Tax Consideration with regard to Foreign Investment in India

EFFECTIVE TAX RATE FOR THE ASSESSMENT YEARS 2008-09 AND 2009-10—

I. In case of a foreign company, 40 per cent of the total income. The income-tax so calculated or in section 111A or section 112 of the Income-tax Act, 1961shall in case of every foreign company be increased by a surcharge of 2.5 per cent of such income-tax, if the total income exceeds Rs. 1 crore.
II. Rate of tax for foreign companies on dividend received from Indian company shall be 20 per cent as increased by surcharge, education cess and secondary higher education cess as applicable, and section 115-O of the Act shall not be applicable.
    - Marginal relief - In case of a foreign company, where the total income exceeds Rs. 1 crore, then the aggregate of income-tax and surcharge shall be restricted to:

      (Tax on Rs.1 crore) + (Total income - Rs. 1crore)
    - Education Cess and Secondary Higher Education Cess - The income-tax so computed shall be increased by surcharge and shall further be increased by Education cess and Secondary Higher Education cess by 2 per cent and 1 per cent, respectively.

PROVISIONS OF CAPITAL GAIN ARISE ON TRANSFER OF CAPITAL ASSETS-

(a) Capital gain on transfer of capital assets being shares or debentures in an Indian company shall be computed by applying the first proviso to section 48 of the Act.

As per the first proviso to section 48, the capital gains arising from the transfer of shares or debentures in an Indian company shall be computed by converting

(i) the cost of acquisition of the asset
(ii) the expenditure incurred wholly and exclusively in connection with such transfer and

(iii) sale consideration received or accruing as a result of capital asset into the same foreign currency as was initially utilised in the purchase of such shares or debentures. The capital gain so computed in the foreign currency shall be reconverted into Indian currency.

The method of conversion is stated as per rule 115A of the Income-tax Rules, 1962 which is as follows:

- The cost of acquisition shall be converted at the average of the Telegraphic Transfer Buying Rate (TTBR) and the Telegraphic Transfer Selling Rate (TTSR) (of the foreign currency initially utilised for the purchase of shares/debentures) as on the date of acquisition of shares/debentures.
- The expenditure in connection with the transfer shall be converted at the average of TTBR and TTSR (of the foreign currency initially utilised for the purchase of shares/debentures) as on the date of transfer of shares/debentures.
- The sale consideration shall be converted at the average of TTBR and TTSR (of the foreign currency initially utilised for the purchase of shares/debentures) as on the date of transfer of shares/debentures.
- The capital gains computed in the foreign currency shall be converted into Indian currency by applying TTBR as on the date of transfer of shares/debentures.

(b) Computation of tax on capital gain arises on transfer of capital assets being shares

- Short-term capital gain under section 111A :

Short-term capital gain arises on transfer of capital asset being equity shares in a company or a unit of an equity oriented fund on or after October 1, 2004 and such transaction is chargeable to securities transaction tax which is to be charged at the rate of 10 per cent for the assessment year 2008-09 and at 15 per cent for the assessment year 2009-10.

- Long-term capital gain on transfer of shares :

After introduction of section 10(38) by the Finance Act, 2004, any long term capital gain arising on transfer of capital assets being equity shares, units of equity oriented fund shall be exempt from tax.

Explanation

(a) Section 10(38) shall not apply in the following cases :

(i) Where listed equity shares are sold on or after October 1, 2004 other than through recognized stock exchange.

(ii) Where units of equity oriented fund are sold on or after October 1, 2004 other than through recognized stock exchange.

(iii) Where listed debentures/bonds are sold since exemption under section 10(38) is not available for listed debenture/bonds.

(iv) Where units of a mutual fund other than equity oriented fund are sold since exemption under section 10(38) is not available to units of a mutual fund other than equity oriented fund.

(b) Equity oriented fund means a fund—

(i) Where the invisible funds are invested by way of equity shares in domestic companies to the extent of more than 65 per cent of the proceeds of such fund; and

(ii) Which has been set up under a scheme of mutual fund specified under section 10(23D).

- Further incentives to attract foreign investments - As per section 47(viii), the transaction shall not be regarded as transfer if Bonds or Global Depository Receipts are, referred to in section 115AC, made outside India by a non-resident to another non-resident.

<u>CAPITAL GAIN ON TRANSFER OF CAPITAL ASSETS OTHER THAN SHARES -</u>

SHORT-TERM CAPITAL GAIN - Short-term capital gain arising on transfer of capital assets shall be charged at normal corporate/individual tax rates.

LONG-TERM CAPITAL GAIN UNDER SECTION 112 - Any long-term capital gain arising on transfer of capital asset shall be chargeable at the rate of 20 per cent.

PROVISO TO SECTION 112 - Where the tax payable in respect of any income arising from the transfer of a long-term capital asset, being listed securities or units or zero coupon bond, exceeds 10 per cent of the amount of capital gains computed before giving effect to the provisions of the second proviso to section 48 (i.e., without indexation), then such excess shall be ignored for the purposes of computing the tax payable by the assessee. In other words, the tax on capital gains from listed securities or units or zero coupon bonds being long-term shall be the lower of the following:

(i) Tax on capital gains computed normally at the rate of 20 per cent as per the provisions of section 112 or

(ii) Tax on capital gains computed normally but without giving the benefit of indexation (i.e., the second proviso to section 48), if applicable, at the rate of 10 per cent as per the provisions of section 112.