

# Market Analysis: India

## Overview

Population	1.16 billion
Total area	3.29 million sq km
Capital	New Delhi
Major language(s)	Hindi and English, with more than 20 other official languages
Time zone	GMT + 5.5 hours (New Delhi)
Currency	Indian rupee (INR)
Central bank	Reserve Bank of India (RBI)
Gross domestic product	2,988.9bn total (2007); 9.2% real growth rate (2007); 2,659 per capita (2007 est.)
Inflation rate (consumer prices)	6.4% (2007)

## Trade

Exports	USD151.3bn f.o.b. (2007)	Imports	USD247.0bn c.i.f. (2007)
Major exports	Minerals and associated products; jewels, jewellery and precious metals; chemicals and chemical products; iron and steel; apparel and clothing accessories (2007)	Major imports	Minerals and associated products; jewels, jewellery and precious metals; machinery and mechanical appliances; electrical machinery and equipment; iron and steel (2007)
Major markets (% of total)	US – 15.1%, UAE – 8.8%, China – 8.4%, UK – 4.3% (2007)	Major suppliers (% of total)	China – 10.5%, US – 7.8%, Germany – 4.5%, Singapore – 4.5%, Australia – 3.7% (2007)
Trade with rest of world	USD398.3bn (2007)	Trade with Asia	USD134.4bn (2007)

## Banking System and Bank Accounts

- ▶ The Reserve Bank of India (RBI) is the central bank of India and the main regulator for banks. India's commercial banking sector is made up of public-sector banks (including the State Bank of India group and 20 other nationalised banks), private-sector banks and foreign banks. Although the public-sector banks have a large network of branches, the Indian private-sector banks are fast catching up in terms of revenue, size and business growth.
- ▶ Customers who are not incorporated in India and have branches, liaison or project offices in India, are regulated by Section 6(3)(i) of the Foreign Exchange Management Act 1999. These companies with approval from the RBI can open a bank account in India.
- ▶ At the time of opening of the bank account, the account holder is required to furnish an undertaking to the authorised dealer that debits to the account are for the purpose of investments in India, and credits representing sale proceeds of investments will be in accordance with RBI regulations.

- The following types of bank accounts are currently available:

Account type	Local current	Local savings <sup>2</sup>	Foreign current <sup>1</sup>	Foreign savings <sup>2</sup>
Resident	Yes	Yes	Yes	No
Non-resident	Yes	Yes	No	No
Credit interest	No	Yes	No	Yes

1. Banks in India are not permitted to offer any foreign currency current accounts, except special categories such as exchange earner's foreign currency (EEFC) deposit, resident foreign currency (domestic) [RFC (D)] account, which can be opened by resident individuals, and resident foreign currency account (RFC), which can be opened by non-resident individuals returning to India.
2. Corporates are not permitted to open savings accounts. However, individual customers can open local savings accounts.

## Clearing Systems and Payment Instruments

Electronic clearing systems	Comments
Real-Time Gross Settlement (RTGS)	<ul style="list-style-type: none"> <li>• Electronic payments instructions can be processed in real time.</li> <li>• RTGS is positioned for high value transactions.</li> <li>• Provides deal-by-deal instant settlement and continuous gross settlement without netting.</li> <li>• Minimum amount permitted for transfer is INR100,000.</li> <li>• Credit is received within two hours of transaction.</li> <li>• More than 47,000 branches enabled on RTGS.</li> </ul>
National Electronic Funds Transfer (NEFT)	<ul style="list-style-type: none"> <li>• NEFT is an electronic funds transfer system between banks using the SFMS (Structured Financial Messaging Solution) messaging application.</li> <li>• Positioned for bulk low-value retail transactions.</li> <li>• All settlements are centralised at RBI, Mumbai. Hence, there are no coverage restrictions.</li> <li>• NEFT is run in six batches per day: 9:00am, 11:00am, 12:00 noon, 1:00pm, 3:00pm and 5:00pm. NEFT has a same-day settlement period for batches up to the 1:00pm cycle.</li> <li>• More than 47,000+ branches enabled on NEFT.</li> </ul>
Electronic Clearing Service (ECS)	<ul style="list-style-type: none"> <li>• Enables large-volume transfers of small-value transactions.</li> <li>• Institutions and corporations disbursing interest or dividends to their investors use this payment mode.</li> <li>• Works on a four-day cycle.</li> <li>• Transaction details and settlement details are captured on diskettes for data transfer.</li> <li>• More than 60 locations covered, including 15 RBI locations.</li> </ul>

