Embassy of India
Berlin, Germany

MAKE IN INDIA MITTELSTAND!

Rödl & Partner

NEWSLETTER

Investment Support for German Mittelstand Enterprises

IN THIS ISSUE:

Economic Update

In the last edition of our “Make in India Mittelstand!” Economic Overview, India’s Chandrayaan-3 spacecraft was on the verge of landing on the moon. Now, a month later, India has officially become the 4th nation to successfully land a spacecraft on the moon, thereby officially lifting India into the realm of a space power. This comes at a time of an overall positive development of India’s standing on the global stage.

https://www.bundesregierung.de/breg-de/aktuelles/g20-in-neu-delhi-2221690

And as the year continues, so does the interest in current Indian affairs. The expansion of the BRICS framework continues to generate interest and new points of discussion in all countries around the world. The BRICS (formerly consisting of Brazil, Russia, India, China, and South Africa) have recently announced that they will take on 6 additional members, hence now making up for more than 30% of the global GDP and 46% of the world population. In comparison, the current G7 makes up 10% of the world’s population and 27% of the world economy.

This comes at an extremely interesting point in time since recently, India’s foreign trade crossed the $800 bn mark for the first time in six months. Despite the current global demand in goods decreasing, India's trade balance is only lagging behind by 2.5% in comparison to last year. Challenges that India, among other countries, is currently facing are non-tariff barriers such as the EU's newly implemented carbon tax.

Nevertheless, the International Monetary Fund (IMF) has increased India's forecast for FY24 by 20 basis points in its latest World Economic outlook. This is due to the fact that the current economic situation, despite lagging imports and exports, is still better than what the IMF had expected due to the challenging world economic situation. Some of the robustness of India's economy can be traced back to the strong domestic investments by the government which create productive assets and result in an increase in the business sentiment in the economy.

Furthermore, India is increasing its potential to become an essential destination for the refuelling of "green ships". This includes building and utilizing green hydrogen as an energy source. Over the past years, India has been expanding its capability to utilize and produce green hydrogen. By doing so the Indian Government has worked on various regulatory steps as well as providing financial means for pilot projects which will hopefully quickly yield positive outcomes.

Additionally, India has managed something extraordinary. Prime Minister Modi announced that the G20 summit had overcome their differences and reached an agreement. In light of the current global political polarisation, the agreement is something that no one would have expected this easily, especially since Russia's President Vladimir Putin as well as China's president Xi Jinping were absent during the summit. The G20 concluded that they would accept the African Union (AU) and officially become the 'G21'. In unison with other countries, India signed various agreements to further support trade with Europe. India is hoping, among other things, to strengthen collaborations in the fields of digital technology, e-commerce, and IT services with the other G20 nations to increase the country's exports and overall foreign investment. Moreover, the governments of the European Union, India, Saudi Arabia, France, Germany, Italy, and the U.S. signed a Memorandum of Understanding to establish an India - Middle East - Europe Economic Corridor, which will facilitate and boost trade, improve digital connectivity and ease the delivery of energy resources. The forecast regarding the implementation of the agreements made during the G20 summit in New Delhi is, therefore, an overall optimistic one.

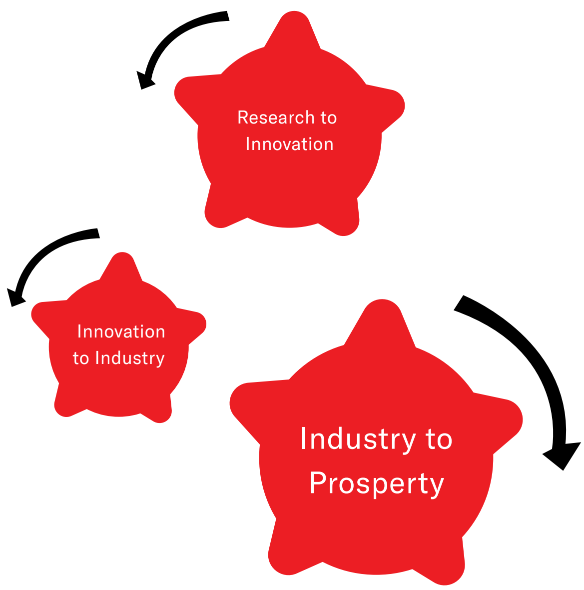
- Maja Yadu, Project Coordinator MIIM, Roedl & Partner

SUBSIDIES FOR MANUFACTURING IN INDIA: PART V

TELANGANA - TIP FRAMEWORK, 2023 & T-IDEA INCENTIVE SCHEME

Formed in 2014, Telangana is the youngest state in India. From 2015 to 2022, the State has shown significant development, to name a few, the Gross Domestic Product grew by 128% and the foreign currency investments attracted since 2014 are around USD 47 bn.

