An Essential Guide to Doing Business in India

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Doing Business in India

Navin Kumar outlines the company structures and some of the factors to be considered when establishing a commercial operation in India.

India is the largest democracy and tenth largest economy in the world. India's economic policies are designed to attract significant capital inflows into India on a sustained basis and to encourage technology calibration agreements between Indian and foreign firms. Policy initiatives taken over the past few years have resulted in significant inflows of foreign investment in all areas of the economy, except those reserved for the public sector.

Today, India is one of the most exciting emerging global markets in the world. Skilled managerial and technical manpower matching the best in the world and a middle class whose size exceeds the population of the USA or the European Union, provide India with a distinct cutting edge in global competition.

India continues to be the best place to start a business, says a global services location index by AT Kearney. In another At Kearney study, India has displaced the US to become the second-most favored destination for foreign direct investment after China. It has now been named as the top performer in South Asia in the annual Doing Business Report issued by the International Finance Corporation (IFC).

Entering in India- Options:

A foreign company/ investor wanting to start a business or establish an entity to undertake business activities may do so through different permitted modes. We have to divided the modes of doing business in India under two heads, which are "while retaining the status of a Foreign Company" and as an "Indian Company, which could be formed as a wholly Owned Subsidiary or through Joint Venture".

As a foreign company:

A Foreign Company may carry on operations in India:

- Through a Branch Office;
- Through a Project Office;
- Through a Liaison Office;

As an Indian Company:

The law relating to companies is governed by the Indian Companies Act, 1956 as amended from time to time. A foreign company can carry its business activities in India by incorporating an Indian Company as follows:

As a Wholly Owned Subsidiary Company (WOS):

A Foreign Company may incorporate an Indian Company in which it could hold 100% shareholding. The government permits setting up of a WOS in certain sectors like IT, development of integrated township, mass rapid transport services, however, 100% foreign equity may be inducted with prior approval of Foreign Investment Promotion Board. The obvious advantages of a WOS are, total control of funding, management and profit sharing of the business. But at present, its management being foreign, ignorance of local customs and method can be disadvantageous.

Joint Venture Company (JV Company):

A joint venture is a popular and most preferred route for FDI in India. It is a preferred strategy of a foreign investor/ company to enter in India through a domestic partner. Entry of JV Company is an Indian Company formed in pursuance to a joint venture agreement between Indian and Foreign partners. The Joint Venture partners may constitute a JV Company in the following manner: By formation of a new company, where both the Foreign Company and Indian Company would participate and contribute towards the share capital of the JV Company according to their mutual understanding and subject to the limit prescribed for the foreign investment in that sector, or Foreign Company may contribute into the share capital of existing Indian Company, subject to the requisite permissions/limit prescribed for the foreign investment in that sector.

Liaison Office/Branch Office / Project Office:

In some situations a foreign company would prefer to assess the market in India may establish a liaison office. A liaison office requires a light structural set up and represents a place of business in India for the parent company. The role of such office is limited to collection of information about the possible venture and familiarizing the local customers with their products. However, the branch / project / liaison office could undertake the permitted activities only. A liaison office is not permitted to engage in trading or any commercial activity and its expenses are met the foreign office of the company through remittances. Prior permission of Reserve Bank of India is required to set up a liaison office.

Formation of a legal entity to enter in India:

For liaison office/ branch office or project office, necessary permission is required to be obtained in the prescribed format along with requisite fee with the Reserve Bank of India. The bank is the authority, which grants such permission.

Indian Company:

A foreign company/ investor may also excise its option of forming a company under Indian laws. The Registrar of Companies is the authority, which grants the certificate of incorporation.

Type of Companies

The two prominent heads under which the companies could be incorporated in India, which are used for the business purposes are; Private Limited Company, and, Public Limited Company

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Incorporation of an Indian Company

The incorporation of a company in India requires filing of requisite documents in the prescribed formats with the Registrar of Companies of the concerned State or Union Territory with the official fee.