- Cheques remain the most common method of payment in India. Currently there are 1,092 local clearing houses across the country, with those in Indian metropolitan areas being controlled by the central bank, while clearing in non-metropolitan areas and smaller towns is usually run by state-owned banks.
- Historically, the clearing systems have been local and confined to a defined jurisdiction covering all the banks situated in the area under a particular zone. However, with the introduction of the Speed Clearing Service and the cheque truncation system, clearing houses are now empowered to process instruments from other jurisdictions and areas.
- In addition, regulators are encouraging electronic payments through NEFT, RTGS and ECS, as well as direct debits and direct credits.

## Legal, Company and Regulatory

- Apart from the RBI, other important regulatory bodies in India include:
- The Securities Exchange Board of India (SEBI), which regulates capital market activities;
  - The Central Board of Excise and Customs;
  - The Central Board of Direct Taxes, which provides essential inputs for policy and planning of direct taxes in India, and is responsible for administration of direct tax laws through the Income Tax Department; and

- The Insurance Regulatory and Development Authority (IRDA), which regulates the insurance industry.
- ▶ Requirements for establishing a company in India are governed by the Companies Act, 1956. Among others, the key requirements include the following provisions:
  - Private companies should have a minimum paid-up capital of INR100,000 or such higher paid-up capital as may be prescribed. A public company should have a minimum paid-up capital of INR500,000 or such higher paid-up capital as may be prescribed. Please note that exact capital requirements vary according to industry sector.
  - A company may be formed by any seven or more persons (in the case of a private company any two or more persons) by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Companies Act as regards registration.
  - No company shall be registered by a name which, in the opinion of the central government, is undesirable. A name which is identical with or too nearly resembles the name by which a company in existence has been previously registered or a registered trade mark, or a trade mark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999 may be deemed to be undesirable by the central government.
  - As regards the incorporation of subsidiary company in India of a foreign company, the usual provisions of the Companies Act apply as regards incorporation and other day-to-day corporate matters. However, investment in India by a foreign company by way of incorporating a subsidiary must also comply with the government's current foreign direct investment policy and other regulatory requirements.

### Liquidity, Currency and Tax

- ▶ Under the provisions of the Foreign Exchange Management Act, 1999, foreign companies in India are authorised to remit profits, royalties, dividends and capital, subject to foreign exchange controls administered by the RBI. Remittances are permitted only after accounts have been audited and taxes have been paid. Foreign exchange hedging is not permitted and deposits in foreign currency are restricted by the central bank.
- ▶ Only single currency cash concentration is allowed in India and in a cash concentration structure interest payable by one participating company to another is subject to withholding income tax.
- ▶ Cash concentration across legal entities (pool vs main) can trigger significant tax implications, based on legal status and holding structure of the participating entities. Any advance or loan given by a closely held company to either its shareholder(s) holding 10% or more of the voting power or any other company in which such shareholder(s) has substantial interest, is assumed as taxable dividends in the hands of the receiving company to the extent the lending company possesses accumulated profits. Two relevant exceptions to this rule are :
  - Where lending forms substantial part of the lending company's business;
  - Where the lending company is a listed company or is a subsidiary of a listed company.
 Tax deductibility of the cost of funds for the lending company may be impacted where it is utilised to fund other group entities. Also, interest payable between such group companies will be subject to withholding tax at 20% (plus surcharge and cess as applicable) on a gross basis, which will create cash flow gaps.
- ▶ Notional pooling is not permitted in India.
- ▶ Common investment instruments used by corporates for surplus liquidity include term deposits, cluster deposits, and mutual funds. (The previous alternative of exchange earner's foreign currency (EEFC) deposits ceased to exist as of 31 October 2008.)