To attract further investments, the state has come up with the Telangana Industrial Policy (TIP) Framework, 2023. Under this framework, with the motto of "Minimum Inspection and Maximum Facilitation," the state has provided the key highlights of "T-IDEA (Telangana State Industrial Development and Entrepreneur Advancement) Incentive Scheme.



Vision for Industrialization

Note: Please note that the T-IDEA Incentive Scheme has not been issued / notified yet. The application for benefits mentioned in the following paragraphs would be covered under the said scheme. Further, the exact quantum of benefits that would be available under the said scheme can only be calculated once the scheme is issued / notified.

Who can apply for the benefits under the T-IDEA Incentive Scheme?

An entity commencing a new unit in the state of Telangana or undertaking expansion or diversification of an existing unit in the state of Telangana falling under the following specified categories can apply for the benefits. The categories – Micro Enterprises, Small and Medium Industries, Other Large Projects, and Mega Projects are based on "Investment in Plant and Machinery" or "Provision of Employment Opportunities". The categorization provided under TIP Framework, 2023 for the T-IDEA Incentive Scheme can be further understood from the following:

Micro Enterprises - Investment in Plant & Machinery less than INR 2.5 mn

Small Industries - Investment in Plant & Machinery between INR 2.5 mn to INR 50 mn

Medium Industries - Investment in Plant & Machinery between INR 50 mn to INR 100 mn

Other Large Projects - Investment in Plant & Machinery between INR 100 mn to INR 2000 mn

Mega Projects - Investment in Plant & Machinery between INR 2000 mn or Employment more than 1000 persons

It is important to note that the thresholds required to qualify as a Mega Project in the state of Telangana is one of the lowest as compared to the industrial policies offered by various other states of India.

What benefits would be offered by the state government of Telangana under the T-IDEA Incentive Scheme?

The Telangana State Government is committed to encouraging the process of industrialization by making various kinds of incentives available to the industries. In order to do so, the Telangana State Government would introduce a transparent online application system and guarantee that the incentives would also be released in a transparent manner directly to the bank accounts of the individual applicants on a timely basis. The TIP Framework, 2023 highlights that the following incentives would be covered under the T-IDEA incentive scheme:

VAT Reimbursement	Stamp Duty Reimbursement	Land Cost Rebate	Power Cost Reimbursement	Investment Subsidy
Interest Subsidy	Reimbursement of Infrastructure Development Costs	Training and Skill Development Cost Reimbursement	Quality/Patent Support	Clean Production Measures

Apart from the incentives mentioned in the adjacent boxes, Mega Projects with an investment of more than INR 2,000 mn in plant and machinery or employment over 1,000 persons would get an opportunity to receive tailor made incentives in addition to the standard large category industrial incentives.

What are the other benefits offered by the state government of Telangana under the TIP Framework, 2023?

New Initiatives – The State is also coming up with new initiatives like New Pharma City with well-developed infrastructure including waste management, Development of the Hyderabad- Warangal Industrial Corridor, Development of Warangal as the Textile Hub of Telangana, Sector specific industrial parks (Furniture, Toys, Plastic etc.), T-Hub 2.0, T-Works & T-Image (World's largest innovation campus), etc.

Infrastructure Development – The TSIIC would develop all required infrastructure for the sector-specific parks like approach roads, water supply, industrial power, and common effluent treatment facilities. Along similar lines, the entire internal infrastructure within an industrial park, comprising of internal roads, water distribution lines, drains, waste disposal facilities, etc. would be developed by the TSIIC before the lands are allotted to the respective industrial units.

Industrial Land Bank – An extent of 1,50,000 acres of Government Land has been transferred and is now vested with Telangana State Industrial Investment Corporation (TSIIC). This last is ready to be occupied for industrial purposes. In addition, TSIIC also has 150 ready-to-occupy Industrial Parks.

Skill Development – Skill development programs undertaken by the State government under the Telangana State Accelerated SSI Skills Training (T-ASSIST) program would aim to train the youth in getting entry-level jobs and upgradation of skills of the existing employees.

