

Doing Business in India

Choosing a Legal Structure





Introduction

Based in Dubai in the United Arab Emirates, **Hugh Fraser International** is a corporate and commercial legal consultancy focused on supporting our clients' international business interests.

We have recently established an alliance with a law firm in India and this brochure provides an introduction to the legal and commercial issues involved in establishing and carrying on a business in India.

India as an Investment Destination

India is a Union of States with parliamentary system of government and has a stable and vibrant democratic system.

It is likely to become the world's second largest economy and have the largest population within the next twenty five years.

There has been a large world wide interest in taking advantage of the large market, incentives and facilities, which India is providing in the manufacturing, infrastructure development and service sectors, among others. Now, India can be considered as the fastest growing free market economy and a favoured global business destination.

It offers hugely growing opportunities for investors particularly in the energy sector, supported by a number of business-friendly initiatives being introduced by its Government.

The purpose of this article is to provide a birds-eye-view of the Indian legal issues to those international players who are considering doing business in India.



Administrative Agencies

Department of Industrial Policy & Promotion

Government of India (“GOI”) through its Department of Industrial Policy & Promotion (“DIPP”) Ministry of Commerce & Industry regulates the Policy and Procedures of Foreign Direct Investment (“FDI”).

The FDI policy is reviewed from time to time and The Government of India/DIPP has recently undertaken a comprehensive review of the FDI policy and associated procedures. As a result, a number of rationalisation measures have been undertaken which, inter-alia, include:

- Dispensing with the need for multiple approvals from Government and/or regulatory agencies
- Extending the automatic route to more sectors
- Allowing FDI in new sectors.

Reserve Bank of India

The Reserve Bank of India (“RBI”) is the central bank of the country. The RBI is vested with the powers to manage/implement Foreign Exchange Management Act, (“FEMA”). All the foreign exchange transactions to and from India are regulated through FEMA, and regulations and notifications issued by RBI, from time to time. The RBI has been proactive and keeping pace with the objective of economic liberalisation aiming at a fully convertible Indian Rupee.

Administrative Ministries

Based on the sector in which the investment is proposed it may be necessary for an investor to deal with the concerned Ministries of the GOI.

FDI Policy

Automatic Route

The Industrial Policy of 1991 introduced an ‘Automatic Route’ for FDI not requiring approval from Government of India. Originally, there were 35 industries and was subject to an investment ceiling for the relevant sector and still required approval from RBI. Since then, the scope of Automatic Route has been expanded and the requirement of RBI's approval has also been waived. Now, FDI under the automatic route does not require prior approval either by the GOI or the RBI.

The present Automatic Route allows foreign investors to invest in India through their special purpose subsidiary vehicles up to 100%. Indian companies engaged in all industries, except for certain select industries/sectors can issue shares to foreign investors up to 100% of their paid up capital. However, still there are sectors which have sectoral caps for FDI, example 49% or 26%. An investor is advised to take legal opinion and assistance in this regard since a lot of FDI friendly changes are happening in various sectors.

Under the automatic route, the investors are only required to notify the concerned regional office of RBI within 30 days of receipt of inward remittances and file required documents with that office within 30 days of issue of shares to foreign investors.



Non-automatic Route

This category includes investments in certain restricted sectors or investments exceeding the sectoral caps/policies and those proposals where the foreign investor has or had any previous joint venture or technology transfer / trademark agreement in the same field in India. For making investments the sectors/industries falling in this category prior permission of the Foreign Investment Promotion Board, ('FIPB'), Secretariat for Industrial Assistance ('SIA'), GOI will be required.

Under the "Non-automatic"/ "Government approval" route, applications for FDI proposals, other than by Non-Resident Indians, and proposals for FDI in 'Single Brand' product retailing, are received in the Department of Economic Affairs, North Block, New Delhi. Proposals for FDI in 'Single Brand' product retailing and by Non-Resident Indians are received in the Department of Industrial Policy & Promotion, Udyog Bhavan, New Delhi.

Any investment in a company that is engaged in an activity in the sectors listed in Annexure A of the FDI Policy needs specific approval of Government of India. There are also some areas where though Automatic Route is available, foreign investors cannot invest beyond a certain percentage of the paid up capital of the Indian companies or where investment is subject to some other conditions.



Choosing your setup

Choosing an appropriate set up is an important aspect of doing business in India. Such selection of an appropriate set-up will make both economic and commercial sense by helping the investor to optimize its exposure and minimize risks.

