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Indo-UK Patrika

Welcome to 2012's first edition of our Indo-UK Patrika quarterly newsletter. This issue looks at various topics in vogue on the Indo UK business corridor, ranging from IFRS, the Pay As You Earn System, and the UK immigration landscape to recent changes to FDI in India, the UK Labour Law, and Indian investments into the UK property market.

IFRS in India – What's next?

Rravindra Vadalii, IFRS consultant at *Mehra Goel & Co,* throws light on the changing dynamics of the IFRS regime in India and what the future holds.

IFRS -International Financial Reporting Standard - was the buzzword until about a year ago and it is much less talked about. Of course, there are some people who would prefer to call it IND AS – Indian Accounting Standards or Converged Accounting Standards.

Actually, the genesis of 'IND AS' itself summarises the overall approach in bringing in a new set of accounting standards to India. Let us all go back almost half a decade to understand the journey so far. The Indian Accounting fraternity got a whiff of IFRS way back in 2006-2007. The first formal document by any Authority in India was the **concept paper on convergence**, released in October 2007, which laid down a road map for achieving convergence with IFRSs, with a view to making India IFRS-compliant.

Some of the key concepts and ideologies suggested by the concept paper, which are relevant today, are:

- The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world.
- High standards of financial reporting underpin the trust investors that place in financial and non-financial information. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS;
- 'Convergence' means *"to design and maintain national accounting standards in a way that financial statements, prepared in accordance with national accounting standards, draw unreserved statement of compliance with IFRSs"*.

Following this, nothing substantial happened, at least visibly, until towards the end of 2008/ early 2009. Action started when, on 25 September 2009, the leaders of the G-20 summit in Pittsburgh called on "international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process", and complete their convergence project by June 2011. The Indian prime Minister was part of the forum which concurred to this and gave a commitment that India shall converge/adopt. A core group was constituted by the Ministry of Corporate Affairs (MCA). The core group had officials; it comprised officials from MCA, Ministry of Finance, professional bodies, Industry representatives and other experts.

In January 2010, the core group concluded that India would converge with IFRS, effective from 1 April 2011. Immediately after that, on 22 January 2010, the MCA announced through a press release the Convergence implementation schedule. The implementation schedule sought to bring, in the first phase, only the large companies (other than banks, insurance and NBFCs) satisfying any of the following criteria:

a) Part of NSE – Nifty 50;

b) Part of BSE - Sensex 30;

c) Companies whose shares or other securities are listed on stock exchanges outside India;

d) Companies which have a net worth in excess of INR 10 billion whether listed or not.

There were similar schedules for Banks, Insurance Companies and Non Banking Financial Institutions commencing 1 April 2012.

Some estimated this list to include the top 300-400 companies in India with access to the best resources, personnel, policies and Corporate Governance.

Thereafter, ICAI and NACAS – National Advisory Committee on Accounting Standards - did a wonderful job in drafting the converged standards and exposing them for public comment around September/October 2010. On 25 February 2011, the MCA notified 35 converged sets of standards (IND AS), however, it withheld the implementation of the same, ie the date(s) from which these would apply to companies. The notification stated that MCA shall notify the implementation on a later date. That 'later date' of course hasn't arrived. 1 April 2011 has come and gone; we are now nearing 1 April 2012.

One of the reasons that IFRS/IND AS was not officially implemented could be that the revenue department had not evaluated the impact of IFRS on taxes/revenue collections. While some maintain that Revenue departments should go by existing Indian standards for 'Tax incidence' purposes only, and IFRS based standards for Companies Act or reporting to shareholder purposes, this, in the long run, is only going to add to the confusion for corporates and regulators alike.

In the meantime, The Central Board of Direct Taxes (CBDT) has made public the discussion paper on accounting standards, to be known as Tax Accounting Standards (TAS), for feedback from all concerned. The proposed TAS, while enabling smooth transition to IFRS, is likely to provide certainty on accounting issues for tax purposes, as it removes alternatives and will cover all tax accounting issues. The TAS, applicable only to computation of taxable income under the Income Tax Act 1961, will be different from accounting standards issued by the Institute of Chartered Accountants of India (ICAI) and notified by the Ministry of Corporate Affairs under the Companies Act 1956. However, separate books of account are not required to be maintained under TAS, thus reducing the compliance burden on businesses.