Review of Industrial Laws – In alignment with the Government of India, the State government of Telangana would also review the laws and rules applicable to the industries to either remove or completely revise the laws to make those relevant for the present circumstances.

When should an entity evaluate subsidies for manufacturing in India?

PIANNING STAGE → **SET-UP STAGE** → **OPERATION STAGE**

Prior to finalisation of the location to set up the manufacturing facility in India, an entity should evaluate which state would offer the best incentives and benefits under the various policies.

Why should an entity evaluate subsidies for manufacturing before setting up business in India?

Being the fastest-growing major economy in the world, India is an attractive investment opportunity for businesses around the world. Understanding this factor and with the vision of “Make in India”, the Central and State governments of India are incentivizing businesses to set up manufacturing units in India.

Apart from the above-discussed T-Idea, the Telangana State government would also issue Sectoral Policies and structure of incentives for Thrust Sectors. These sectors include – Life Sciences, IT Hardware, Precision Engineering, Food Processing and Nutrition Products, Automobiles, Transport Vehicles and Auto-Components, Textiles and Apparel, Plastics and Polymers, Engineering and Capital Goods, Gems and Jewelry, Waste Management and Green Technologies, Renewable Energy and Solar Parks, Mineral based, and Wood-based Industries, Transportation, Logistic Hub etc.

Further, the Central Government of India has separate incentives under the Foreign Trade Policy and has notified various sector-specific policies. Furthermore, other states in India also offer state-specific and sector-specific schemes of incentives for the promotion of the manufacturing industry some of which we have covered in the previous parts of this article series. Please note that several policies are not exclusive, and an eligible entity can claim benefits under 2-3 different policies for the same manufacturing unit.

In case a business entity claims benefits under either of these schemes, it can result in a substantial reduction of the capital investment over a period and effective management of cash flow for the business. Accordingly, with the wide range of schemes and incentives available to manufacturing units in India, which offer different and substantial benefits and incentives, it becomes relevant to analyze these schemes and policies prior to finalizing the location to set up a manufacturing unit in India.

- ***Anand Khetan, Partner, Roedl & Partner***
- ***Eesha Umbarkar, Senior Associate, Roedl & Partner***

India: Inter-Company Loan(s): Transfer Pricing Implications

Background

With the liberalization of foreign investment in the Indian markets, the structure of foreign inflow gradually witnessed a shift from traditional capital or private equity funding to a newer and structured debt funding known as External Commercial Borrowing ('ECB').

This growth of ECBs through these years, which also represents the most common form of inter-company financing by Multinational Enterprises ('MNE') for their Indian entity operations, can be attributed to the interest rate disparity within the domestic and international market, mixed with the corporate tax benefit of interest expenditure allowance and lower withholding rates being available under the Indian tax regulations, subject to attached conditions.

Regulatory Framework

To regulate the inflow of ECBs, the apex banking authority in India, the Reserve Bank of India ('RBI') was empowered by Foreign Exchange Management Act, 1999 ('FEMA') to regulate such debt arrangements and pass necessary regulations.

Accordingly, FEMA regulations were framed which essentially eased the regulatory burden of approvals on the Indian borrowers, with an automatic approval route, wherein no prior approval or consent from the Indian government ('GoI') is required, provided that the area of investment made is not sensitive and does not require regular monitoring.

In this regard, RBI has been issuing Master Directions since 2016 on all regulatory matters. This Master Direction provides for all-in-cost ceilings i.e. interest rate thresholds, subject to the nature and tenure of the ECBs, and also consolidates and subsumes all instructions, directions, and circulars till date.

An indicative summary of the all-in-cost ceilings applicable as per the latest Master Direction, updated as on June 09, 2022, has been provided below for ease of reference:

Particulars	All-in-cost ceiling p.a.	Purpose	Maximum Limit
Loan through ECB	**Existing ECBs in LIBOR** – Benchmark rate + 550 bps	All purposes except those specifically disallowed in the negative end-use list	Different for different sectors
	New ECB in FCY – Benchmark rate + 500 bps		
	ECB in INR – Benchmark rate (prevailing yield of GoI securities with the same maturity) + 450 bps		

Transfer Pricing Regulations and the Benchmarking Requirements

Thus, as depicted above, these RBI Master Directions do provide for plain vanilla guidance toward the maximum interest rate payable for ECBs, however, any reliance by the Indian entity on these regulations while fixing the interest rate and/ or for justification of the interest rate paid/ payable to overseas MNE Group entity is increasingly being rejected by the Indian Tax authorities.

