. finance, administration, reporting, marketing, legal support and such
- ▲ Such payments are within regulatory threshold i.e. FEMA (foreign exchange regulator) allows that management/consultancy fee can be paid to a non-resident without any monetary ceiling
- ▲ Payment subject to 10% tax withholding. No major service tax implications

“Most common arrangement found in a parent-subsidiary relationship”

MANAGEMENT FEE

OBSERVATIONS BY TAX AUTHORITIES (consequent to recent judgment in Gemplus India, a group company of French subsidiary)

- ▲ Nature of payment and actual delivery of services to Sub Co
- ▲ Necessity of availing such services for Sub Co
- ▲ Actual benefit derived by Sub Co
- ▲ Basis of Pricing
 - *mere cost allocation v. marked up price*
 - *price justification*

“Each aspect of the transaction is being challenged by revenue authorities”

MANAGEMENT FEE

RECOMMENDATIONS

Strengthening of documentation

- ▲ All payments must be evidenced by a written instrument (agreement) with clear and detailed description of services
- ▲ The Sub Co must demonstrate need for such services and corresponding benefits through appropriate documentation
- ▲ Satisfy the arm's length principal using accepted TP methodologies
- ▲ P Co to also maintain documentary evidence to substantiate that services are rendered specifically for Indian subsidiary

“Documentation is key”

PAN FOR FOREIGN COMPANIES

what does it mean

PAN FOR FOREIGN COMPANIES

ISSUE

- ▲ Effective April 1, 2010, it is mandatory for foreign companies to quote their Permanent Account Number (PAN) if they are in receipt of sums which are **chargeable to tax in India**, in hands of such non-resident

CONSEQUENCES

- ▲ If PAN not obtained, tax withholding to apply at a higher rate of 20%
- ▲ Payment not tax deductible for payer if withholding requirements not met

“PAN is mandatory”

PAN FOR FOREIGN COMPANIES

POSSIBLE IMPLICATIONS

- ▲ Since onus rests with payer in India, PAN is demanded for every payment to a Non-resident even when it is not chargeable to tax in India
- ▲ Substantial increase in overall cost of project where agreement is to pay net of tax and grossing up is required
- ▲ Corresponding credit of additional withholding tax not available in home country (generally restricted to 10% as per most tax treaties)
- ▲ Tax compliances in India and perceived threat of PE for non-resident recipients

“Withholding Rate of 20% is higher than rate under tax treaty i.e. apparent conflict exists”

PAN FOR FOREIGN COMPANIES

RECOMMENDATIONS

- ▲ Obtain PAN. Process is not cumbersome
- ▲ Since onus of payment and tax withholding rests with payer, **convince the payer** if you believe that income is not subject to tax in India
- ▲ Explore the option of a **NIL tax withholding certificate** if time is on hand (2-4 months)

“Be Conservative – Apply For PAN”

DEPUTATION / SECONDMENT

all about documentation

DEPUTATION/ SECONDMENTS

FACTS

- ▲ P Co dispatches employees to India Sub Co in two capacities
 - *engineers for transfer of know-how / technical services (contractual obligation)*
 - *senior staff for managerial/operational functions (no obligation)*
- ▲ A formal Technical Service Agreement (TSA) is executed
- ▲ No formal Secondment agreement is executed
- ▲ Part salary of seconded staff paid by P Co, subsequently reimbursed by Sub Co

“Reimbursements to P Co towards Salaries / Benefits to Seconded Managerial Staff Paid Overseas Can Be Treated as Technical Fee, Subject to Withholding Tax (10%) and Service Tax”

DEPUTATION/ SECONDMENTS

RECOMMENDATIONS

Documentation is the key to avoid such situations. The prime purpose here is to establish that both payments are mutually exclusive and thus, reimbursements are not FEE

- ▲ A secondment agreement between P Co and S Co, which should specify that
 - all rights related to employment have shifted to S Co
 - indicate that secondments are not consequent to Technical Service Arrangement
 - any cost paid by P Co to be reimbursed on cost

- ▲ An independent employment agreement between Sub Co and seconded employee to state that S Co possess complete rights over employment of seconded employee

“Such documentation Would Ensure that Deputations Are Treated as Employment and Any Reimbursements to P Co are characterised as FEE”