This is now likely to pave the way for IFRS based standards to become effective for Indian Corporates in the next three to nine months. Having said that, the IFRSs are also undergoing substantial change, due to the convergence project between IASB and US Accounting Regulators. One will, of course, have to monitor the way forward on this front in India.

Pay As You Earn and Real Time Information Reporting

Tim Stovold, tax partner at *Kingston Smith LLP*, considers the implications of the proposed changes to the UK Pay As You Earn system, with special emphasis on how the International employers in the UK will be impacted.

From 6 April 2013, the UK Pay As You Earn (PAYE) system, which is used by employers to deduct tax at source from payments made to employees, is due to change. From April 2013, the details of salaries paid to employees and tax deductions made will be reported each time a payment is made instead of at the end of the year. This additional reporting to HM Revenue & Customs (HMRC) is known as Real Time Information (RTI) and is likely to cause some administrative problems for employers of internationally mobile employees.

The RTI system is mainly driven by two objectives. The first is to make the existing tax deduction at source PAYE system more accurate so that there is less need for further tax or refunds to be dealt with through the submission of personal tax returns. The second is the introduction of the Universal Credits system by the Department of Work and Pensions, which is the biggest overhaul of the benefits system since the 1940s. The new Universal Credits system will, in part, determine the welfare payment entitlement, based on a person's earnings, so the government needs RTI to ensure that the correct payments are made.

The welfare system is largely irrelevant to expatriate employees working in the UK, as their immigration status would normally give them "restricted access to public funds" so they are not entitled to welfare payments. However, the government has made it clear that there will be no exemptions from RTI so even expatriate employers must comply with this new regime.

From April 2012, the RTI system is being piloted with a number of employers. This pilot will include a small number of expatriate employers so it is hoped that some of the issues particular to this group of employers will be addressed before April 2013. However, there is a wide breadth of expatriate issues so it is certain that new issues will emerge after April 2013, when the system becomes compulsory.

The first step in RTI is that each employer will need to reconcile their data with that held by HMRC. This is being called "employer alignment" and means that every employee that will be paid under RTI will need to be allocated within the Revenue's system to the employer's PAYE scheme. This will largely be the case already for expatriate employees, as it has been a requirement for some time now that employers to file P46 (expat) forms when a new employee arrives in order to open or create a record within HMRC's system, whilst they should also be filing a P45 form when the employee leaves.

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However, we can anticipate that the RTI system will largely be driven by each employee having a unique Social Security number, which is known as a National Insurance (NI) number, as these are issued to all UK Nationals when they reach the age of 16. Expatriates will not automatically have a NI number so will need to apply for one, which can take more than four weeks. In the absence of this number, the RTI system will try to track an employee via their name and date of birth, which can lead to records being mis-matched or generated in duplicate.

Existing expatriate employers should prepare for “employer alignment” by ensuring that they have captured within their system the full name of each employee, their gender, their NI number, if known, and their date of birth. They will also need to be able to produce an accurate record of which employees will be physically working in the UK on 6 April 2013 and this data is likely to be needed before the pay date at the end of that month, so there is a relatively short period to collate this data and to then reconcile it to HMRC’s systems.

Once the RTI system is up and running, HMRC will have full details of salaries that have been paid, and tax and NI paid each month. This will allow them to check the calculations of tax to ensure that this is accurate without ever having the need to visit the employer. This may also allow them to monitor more closely payments that are made under detached duty dispensations, minimum salary levels for the purposes of certificates of sponsorship and the National Minimum Wage. Until RTI has been implemented, these checks can only be carried out on-site by HMRC visiting employers, but with RTI, we can eventually expect some aspects of employer compliance reviews to be automated from within the offices of HMRC and the UK Border Agency.

There is also some uncertainty over whether the expatriate employers who operate annual modified payroll schemes and process monthly payments on an estimated basis with a full recalculation at the end of the year can continue to do so under RTI. I have raised this with HMRC and the expectation is that this will still be possible, but the details of how this will work under RTI are still to be agreed in the course of the pilot.

As with any new regime, it will be accompanied by a new penalty system for non-compliance, so the consequences of not keeping accurate records could be penalties and surcharges, but it is expected that the penalties will not be enforced whilst the system is settling down.

