Consulate General of India
Toronto

Setting-up business in India

Tax and Legal Issues

1. Having your own setup.

Many foreign investors prefer to have their own setup in India. This gives them better control over management of the organization. It also is the best guarantee that the company's processes are being followed. Furthermore this may in some cases tend to be preferable, especially if the volume of work is large or the work is sensitive in nature. However there are also disadvantages in this approach. One is regarding flexibility. Often these branches or subsidiaries are bound by the policies of the parent company and this may make it unwieldy when it comes to Indian legal and cultural framework. Secondly, management of a remote setup is always more difficult, especially if the work involved is intermittent and small in volume.

Basically there are four types of direct foreign investment businesses in India:
a. Branch Office
b. 100% Subsidiary
c. Joint Venture Companies
d. Acquiring Existing Indian companies

a. Branch office

It's really simple to set up a branch office in India. You are allowed to open an branch office if you are engaged in manufacturing or trading for the following activities:

- To represent your company in various matters in India e.g., acting as buying/selling agents in India, etc.
- To conduct research work in which the parent company is engaged provided the results of the research work are made available to the Indian companies
- To undertake export and import trading activities.
- To promote the possible technical and financial collaborations between the Indian companies and overseas companies.

Under this setup, you will not be allowed to do any sales in India for any of your products or services. However if your are only looking at doing your software development or IT enabled services, then this is the easiest option. For this you need to fill up Form FNC -12 to the address given below:

The Controller
Exchange Control Department
Reserve Bank of India, Foreign Investment Division
Central Office, Central Office Building, 11th Floor
Bombay - 400 023.

Any Chartered accountant in India will be able to source you this form.

b. Wholly Owned Companies (100% Subsidiary)

If you would like to hand over control to the local management or would like to sell your products in India then look at this option. For the software industry, the Government of India allows up to 100% ownership by the Foreign Investor. Also, if you were to set up your office in an Export Processing Zone (EPZ), Software Technology Park (STP) or Electronic Hardware Technology Park (EHTP), then you will automatically be given permission for 100% ownership. The catch though is that you will have to export at least 75% of the final output out of India. Many of India's States have at least one of these Parks. Automatic approvals are given by the Secretariat for Industrial Approval for setting up 100% Export Oriented Units ("EOU"). These zones are designed to provide internationally competitive infrastructure facilities and duty-free and low cost environment. Various monetary and non-monetary incentives are granted which include import duty exemption, complete tax holiday, decentralized "single window clearance," etc.

Establishing units in EPZ or STPs have the following advantages:

- Duty Free imports
- Tax free income,
- Readymade infrastructure
- Housing and living facilities (in some cases).

For setting up units under 100% Export Oriented Unit Scheme you must submit an application to:

The Secretariat for the Industrial Approvals (SIA)
Department of Industrial Development,
Udyog Bhawan, New Delhi - 110 001

For setting up units in EPZs, you can apply to the Development Commissioner of the concerned Export Processing Zone in 10 copies along with a crossed Demand Draft of Rs 2500/= (approx $60) drawn in favor of The Pay & Accounts Officer, Department of Industrial Development, Ministry of Industry, and payable at the State Bank of India, Nirman Bhawan Branch, New Delhi.

c. Joint Venture Companies:

This is a common form of investment, because it allows the Foreign Investor and the Indian partner to do what each does best - the foreign partner brings in technology, systems and products and the Indian partner takes care of Human resources, marketing and legal and tax issues. This is a special favorite for foreign companies just moving into India, since it gives you the distribution channel to get sales moving quickly. However over the long term you may prefer to move to a 100% subsidiary, to establish greater control. This is commonly done by means of stock buyouts or fresh investments. Both Wholly owned Companies and Joint ventures may be registered as Private Limited Liability (Pvt. Ltd.) or Public Limited Liability (Public Ltd.). Currently the government allows 51% shareholding by foreign companies in all but a small list of companies (these companies are essential to India's national security).

d. Acquisition of existing Indian Companies

You have also the option of acquiring a company already existing in India. Such acquisition could take place through the issue of fresh capital and /or transfer of shares of an existing Indian company to the foreign investor with the effect of transferring control. Shares of an Indian company could be acquired from another foreign investor, subject to RBI approval. This will give you the advantage of a readymade setup. The Foreign Exchange Regulations Act (FERA) makes it necessary that Reserve Bank of India (India's Federal Reserve Bank) permission be taken prior to acquisition of shares in an Indian company by a foreign investor. Similar permission is required in case of transfer of shares from you to a person resident in India. Either the transferor or the transferee can apply for permission.. However be careful with this one. If the company is listed on the stock exchange, then you cannot hold more that 5% of the total paid up capital and all Foreign investors and Non Resident Indians (in case there's more than one) cannot own in total more than 24% of the capital.

Corporate Tax and other Incentives:

The corporate income tax effective rate for domestic companies is 35% while the profits of branches in India of foreign companies are taxed at 45%. Companies incorporated in India (any setup other than a branch) even with 100% foreign ownership, are considered domestic companies under the Indian laws.

However, the New Export-Import Policy of 1992 provides substantial tax incentives for investments in Export. Major exporters are allowed to operate bank accounts abroad to facilitate trade. Companies that sell in the Indian market as well as international markets may deduct export earnings from their tax liabilities.
Exporters and other foreign exchange earners have been permitted to retain 25% of their foreign exchange earnings in foreign currency. For 100% Export Oriented

Units and units in Export Processing Zones, Electronic Hardware Technology Parks, retention up to 50% is allowed.

Other incentives include:

- Tax holiday for a period of 5 continuous years in the first 8 years from the year of commencement of production.
- Exemption from taxes on exports earnings even after the period of tax holiday.
- Exemption from central and state taxes on production and sale.
- Permission to install machinery on lease.
- Freedom to borrow self-liquidating foreign currency loans at the prime rate of interest.
- Inter-unit transfers of finished goods among exporting units.

2. Outsourcing your work to India

The other option is to completely outsource your work to Indian companies. This has it's own advantages. For example

- For intermittent jobs, it may make better sense to pay only when you have work.
- Also if the volume of work were small, it would always be difficult to achieve economy of scale.
- Outsourcing ensures that while you may not be the best in a certain area, you are giving the work to someone who's really good at it. That leaves you to focus on what you do best.
- Many Indian companies do a lot of business with International clients, so they would often be able to bring in expertise and advice from their earlier work.
- Lastly but definitely not least, you have no legal hurdles to overcome when you outsource.