The incorporation generally takes not more than 3-4 weeks time (subject to availability of the desired name / documents). In case of private company, the operations could immediately start, whereas in case of a public company it has to obtain a Certificate of Commencement of Business before it could actually undertake commercial activities. A company can commence its business after receiving certificate of incorporation from the office of the Registrar of Companies.

Compliance under the various laws:

When a company is formed and has started its operations, it is required to comply with provisions of various laws applicable.

Application of foreign exchange law:

Foreign Direct investment in India is governed by Foreign Exchange Management Act, 1999 (FEMA). Under the Act, the Reserve Bank of India (RBI) has been given powers to make rules and regulations for foreign direct investment under its automatic route pursuant to the power vested in it under FEMA, subject to the sectoral limits specified from time to time by Central Government.

Income Tax:

The tax liability upon the income of a company is based on the nature of its income as well as its residential status and is governed by the provisions of Income Tax Act, 1961.

A foreign company carrying on operations in India through its branch or project office or simply as exporter of goods / services to India is generally treated as a non-resident and is taxed in India on the following incomes:

- Income received or deemed to be received in India.
- Income accrued, arises or deemed to accrue or arise in India.

The following types of income are deemed to accrue or arise in India:

- Income arising from any business connection in India. The term business connection generally implies a close connection between the activities performed in India and the business carried on outside India;
- Interest, royalties and fees for technical services paid by an India resident to a non-resident, or paid by one non-resident to another for the purpose of business of the payer in India.

Further, the taxation of a non-resident is also governed by the relevant Double Taxation Avoidance Agreement with the country in which it is resident, where such an agreement exists. Generally these treaties provide for a lower rate of tax on dividend, interest, royalty and technical service fee, or may even exempt such items from taxation in India.

A WOS or a JV Company incorporated in India are classified as resident and are taxed on their global income in India.

The rate of income tax applicable to foreign companies is 40% plus a 5% surcharge. No additional tax is levied on remittance made by branch office. A deduction of up 5% of gross taxable income (calculated in specified manner) towards head office expenditure is also available to foreign companies.

Income tax would be applicable on: the domestic company, once it commences commercial operations and generate taxable profit; the parent company, on the dividends / other fees & royalties received from the domestic company in case the domestic company is a WOS of a foreign company.

MAT is applicable to a Foreign as well as Indian company if the tax payable by it on its taxable income is lower than 7.5% of its book profits calculated in the specified manner. In such cases, tax rate is deemed to be 7.5% of the book profit and the surcharge applicable.

In addition to the above, there are some taxes applicable in given facts and circumstances, such as- sales tax (state/ central), excise duty, customs duty, research and development tax and other taxes. Apart from these taxes, there are various tax exemptions available to the Indian as well as foreign companies. These include, profits of a hotel or tour operator from services provided to foreign tourists.

Remittances:

A domestic company (whether it is a WOS or JV Company) is required to make certain remittances outside India. The rules pertaining to such remittances are governed by the Exchange control regulations of RBI.

To sum up, it could be asserted that the India has most liberal and transparent policies on foreign direct investment among major economies of the world. According to a report by Economist Intelligence Unit, compiled in cooperation with Columbia program on International Investment (CPII), India is likely to receive DDI of US $ 20.4 billion every year during 2007-11. Also, according to UNCTAD's world investment report, India has emerged as the second most sought after location after China, ahead of US and Russia, for global FDI in 2007.

The information contained in this article is of general and informatory in nature and shall not be intended to constitute as a legal advice. Although, the author endeavors to provide accurate and timely information, there can be no guarantee that the information is accurate as of date or continue to be accurate in the near future.

Navin Kumar, is a Partner in a leading Indian Law firm Naashree Associates, Advocates. His columns on various legal issues are published in prominent national dailies and magazines in India. For the past ten years he has rendered comprehensive legal services to Indian as well as foreign corporations.