In conclusion, from April 2013, the requirement for expatriate employers to supply regular, accurate data to HMRC will become more onerous, with little corresponding benefit for the expatriate employers or employees; so, as more information about the launch of RTI becomes available, employers will need to start to address this within their internal systems and procedures to ensure that they are prepared to deal with these new obligations. There is a general concern that the introduction of RTI is being rushed but it cannot be delayed, as the government has committed to the Universal Credits system, so we do not anticipate its introduction being deferred.

A Year in Immigration

David Crawford, partner at immigration law firm *Fragomen LLP*, comments on how 2011 has seen a lot of action on the UK Immigration front and how 2012 is shaping up to be no different.

There was an awful lot of change to the UK’s immigration rules in 2011, a particularly busy period for the immigration law community. The coming year promises to be just as eventful, so a quieter January is the perfect time to reflect on the policy changes we have seen and the new initiatives we can expect in 2012.

The first raft of changes was announced in March, when the Government announced plans to make student visa policy much more selective. Sweeping reforms would lead to a number of strict policy changes: English language requirements increased; additional accreditation requirements for colleges teaching foreign students were introduced; and family members could only accompany post graduate and state sponsored students.

Plans to scrap the post-study work route, which allows students two years to seek employment after their course ends, increased the need for employers to plan early for any graduate recruitment. From this April, graduates will only be able to stay in the UK after graduation if they have a permanent job and sponsorship. Businesses need to be ready for this policy change, at the very least ensuring that they have a sponsor licence and sufficient certificates of sponsorship.

The most notable changes came about in April when an annual limit of 20,700 spaces was placed on the number of skilled non-EU migrants who could enter to take jobs in the UK. The limit of 20,700 was derived by top economists, but carried little meaning for the average employer. In actual fact, it has proved ample and, if current rates continue, only half the places will be used by April 2012.

Tighter Intra-Company Transfer (ICT) rules for assignees were introduced, a cause of concern for employers, especially India-based businesses. In the event, most businesses have adapted their business models by reducing assignment lengths to a year for employees whose salaries fall below the £40,000 annual salary threshold.

Current Consultations

During the next 12 months we expect to see a raft of policy changes flowing from three consultations published during the summer and autumn of 2011. The independent

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Migration Advisory Committee (MAC), the Government's key advisers, played a central part in each policy review.

A family policy consultation asked whether minimum salary expectations should be set for British nationals looking to have a non-EU spouse or child join them in the UK. The MAC recommended setting the threshold at £18,700.

A consultation on settlement was a cause for concern for businesses, mooting the prospect of skilled workers being prevented from settling permanently in the UK. The MAC implicitly recommended against this, instead suggesting that settlement should only be available to those earning between £31,000 and £49,000 per year.

As the year drew to a close, we received our final consultation. This time the MAC were asked what the level of the limit on skilled workers should be for 2012/13, whether salaries should be increased further for ICT, if skills requirements should be stepped up and whether rules should be relaxed for those earning in excess of £70,000 per annum.

What to watch

The Government are still to announce any policy changes on family and settlement, but we expect an announcement in the coming weeks. The MAC will provide advice to the Government on their latest consultation at the end of January 2012. We expect the new policy to be announced in March, necessitating fast but effective business planning, as this could include changes to the way in which detached duty dispensation payments are treated for the purpose of determining the salary levels.

And now, after a short pause for breath, we can continue to plan for 2012. Any changes to settlement and skilled worker policies are likely to be implemented on 6 April, with the relevant legislation having been laid in mid-March. Employers will need to watch out for these regulatory changes and be mindful of the potential impacts on the way they operate. At *Fragomen* we will continue to report events and provide advice, as any new initiatives are introduced.

'Single-Brand Retail Trading' in India – What the opening up of this sector means for foreign investors

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Garima Basu, Partner at *ALMT Legal*'s London office, throws light on the recent changes to the FDI regime in the Indian Retail sector and its potential to change the name of the game.

Amidst growing pressure from the international community, and in a hurried bid to tackle its own 9% inflation rate, the Indian Government has recently notified a complete liberalisation of the single-brand retail sector in India. Formerly, Foreign Direct Investment (FDI) was permitted up to a maximum of 51% in single brand retail trading, and was subject to obtaining prior approval of the Government and compliance with certain other conditions. The policy had not changed much since it was first introduced in 2006. On 10 January 2012, the Government issued a revised policy statement raising the FDI cap from 51% to 100%, while still subjecting it to prior Government approval.