EPC CONTRACTS

key tax issues

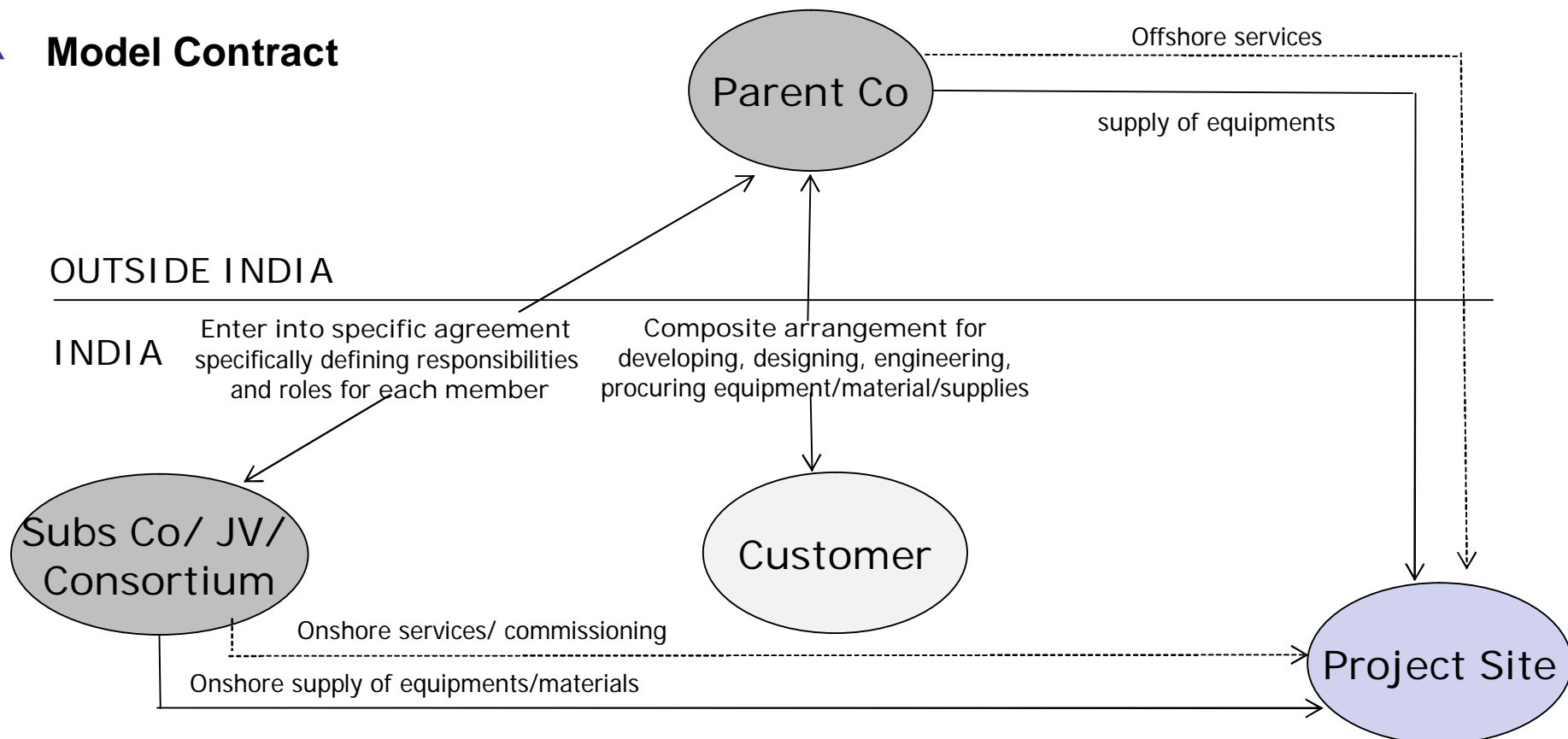
EPC CONTRACTS

▲ Structure

A contract involving Erection, Procurement & Commissioning (Turnkey Basis) (EPC) resulting in several distinctly identifiable streams of income primarily

- ▶ Offshore – Portion of the contract performs outside India
- ▶ Onshore - Portion of the contract performs inside India

▲ Model Contract



EPC CONTRACTS

▲ Summary of Income-tax Implications

Revenue Streams	No PE in India	PE in India
Offshore Supplies	Not Taxable	Taxable (2)
Offshore Services	Taxable (1)	Taxable (2)
Onshore Supplies	NA	Taxable (2)
Onshore Services	Taxable (1)	Taxable (2)

(1) generally taxable at 10% on **gross fee**

(2) contracts involving PE generally taxable at 42.02% on **net income**

▲ Do's & Dont's (for Sub Co's)

- ▶ To ensure **no participation** in the negotiations and making of offshore supply contract
- ▶ Offshore supply contract should be on FOB basis and **no involvement of subs co in delivery of materials/equipment in India**
- ▶ Subs co **not to involve in any warranty/after sales support** of such offshore materials
- ▶ Role of Subs Co should be **explicitly defined to the extent of the operations performed in India**
- ▶ Not to **sign contracts or bind P Co** in any manner.

**KEY PROVISION OF
DIRECT TAX CODE, 2010 (DTC)**

effective april 1, 2012

TAX RATE - COMPARISON

Particulars	Income Tax Act, 1961	DTC
Domestic Company	32.44%	30%
Foreign Company	42.02%	30%
Branch Profit Tax (BPT)	Nil	15%
Minimum Alternate Tax (MAT)	20.01% on book profit	20% on book profit
Dividend Distribution Tax (DDT)	16.22%	15%

OTHER RELATED PROVISIONS - COMPARISON

Particulars	Income Tax Act, 1961	DTC
Residency Test	Foreign company is resident in India if controlled/managed wholly in India	Foreign company is resident in India if place of effective management is in India at any time
Controlled Foreign Corporation (CFC)	Not relevant	Introduced to tax the passive income of foreign company
Tax Treaty and Local Law Interplay	Treaty will override and Act will apply only to the extent it is beneficial	Treaty benefits are restricted where General Anti Avoidance Rules (GAAR) , Branch Profits Tax (BPT) or Controlled Foreign Company (CFC) provisions invoked
Due date for filing return	September 30	August 31

ABOUT US

Corporate Catalyst India

(in joint venture with SCS Global)

&

ASA & Associates chartered accountants
(a member firm of NIS Global)

OUR STRENGTHS

- **CCI** – joint venture with **SCS Global**
- **ASA** - member of **NIS Global**, an international association of independent accounting firms
- Own offices in **6 cities** i.e. Delhi, Mumbai, Bangalore, Chennai, Hyderabad, Kochi
- Approximately 70 per cent are **overseas clients**
- Offices across India and **affiliations worldwide**
- More than 20 years **work experience**
- Professional **staff strength** of about 300 in India & 1,500 through associate network

OUR SERVICES



Services

- ❑ **Business Advisory – Inbound investments**
- ❑ **Transaction Advisory – M&A, Restructuring**
- ❑ **Market Research/ Industrial Analysis**
- ❑ **Tax – Expatriates, Transfer Pricing**
- ❑ **Compliance – Bookkeeping, IFRS, SOX**
- ❑ **Audit – Statutory, Internal**

THANK YOU

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