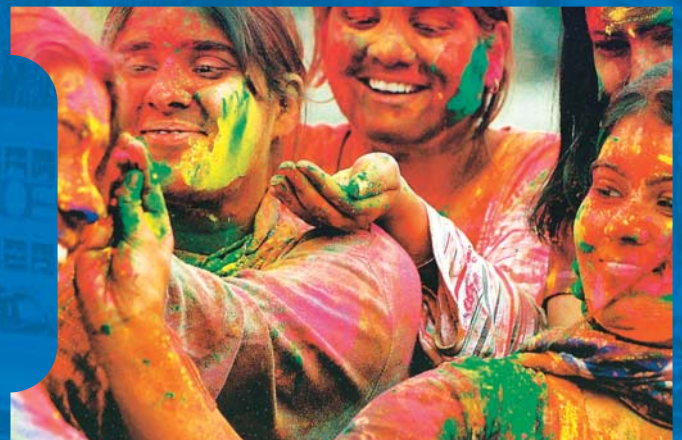
It is important that the country's legal and regulatory stipulations and requirements are followed with utmost care. This will require the assistance of qualified and experienced legal professionals.

The following are the types of set-ups as per the Indian laws and regulations:

- Liaison office/ Representative office
- Project office
- Branch office
- Wholly owned subsidiary company
- Joint venture company with Indian or foreign partners
- Partnerships

Partnerships

Out of these, Partnerships are the most rarely used form. This is mainly because of the exposure to unlimited liability. Indian law has no provisions for limited partnerships, even though there is a proposal pending with the GOI for allowing certain limited liability partnerships.



Liaison Office/ Representative Office

The role of the liaison office is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian customers. It can promote export/import from/to India and also facilitate technical/financial collaboration between parent company and companies in India. The liaison office cannot undertake any commercial activity directly or indirectly and cannot, therefore, earn any income in India. Approval for establishing a liaison office in India is granted by RBI. Any violation of the procedure can lead to serious complications with the RBI, other statutory authorities and the federal tax authorities.

Project Office

Foreign Companies planning to execute specific projects in India can set up temporary project/site offices in India. RBI has now granted general permission to foreign entities to establish Project Offices subject to specific conditions. Such offices can not undertake or carry on any activity other than the activity relating and incidental to execution of the project. Project Offices may remit outside India the surplus of the project on its completion, general permission for which has been granted by the RBI.



Branch Office

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes:

- Export/Import of goods.
- Rendering professional or consultancy services
- Carrying out research work, in which the parent company is engaged.
- Promoting technical or financial collaborations between Indian companies and a parent or overseas group company.
- Representing the parent company in India and acting as buying/selling agents in India.
- Rendering services in Information Technology and development of software in India.
- Rendering technical support to the products supplied by the parent/group companies.
- Foreign airline/shipping company.

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to subcontract these to an Indian manufacturer.

Branch Offices established with the approval of RBI may remit outside India the profits of the branch, net of applicable Indian taxes and subject to RBI guidelines. Permission for setting up branch offices is granted by the RBI.

It may be noted that all the foreign companies which have set-up a place of business in India, whether Liaison Office, Project Office or Branch Office have to comply with certain specific provisions of the Indian Companies Act, 1956. However, no such compliance is required for a foreign partnership entering into such activities.

Incorporated Entity

The Indian Companies Act, 1956 deals with the legal and procedural aspects of the formation, registration, administration, operation and winding up of companies.

Depending on the sectoral caps, as per the FDI Policy, a foreign investor may have the following options:

- Establishing a Wholly Owned Subsidiary
- Joint Ventures company; or
- Acquiring an existing company

If under the FDI Policy foreign equity in a target sector is allowed up to 100%, depending on the requirements of the investor, the foreign investor can opt for a Wholly Owned Subsidiary.

Joint venture companies are made possible by joining the strengths of two or more investors. It can be used in sectors in which 100% FDI is permitted and/or in sector which limits the FDI sectoral caps. The Joint Venture partner can be an Indian or foreigner, provided that the total FDI cannot exceed the sectoral cap if any fixed.

It may be noted that as per the Indian Companies Act at least two shareholders are necessary to form a private company with limited liability, even though the second shareholder can be a nominee of the first shareholder and can hold as low as one share. On the other hand, in a public company a minimum of 5 share holders are necessary.

A listed public company in addition to the Companies Act shall also be required to comply with the rules and regulations issued by the Securities and Exchange Board of India ("SEBI"), a statutory body, which has put in place various regulations including a take over code among others. In addition to this, the listing agreements between the company and the stock exchanges can provide for issues like corporate governance, delisting norms, among others.

The ideal and most favored vehicle for a FDI is private limited company. It can be a closely held company with appropriate restrictions on the right to transfer shares (unlike a listed/unlisted public company, where no such restriction is legally permitted) and less statutory restrictions and compliance requirements.