Some of the major international brands like Nokia, Adidas, Gucci etc. have already opened retail stores in major cities in India. However, due to policy constraints, these companies were forced to collaborate and enter into joint ventures with domestic retail players, unless their business model required a local partner with expertise. With the new policy, these companies can now buyout the domestic partners and assume full ownership of their business in India, and equally new players can set up wholly owned subsidiary companies in India.

However, this move comes with a rider and foreign investors are advised to read the small print of the new notification carefully. All new business proposals involving FDI beyond 51% will require mandatory sourcing of at least 30% of the value of products sold (minimum sourcing), from Indian small industries. 'Small industries' have been defined to mean industries (including village and cottage industries, artisans and craftsmen) which have a total investment in plant and machinery not exceeding USD 1 million (approx. GBP 650,000), as computed at the time of installation, without providing for depreciation, (maximum valuation). Further, this domestic sourcing requirement must be self-certified by the Indian company with the FDI, and subsequently checked by statutory auditors. The Indian company with FDI will, therefore, need to constantly monitor the minimum sourcing threshold as well as the maximum valuation cap. If, at any time, the maximum valuation of the small industry is exceeded, it will no longer qualify as a small industry.

The other conditions to be complied with as per the previous FDI policy will continue to apply, namely:

- products to be sold should be of a 'single brand' only;
- products should be sold under the same brand internationally, i.e. products should be sold under the same brand in one or more countries other than India;
- only those products which are branded during manufacturing would be covered under single brand product retail trading;
- the foreign investor should be the owner of the brand.

This positive move of the Government is being viewed as a prelude to further liberalisation and opening up of multi-brand retail and e-commerce retail trade in India. In

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November 2011, the Government's attempts to permit FDI in multi-brand retail were thwarted by heavy resistance from local players, even though there is a realisation that there is a constant need to develop the retail sector, which requires a lot of investment, especially in infrastructure, supply chain, warehousing and logistics, and has the potential to generate employment for millions. A number of international retailers (such as Walmart, Tesco etc) have, in the meantime, adopted a back-seat approach model via license/distribution/franchise or back-end management/business support services models in India.

In the e-commerce space, FDI is already permitted up to 100% in business to business (B2B) e-commerce activities without any Government approvals; however, e-commerce retail trading is not allowed. This directly affects the business model of some companies like Amazon, which operate under direct customer interface models worldwide.

Easing the burden on business - Changes to employment law

Phillip D'Costa, Partner at *Davenport Lyons* solicitors, considers the implications of the proposed changes to employment law in the UK.

The UK already possesses one of the most lightly regulated and flexible labour markets amongst developed countries. This feature gives it an advantage over its European competitors by making it an easier place to invest. For instance, it is generally regarded as being far easier to dismiss under performing employees in the UK than in most jurisdictions on mainland Europe. Conversely, disputes between businesses and their employees can be resolved through mediation, litigation or through a claim in the Employment Tribunal. More straightforward claims in the Tribunal can, in some cases, be handled directly by the business and the employee without incurring court fees or legal costs.

In an effort to maintain its competitive advantage as one of the best places to do business, on 23 November 2011, the Government set out far reaching proposals to reform the UK's employment laws.

The main changes

The main highlights of these proposed reforms include:-

- considering the introduction of compensated no-fault dismissals for "micro employers", ie, those employers with fewer than ten employees;
- increasing the qualifying period for employees bringing a claim for unfair dismissal from one to two years, doubling the period of service required before an employee can bring such a claim;
- allowing businesses to have discussions with staff about poor performance without the risk of those discussions being relied on in proceedings;
- allowing employment judges to deal with cases alone (rather than as a three member Tribunal);
- simplifying the procedural steps required to be followed by a business in order to carry out a fair dismissal;
- consolidating the regulations in relation to the national minimum wage and;
- introducing a compulsory conciliation of all employment disputes by the ACAS Conciliation Service before a Tribunal claim can be brought. This is a free conciliation service dedicated to improving the work place and resolving human resource disputes through mediation.

In addition, the Government has initiated an independent review of Employment Tribunal procedures in order to streamline their functions. At present, it may take up to ten months from the issue of an application before a claim is heard before the Tribunal. Whilst these timescales are already faster than in most jurisdictions, the Government is looking to improve the timescales further.