► Corporate tax rates are as follows:

Company	Regular tax	Tax rate (inclusive of applicable surcharge and cess )
Domestic company	(a) Where total income is more than INR10m	33.99%
	(b) Where the total income is equal to or less than INR10m	30.90%
Foreign company	(a) Where total income is more than INR10m	42.23%
	(b) Where the total income is equal to or less than INR10m	41.20%

► Withholding tax rates (exclusive of surcharge and education cess) for foreign companies are as follows:

Source of income	Withholding tax rate for non-treaty foreign companies	Withholding tax rates for US companies carrying out business in India under the India-US tax treaty
Dividends	Dividends referred to in Section 1150 of the Income Tax Act are exempt. Any income received in respect of units of a mutual fund specified under Section 10(23D) or the specified company is also exempt.	15% if at least 10% of the capital is owned by the company. In other cases, 25%.
Interest income	20%	10% if the recipient is a bonafide bank or a financial institution. In other cases, 15%.
Royalties	10% where the agreement is made on or after 1 June 2005. For agreements made prior to 1 June 2005, there are different rates depending on the date when the agreement was made.	10% for equipment rental and for ancillary or subsidiary services thereto. In other cases, 15%.
Technical services	10% where the agreement is made on or after 1 June 2005. For agreements made prior to 1 June 2005, there are different rates depending on the date when the agreement was made.	10% for equipment rental and for ancillary or subsidiary services thereto. In other cases, 15%.
Other income	40%, plus surcharge and cess as applicable.	Nil if treaty benefit is available. Otherwise, the tax rate is 40%, plus surcharge and cess as applicable.



### Market Watch

India is undergoing significant changes and improvements to its clearing infrastructure. Some of the major enhancements and initiatives include:

- Usage of electronic clearing systems in India is increasing, with significant growth in the use of the NEFT and RTGS systems. The use of paper-clearing systems continue to grow, although not at the same rates as electronic clearing systems.
- The RBI is in the first phase of launching a National Electronic Clearing Service (NECS), a new electronic payment product that is expected to be an enriched version of the ECS proposition. NECS is proposed to be launched under the same infrastructure as NEFT and would be available to all NEFT-enabled banks.
- The RBI has recently introduced the Speed Clearing Service, with the objective of processing outstation cheques as local cheques by banks which are enabled on the central bank's Core Banking System. Customers can present cheques from 83 banks and more than 29,000 branches under the speed Clearing system to be processed under local clearing. The turnaround time realised for all instruments processed under speed clearing would be similar to local cheque processing.
- Under the cheque truncation system, instead of the physical instrument, an electronic image of the cheque is sent to the drawee branch along with the relevant cheque related information. This

effectively reduces the turnaround time for the processing of cheques, along with the associated cost of transit and delay in processing, etc. and speeds up the process of cheques realisation. A pilot scheme for the system is currently underway in the National Capital Region (New Delhi and four surrounding states).

- With effect from 1 August 2008, the RBI has mandated that all payment transactions above INR1m by RBI-regulated entities in RBI-regulated markets be routed through electronic payment systems, i.e. RTGS, NEFT or ECS.
- Under a mandate by the Central Board of Excise and Customs, customers with annual obligations above INR5m are obliged to pay service tax and excise duty electronically.
- Similarly, with effect from 1 April 2008, the Central Board of Direct Taxes has mandated that companies and all persons other than companies who are mandated to conduct a tax audit must pay their direct tax liability (including withholding tax, corporate tax, wealth tax, fringe benefit tax, etc.) electronically.

HSBC Global Payments and Cash Management	Tel: [91] (22) 6669 6301	E-mail: <a href="mailto:indiacash@hsbc.com">indiacash@hsbc.com</a>
HSBC Trade and Supply Chain	Tel: [91] (22) 6746 5517	E-mail: <a href="mailto:tradeandsupplychain@hsbc.com">tradeandsupplychain@hsbc.com</a>