This is for the reason that Tax authorities are of the opinion that these RBI regulations and the interest rate thresholds are provided for foreign exchange regulations purposes and cannot be substituted as an arm's length interest rate adhering to the Transfer Pricing principles.

Further, the Organisation for Economic Co-operation and Development ('OECD') through its Transfer Pricing Guidance on Financial Transactions, as published in February 2020 and incorporated in the revised OECD Guidelines 2022, also addressed the issues revolving around Intra Group Loans and their pricing meeting the arm's length principles. The important conditions set forth as per the revised OECD Guidelines, to determine arm's length price for financial transactions, has been summarized below:

Process	Description
Determination of the creditworthiness of the borrower	The probability of default of a borrower is commonly conveyed as a credit rating.
Search for comparable debt transactions with similar characteristics of the tested loan	External comparables for benchmarking can be searched on publicly available financial databases, by applying appropriate filters to find comparable loan transactions with the same characteristics. – Currency type – Tenure – Purpose: General / Working Capital / Capital Expansion / Re-financing, etc. – Tranche Type: Term Loan / Revolving Credit – Covenants: Secured / Unsecured, Guaranteed / Not Guaranteed, Sponsored / Not Sponsored – Credit Rating
Computation of Arm's Length interest rate	Arm's length interest rate (or range) of the selected comparable loan transactions to be determined, which can be further adjusted to meet the economic conditions of the tested loan transaction: – Interest Swap Adjustment: Fixed to Floating or vice-versa – Tenor Adjustment – Country Risk Adjustment: To factor in the geographical difference

Further, as per the approach adopted the Tax authorities, and as supported by judicial precedents, it can be inferred that the Indian Transfer Pricing Regulations also require comprehensive testing of the interest rate in line with arm's length principles, and mere reliance on the RBI regulations for interest rate thresholds cannot be considered as an appropriate benchmarking approach.

A summary of various recent rulings pronounced on the issue of benchmarking of interest related payments along with the principles laid down by various courts is provided below:

Case Citation	Decision summary
Winergy Drive Systems India Private Limited [ITA.No.1720/Mds/2014]	A reference to unadjusted interest rate in respect of India's External Debt cannot be applied in taxpayer's case, and a separate arm's length determination based on comparables is required to be performed.
LTIMindtree Limited [ITA No.1924/Mum/2014]	The Tax officer was correct in concluding that the interest rate of loan taken by the taxpayer cannot be compared with interest rate of the loan given by the taxpayer to its AE. As it is not in dispute that there is a difference in credit rating of the taxpayer and its AE, and necessary adjustment is required to adjust such difference.
Broadways Overseas Ltd. [ITA Nos. 477/Asr/2015 and others]	The Tax officer erred in benchmarking the interest rate against the expected return from investment in bonds, as the loan advanced in foreign currency should have been benchmarked by using LIBOR.

Way forward

In light of the above, and in the endeavor to implement the ECB interest rates in line with the available Transfer Pricing related guidance, the following points require due consideration:

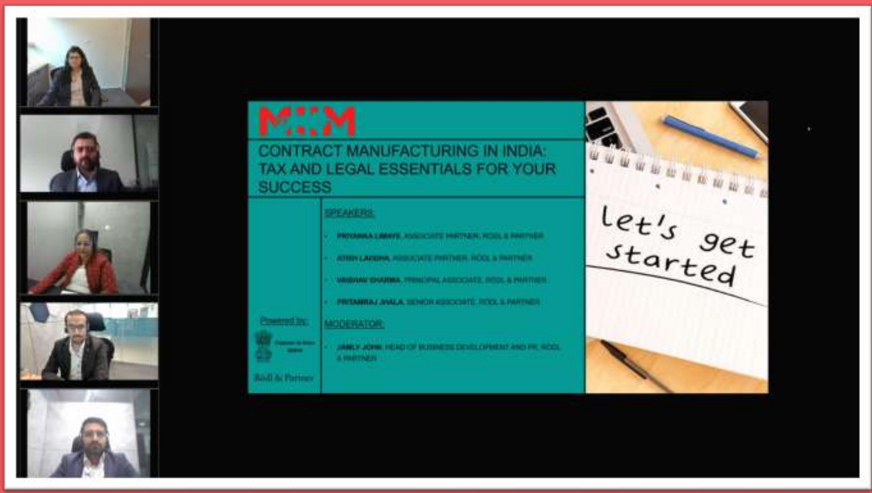
- A benchmarking study is to be conducted from the relevant financial databases, to determine the arm's length interest rate in line with the underlying loan conditions;
- Entering into an ECB arrangement (i.e. agreement) based on the arm's length interest rate so derived;
- Enter into an amendment to the existing ECB agreement, if applicable, based on the revised arm's length interest rate so derived;