There will be a consultation on the introduction of fees for anyone wishing to make a claim to an Employment Tribunal. As such claims are inevitably made by employees rather than the business employing them, this reform is likely to considerably reduce the risk of a business being taken to Tribunal by a discontented or dismissed employee.

The Government proposes developing a rapid resolution scheme to provide an even quicker and cheaper alternative to Employment Tribunals for low value cases such as claims for unpaid salary or holiday pay. Such claims could, under the new system, be dealt with on the basis of written submissions without an oral hearing.

The Government has also proposed plugging the loop hole whereby employees could bring a claim for whistle blowing in relation to a breach of their own employment contract.

It has also proposed changes to the minimum period of mandatory consultation for collective redundancies, which is currently 90 days, and for a review of the UK legislation in respect of the transfer of undertakings between businesses. These can apply where businesses are acquired as a going concern, there is outsourcing/insourcing of services, a "service provision change" or the assignment of a lease of premises from which the same business is operated.

The proposed reforms are viewed as being amongst the most radical changes to the UK employment law system for decades. They are likely to be generally welcomed by both established companies and those looking to set up

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new businesses. Those representing employee rights, such as trade unions, have raised concerns that the proposed changes will make it easier for employers to dismiss employees regarded as difficult or under performing whilst making it much harder for employees to bring successful claims against their employers.

Whilst some of the proposals remain items for further consultation, the earliest changes will come into being from April 2012. It remains to be seen how much of the reforms are retained through this consultation process. However, these proposals demonstrate the UK Government's aim to reduce the overall burden of regulation, making it easier for businesses to create new jobs and manage their staff productively whilst still providing employees with a degree of employment protection.

Property investing in the UK

Mike Hayes, Tax Principal at *Kingston Smith LLP*, discusses how the UK property market has long proved an attractive prospect for the Indian investor and, if properly structured, can give rise to very favourable tax treatment.

Whether you intend to acquire a residence in the UK or are looking for a pure investment with a capital and income return, holding real estate through an offshore structure can be a good option.

Holding a UK property through an overseas company and/or trust arrangement can change where the property is treated as situated for legal purposes. As a result, this can take the asset outside the scope of the UK inheritance tax and capital gains tax. When compared to a personal ownership, this can save 40% and 28% tax on the value, respectively, when the ownership is transferred in the future (whether by sale, gift, or on death). Local taxes may, however, apply and you should choose the location of your holding structure carefully.

Individuals with an Indian heritage, including second or third generation, are uniquely placed to take advantage of the UK-Indian capital taxes treaty, which (with the right planning in place) provides that all non-UK assets can escape the UK inheritance tax net on death. Owning your UK property through an overseas company and/or trust can allow you to take advantage of these provisions and, when combined with a properly drafted Will, could save your family a significant amount of UK inheritance tax.

Planning opportunities to take advantage of the treaty also exist for inheritance tax with existing properties that you may already hold in the UK in your own name.

UK rental profits accruing to an overseas entity remain subject to tax in the UK. The Non Resident Landlord Scheme, which seeks to deduct basic rate tax (20%) at source from rents paid overseas, may also apply. On a successful application to HM Revenue & Customs, rental income can be paid gross, but a UK tax return will still be required to declare the income received to the authorities.

Where a property for your own occupation or that of your family is to be acquired in the UK, using an offshore structure can give rise to an income tax charge. Advice should be taken, as proper planning can protect you from unintended tax consequences.

For a UK resident individual, bringing money into the UK can give rise to a potential tax charge on remittance. HMRC have been undertaking a consultation to relax these provisions where individuals wish to bring money into the UK to invest and it is believed that this will include commercial property investment. Until these changes are brought into law, careful consideration will be required for any UK resident bringing monies from overseas into the UK.

Kingston Smith News

Sir Michael Snyder, Senior Partner, and Chandru Iyer, International Business Development Director, at *Kingston Smith LLP* will be travelling to India in January, covering the major Indian cities including Mumbai, Delhi, Bangalore and Chennai. In addition to meeting clients, prospects and business associates, Sir Michael in his role as Chairman of the UK Government's Professional and Business Services Group, will also be speaking to Indian business representatives and officials at Receptions in Delhi and Mumbai hosted by the British High Commission.

We hope you find this edition of our Indo-UK Patrika an interesting and informative read, and we welcome your feedback. Please email us your thoughts, ideas and suggestions.

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