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*An Association of Independent
Accounting & Consulting Firms*

DOING BUSINESS IN INDIA



COMPANY FORMATION IN INDIA

MAIN FORMS OF COMPANY/BUSINESS IN INDIA

There are various models for starting a Business/Company in India, some of them useful for a foreign entity are as follows:

Liaison Offices (LO)

Foreign Investors willing to look into the Indian market and promote their business before start of commercial operations can establish a liaison office. The liaison office acts as channel of communication with head office. A liaison office is permitted to do promotional activities and networking in India. A liaison office is not allowed to do any business activity or earn income in India.

Branch Office/Project Office Entities

Engaged in manufacturing/trading activities outside India can set up a branch office/ project office in India. A project office is a place to represent the interest of the foreign company executing a project in India for export/import of goods and rendering of services. Profits of a branch office are permitted to be remitted outside India subject to taxation in India. However, a branch office cannot engage itself in manufacturing/ processing activities in India.

Subsidiary/Joint Venture in form of Private Limited/Limited Companies/Partnership Firms

Foreign entities which are starting operations in India, including setting up production processes, can setup wholly owned subsidiaries or JV with Indian or Foreign partners with the maximum flexibility to conduct business in India. Permitted Sources of funding could be Equity or Equity with Debt.

SPECIFIC TAX CONCERNS RELATED TO ESTABLISHING A COMPANY

Of the major tax laws applicable in India, those that impact a foreign entity are as follows:

Central (Federal)

1. Income Tax [including withholding taxes, dividend distribution tax]
2. Excise Duty
3. Customs Duty
4. GST

State

1. VAT
2. Profession Tax
3. GST

LEGAL ISSUES RELATED TO ESTABLISHING A COMPANY

Liaison Office: Prior approval of the Reserve Bank of India (RBI) is required and Intimation to Director General of Police of the State within 5 working days of entity becoming operational is required to be submitted.

Branch Office: Prior approval of RBI required (other than activities in Special Economic Zones, or SEZs), Intimation to Director General of Police of the State within 5 working days of entity becoming

Subsidiary / Joint Venture: No Prior approval required, Only post facto filings with RBI if comes under Automatic Route, Any other case Government of India (GOI)/Foreign Investment Promotion Board (FIPB) approval is required.

CULTURAL CONCERNS RELATED TO ESTABLISHING A COMPANY

1. India is a land of different cultures – too aggressive or forceful or confronting behavior should be avoided
2. Both strongly held traditional values and emerging modern business practices are prevalent
3. Greet with a handshake or Namaste
4. Always use formal titles (Mr., Dr., Sir, Madam) when greeting for first time
5. Punctuality – be prepared for delays in appointments, particularly in Government offices
6. Most Indians are reluctant to say no directly - try to understand the message behind the words
7. Get to know your counterpart as a person and gain his trust
8. Be willing to share a cup of tea/coffee and indulge in small talk before getting down to the main business
9. Do not be offended at personal questions

OTHER COUNTRY-SPECIFIC ISSUES RELATED TO ESTABLISHING A COMPANY

1. Prohibited Sector

Certain sectors are prohibited for investment by a Non-resident Entity including; Retail Trading (except single brand and online trading for food products), Atomic Energy, Lottery Business, Gambling & Betting; Real estate business or construction etc.; chit fund, Agriculture (excluding floriculture, horticulture, seed development, animal husbandry, pisciculture, cultivation of vegetables & mushrooms under controlled conditions, services related to agro and allied sectors) and plantations (other than tea plantations)

2. Foreign Direct Investment (FDI) approval is required

For sectors like - Petroleum sector (except refining), LNG/Gas pipelines, Commodity Exchange Infrastructure Companies in the Securities Market, Credit Information companies, Investment companies in infrastructure & services, Defence & Strategic Industries, Atomic Minerals etc.

3. Automatic Approval

100% or below investment is permitted under automatic route for sectors not covered in 2 above.