Acquiring an existing Indian company entirely or partly, operating in collaboration with the existing shareholders is a popular way of entering into India. However, in such ventures, it is necessary to carryout legal, financial, technical due diligence to avoid any unforeseen liability to the company or the foreign investor.

Export Oriented Units ("EOU")

Units undertaking to export their entire production of goods and services may be set up under the Export Processing Zone ("EPZ") Scheme.

At present there are many functional Special Economic Zones ("SEZ") located at various places in India. Any private/public/joint sector, foreign company or State Government or its agencies can set up SEZ.

FDI up to 100% is allowed through the automatic route for all manufacturing activities in Special Economic Zones (SEZs), subject to sectoral norms, except for the following activities:

- Arms and ammunition, explosives and allied items of defence equipment, defence aircraft and warships
- Atomic substances
- Narcotics and psychotropic substances and hazardous chemicals
- Distillation and brewing of alcoholic drinks; and
- Cigarettes / cigars and manufactured tobacco substitutes

100% FDI is permitted under automatic route for setting up 100% EOU, subject to sectoral norms.

Proposals not covered under the automatic route would be considered and approved by FIPB.

Certain other benefits available are:

- Exemption from Customs and Central Excise duties on import/local procurement of capital goods, raw materials, consumables, spares, packing material etc.
- Reimbursement of Central Sales Tax (CST) on purchases made from DTA.
- Corporate Tax Holiday upto 2010.
- Central Value Added Tax credit on Service Tax paid.
- Re-imburement of duty paid on fuels procured from domestic oil companies as per the rate of Drawback notified by the DGFT from time to time.

Taxation in India

India has a complex tax structure and levy of tax ranges from personal income, manufacturing, sale of goods, rendition of services, import of equipment to name a few.

The purpose of this note is to give a broad perspective of the applicable taxes in India. Persons doing business in India need to take appropriate professional advice on taxation. This will help them to structure costing more effectively and also to avoid surprises on the liability side.

India has a three-tier federal structure, comprising the Federal Government, the State Governments and the Local Bodies. It has a well developed tax structure. The power to impose direct and indirect taxes and collect taxes, duties, cesses etc. is distributed among the Federal Government, the State Governments and the Local Bodies, as per the Constitution of India. Since the onset of liberalization in the country, tax structure of the country has been rationalised, and rationalisation is an on going process.

The main taxes/duties levied by the Union Government are:

- Income Tax including Personal Income Tax and Corporate Income Tax (except tax on agricultural income, which the State Governments can levy)
- Gift Tax
- Customs Duty, Countervailing Duty, on the import of goods
- Central Excise
- Central Sales Tax dealing with inter-state sales
- Service Tax charged on certain services
- R&D Cess, imposed on almost any overseas technical fees/consultancy/royalty or know-how fee, by whatever nomenclature called, as long as it involves any 'transfer of technology' in any remote form
- Wealth Tax
- Fringe Benefit Tax which charges tax on certain expenditure incurred by the employers
- Tax on dividends

The main taxes/duties levied by the State Governments are:

- Income Tax on agricultural income
- Sales Tax/Value Added Tax (tax on intra-State sale of goods)
- Stamp Duty (duty on transfer of property)
- State Excise (duty on manufacture of alcohol)
- Land Revenue (levy on land used for agricultural/non-agricultural purposes)
- Duty on Entertainment
- Tax on Professions & Callings

The main taxes/duties levied by the Local Bodies are:

- Property Tax - levy tax on properties (buildings, etc.)
- User Charges for utilities like water supply, drainage, etc.
- Octroi/Entry Tax (tax on entry of goods for use/consumption within areas of the Local Bodies)
- Tax on Markets

Author

Mohan Panikkar, KMP Partners International, Legal and Tax Consultants, New Delhi, India
in association with Hugh Fraser International, Dubai, UAE

DISCLAIMER: *The purpose of this Article is to only give the reader a general understanding of the matters discussed. It is not a legal opinion. There have been many changes in the Policies and Procedures. As such the reader is advised to take specific legal opinion and assistance on the various issues existing at the time of undertaking any investment or other activities. No liability, whatsoever, is assumed by us in any matter relating to this.*

Contact Us

dubai

po box 118273
floor 20, al attar business tower,
sheikh zayed road, dubai, uae
tel: +971 4 332 0007
fax: +971 4 332 0008

abu dhabi

po box 127144
office 4, mezzanine floor
abu dhabi islamic bank building,
al khaldiya street, abu dhabi, uae
tel.: +971 2 666 0338
fax: +971 2 666 0113

qatar

po box 19846, ministry of
economy and commerce building,
floor 15, suite 1501a, west bay,
doha, state of qatar
tel: +974 496 80 45
fax: +974 496 80 44

info@hfi-international.com

www.hfi-international.com