Accordingly, it is strongly recommended that in an inter-company loan scenario including ECB loans, a benchmarking exercise for determination of the arm's length nature of interest payment to be conducted separately, as the onus lies the taxpayer to justify the arm's length nature of such interest payments along with maintaining appropriate back-up documentation (i.e. benchmarking study).

- ***Gauri Bivare, Associate Partner, Roedl & Partner***
- ***Pritamraj Jhala, Senior Associate, Roedl & Partner***
- ***Aparna Shaligram, Senior Associate, Roedl & Partner***

Webinar-Recap:“Contract Manufacturing in India: Tax and Legal Essentials for Your Success”

On 17th of August 2023, the Make in India Mittelstand Team conducted the webinar “Contract Manufacturing in India: Tax and Legal Essentials for Your Success” with speakers from Rödl & Partner.



Contract manufacturing has become a game-changer for businesses seeking to streamline operations, access cost-effective solutions, and enhance their global competitiveness. India, with its vast pool of skilled labor, supportive government policies and advanced infrastructure, has emerged as a preferred destination for manufacturing. One predominant and particularly popular model is contract manufacturing. It is, however, essential to have a comprehensive understanding of the legal and taxation framework to ensure a smooth and compliant business operation.

It is thus that the webinar explored the complexities and opportunities of Contract Manufacturing in India and provided valuable insights into the legal, direct tax, indirect tax, and transfer pricing aspects of engaging in contract manufacturing operations in India.

Would you like to know more about contract manufacturing? Do you have remaining questions? Watch the recording of the webinar here or reach out to the MIIM Team for more information – we’re happy to help.

Event-Recap: “An Exclusive Interactive Session with H.E. Parvathaneni Harish, Ambassador of India to Germany”

On 29th of August 2023, the Make in India Mittelstand Team invited its esteemed MIIM-members to an exclusive interaction with H.E. Parvathaneni Harish, Ambassador of India to Germany.

The event was specifically tailored to the needs and interests of MIIM member companies and allowed company representatives to discuss their existing or upcoming India plans. For this purpose, the event was organized as an exclusive, limited to MIIM companies only, interactive session. This format not only allowed for a detailed discussion of every company’s India plans, but it also permitted a valuable and insightful interaction with H.E. Ambassador Harish, First Secretary Dr. Dinesh Antil and Martin Wörlein, Head of India & South Asia Advisory, Rödl & Partner. In the fruitful conversations that resulted, advice was shared, concerns addressed and the opportunities of the Indian market were explored.

The event also helped the “Make in India Mittelstand”-Team to get a feedback on the programme in order to incorporate even more topics and potential concerns in the months to come – stay tuned, German Mittelstand!

Upcoming Webinars

A Guide to Your Global Capability Centre in India

16.10.23 (to be confirmed)

13:00 – 14:05 CET (16:30 – 17:35 IST)

Register here for the webinar.

Powering Tomorrow With Green Hydrogen - India‘s ‘Sunrise Sector’

26.10.23

11:00 – 12:15 CET (14:30 – 15:45 IST)
Register here for the webinar.

Stay tuned for many more events!

About MIIM

MIIM' is a market-entry support programme for German Mittelstand and family-owned enterprises launched by Embassy of India Berlin, Germany in 2015; driven by Government of India's national programme, 'MAKE IN INDIA'.

The objective of MIIM programme is to facilitate investments by German Mittelstand and family-owned companies in India and to provide market entry related services.

The MIIM program has enrolled more than 175 companies which represent a cumulative declared investment of 1.5 bn EUR to India.

As a part of MIIM program members are exposed to a wide range of business support services under a single platform. The program is being implemented with the support of its Knowledge Partner – Rödl & Partner, Facilitation Partners including Central and State Government Ministries in India and also key industry partners who can support the companies in various aspects of market entry into India. Offered services includes Strategy consulting, M&A, operational market entry support, tax & legal support, financial services and other services

MAKE IN INDIA MITTELSTAND!

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Investment support for German Mittelstand Enterprises

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