4. Other Legal Requirements

If you want to set up a business in India, you will be required to obtain registration with various authorities and obtain various permits like construction permits, Personal Account Number (PAN), Tax Deduction and Collection Account Number (TAN), registration under shop and establishment Act, Social Security registration, etc.

5. Recent Policy Measure

- a. 100% FDI under automatic route permitted in Brownfield Airport projects
- b. FDI limit for Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline and regional Air Transport Service raised to 100%, with FDI upto 49% permitted under automatic route and FDI beyond 49% through Government approval
- c. 100% FDI under Government route for retail trading, including through e-commerce, has been permitted in respect of food products manufactured and/or produced in India
- d. 100% FDI allowed in Asset Reconstruction Companies under the automatic route
- e. For establishment of branch office, liaison office or project office or any other place of business in India if the principal business of the applicant is Defence, Telecom, Private Security or Information and Broadcasting, approval of Reserve Bank of India would not be required in cases where FIPB approval or license/permission by the concerned Ministry/Regulator has already been granted.

PERMANENT ESTABLISHMENT IN INDIA: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

The Indian Income Tax Act defines permanent establishment as follows: A permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on and does not include liaison office.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

Definition of Subsidiary

An incorporated entity formed and registered under the Companies Act, 2013. It is a distinct legal entity, apart from its shareholders.

Distinguishing features of a Subsidiary:

1. Company form of organization and separate legal entity.
2. The liability of the Parent company is limited to the extent of its shareholding in the Wholly Owned Subsidiary (WOS). The assets of the foreign company are not subject to any attachments
3. Minimum two directors are required, one of them being Indian.
4. Quarterly board meeting & annual meeting of shareholder is compulsory in every year.
5. Subsidiary is not treated as permanent establishment of foreign company, its income is taxed based on residential status.
6. Transfer of shares is restricted, and deposits may not be accepted from the public.
7. Only activities covered and approved in the Memorandum of Association are permitted.

Definition of Branch Office

Companies incorporate outside India and engaged in manufacturing or trading activities are allowed to setup Branch Offices with specific approval of the Indian Central Regulatory Bank (RBI).

Distinguishing features of a Branch:

1. It is an extension of Head Office with right to accrue income in India and has no separate legal standing of its own.
2. It can export/import goods, render professional/consultancy and information technology services, carry out research work in line with parent activities, promote technical & financial collaboration, represent the parent company in India, act as buying/selling agent, and render technical support for the products of the parent company.
3. The liability of the Branch is unlimited. The assets of the parent company are at risk of attachment in case the liabilities of the branch exceeds its assets.
4. Branch offices are managed by an Authorized Representative, resident in India (Country Manager).
5. From a taxation perspective, a branch of a foreign company is deemed to be a 'business connection' of its parent, and thereby constitutes a taxable permanent establishment of the foreign enterprise.
6. The entire expenses in India will be met either out of the funds received from head office through normal banking channels or through income generated by it in India.
7. It cannot expand its activities or undertake any new trading, commercial, or industrial activity other than that is expressly approved by the RBI.

TAX AND ACCOUNTING OBLIGATIONS

1. A Subsidiary Company incorporated in India is subject to minimum base rate of tax @ 30.9% (In case of turnover below 5 Crore base rate will be 29.87%), whereas a Branch office is liable to pay minimum base rate of tax @ 41.2%
2. Dividends can be paid after payment of Dividend Distribution Tax @ 18.176% by a subsidiary, whereas dividend distribution is free for a branch office.
3. Tax Obligations applicable are: Income Tax, withholding taxes, Service Tax, Professional Tax, custom duty etc. for branches as well as subsidiaries.
4. Provisions of Transfer pricing are applicable for branches as well as subsidiaries.
5. Annual Accounts of Branches as well as subsidiaries are required to be audited by a Chartered Accountant of India.

REGISTRATION FORMALITIES

Branch Office

- (i) Parent company must have a profit making track record during the immediately preceding five years and net worth of not less than USD \$100,000 or its equivalent.
- (ii) Required to Obtain PAN/TAN, Service tax code, Shops and Establishment Act Registration, Importer Export Code, VAT, Registrar of Companies (ROC) Registration.
- (iii) Normally registration is allowed for a period of three years.

Subsidiary

- (i) A private company is required to be incorporated with a minimum authorized & paid up capital as may be prescribed and minimum two subscribers. No requirement of track record of parent company as shareholder.
- (ii) Required to Obtain PAN/TAN, Service tax code, Shops and Establishment Act Registration, Importer Export Code, VAT.
- (iii) Once registration is granted it can do business, until the company decides to close down its operations.

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

BRANCH OFFICE

A. Filings:

1. Yearly filings include the filing of audited accounts of Branch Office, World Accounts with Registrar of Companies
2. Yearly submission of Activity Certificate with RBI and AD Bank
3. Annual return with the Income Tax Department
4. Filing of Quarterly/ Monthly TDS returns, VAT, Service Tax Returns

B. Other Legal Obligations/Provisions:

1. The Branch Office will not accept any deposits in India
2. The commission earned by the Branch Office from parties abroad for any agency business will be repatriated to India through normal banking channels.
3. The Branch office shall not undertake any retail trading activity

4. A Branch Office is not allowed to carry out manufacturing or processing activities in India, directly or indirectly.
5. The Branch Office is not allowed to borrow locally unless the prior approval of RBI is given.

HOW TO HIRE MY FIRST EMPLOYEE IN INDIA

India has around 487 million workers, the second largest after China. Indian young workforce is growing rapidly and increasing energy in Indian Markets. Despite having second largest workforce in India manpower is economical.

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

Hiring first employee in India is an easy task in India.

A. For domestic employee, an entity is required to take care of two aspects only, which are as follow:

1. Compliance with Minimum Wages, which is at present around USD \$3,000 Per Annum.
2. Compliance with provisions of withholding taxes applicable in India.

B. Hiring a Foreign resident is subject to fulfillment of certain conditions. Some of them are as follows:

1. Employee is required to obtain an employment visa.
2. Employment visas will not be granted for jobs for which qualified Indians are available. Employment visas will also not be granted for routine, ordinary, or secretarial/clerical jobs.
3. Minimum Wages prescribed are USD \$25,000 Per Annum.

Other Statutory Compliances

In India, labour laws related to social security of employees becomes effective when there are at least 10 employees in the entity. Some of the Labour laws applicable in India are as follows:

1. Provident Fund (Social Security)
2. Gratuity
3. Employees State Insurance
4. Professional Tax and
5. Contribution to Labour Welfare funds etc.

DESIGN AND CONTENTS OF AN EMPLOYMENT CONTRACT

The Employment contract is generally quite flexible and is made to cover the needs of an entity. It will generally cover the following salient features:

1. Period of employment
2. Areas of work and reporting responsibility
3. Work location and working hours per week
4. Compensation
5. Vacation and leaves
6. Compliance with Company Policies and Laws
7. Confidentiality
8. Non-compete clause
9. Termination and Notice period

CAN SOMEBODY DO BUSINESS FOR ME AND NOT BE AN EMPLOYEE?

Yes, it is permitted in India for a person to work an entity and not being employee. These are the ways a person can be hired to work:

1. **Consultant/Contractual Worker:** A person can be engaged directly act as a consultant or contractual worker for an organization without being an employee. Here liability for withholding taxes shall trigger above a particular threshold.
2. **As an Agent to Foreign Entity:** A person can work as an agent of foreign entity. An agent does all acts on behalf of the principal, and the principal is bound by the acts of agent for which an authority is granted to the agent.
3. **Outsourced Workers:** An entity can hire a manpower supply agency, which in turn will select workers based on requirement of entity and engage them with the business entity. These workers work under control and supervision of the business entity. Normally all the statutory compliances in this regard are taken care by the manpower supply agency; failing that, the entity shall be liable. Here the entity is responsible for the supervision and direction of such workers.
4. **Outsourcing of Services:** Many services can be outsourced or done by freelancers. This work may include accounting, manufacturing, website design, marketing, and public relations. Here the work responsibility also lies with the outsourced agency.

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