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TAX PLANNING FOR BUSINESS OPERATIONS IN ASIA

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Doing Business in India: The Legal Entities Available and The Potential Tax Implications

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India continues to be an area of rapid development in the Asia-Pacific region. The following article starts with a review of the various legal entities that are available to a business wishing to establish operations in India and then goes on to review the potential tax implications from operating an Indian business.

India is being considered today as one of the most powerful emerging economies of the world. As a result of wide ranging programs of economic reforms, India is moving firmly into the front ranks of the rapidly growing Asia-Pacific Economic Region.

After announcement of the Economic Policy in 1991 and subsequent announcement of second generation of market-oriented reforms in April 2001 India has made significant progress and is considered as a country where "an economic miracle is waiting to happen." India has remarkably simplified its laws and policies permitting the entry of multinationals, joint ventures, cross border mergers and acquisitions.

Outlined below in briefare the laws and procedures as to how to do business/carry on operations in India, as a Foreign Company and/or as an Indian company. The article is intended to be indicative only and cannot be taken as a legal opinion.

Legal Entities for Doing Business in India

A Foreign Company could undertake business activities through various modes. We have analyzed various modes of doing business in India under two headings, 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".

While retaining its Status 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;

Foreign Company has been defined as a body corporate incorporated outside India, including a firm or other association of individuals under Regulation 2(b) of Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000 under the Foreign Exchange Management Act (FEMA), 1999. Prior permission is required to be obtained from the Reserve Bank of India under the above said regulations for carrying on operations in India through either of the mode.

India is being considered today as one of the most powerful emerging economies of the world. As a result of wide ranging programs of economic reforms, India is moving firmly into the front ranks of the rapidly growing Asia-Pacific Economic Region.

Under the said regulations, a branch/project/liaison office of a Foreign Company is permitted to carry only specified activities in India. The branch and project offices are permitted to undertake commercial activities but a liaison office is not permitted to undertake any commercial activity in India.

As an Indian Company

Indian Companies are incorporated and governed by the Companies Act, 1956 as amended from time to time. A Foreign Company can carry out 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. However, currently there are certain sectors wherein sectoral caps for less than 100% are provided for, thereby, limiting a Foreign Company's participation to that extent only.

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- **Joint Venture Company (JV Company) –** 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.

The choice of the mode to undertake the operations in India depends on the need, strategy and level of commitment of the Foreign Company for Indian market. Each mode has its own advantages and disadvantages.

Please note that the procedure for incorporating a JV Company is the same as that of a subsidiary company, as explained herein later. However, permissions and approvals for participation by a Foreign Company may vary depending upon the facts and circumstances.

The choice of the mode to undertake the operations in India depends on the need, strategy and level of commitment of the Foreign Company for Indian market. Each mode has its own advantages and disadvantages. Normally, the modes of branch or project office is adopted where the Foreign Company wants to first understand the market and test the acceptability of product or services it wants to launch in Indian market whereas the option of formation of Indian

Company or entering into joint venture are exercised where fair idea of the India market and acceptability of the product already exists. No doubt, doing business in India through Indian Company mode has some advantages compared to other modes, which are highlighted as follows:

- insulation to Parent Company against liabilities of the Indian Company;
- lower rate of income tax on Indian companies (35%+5% surcharge) as compared to Foreign Companies (40% +5% surcharge);
- better acceptability in the Indian market;
- easy diversification of businesses;
- payment of technical fees on account of Technical Know-how Agreement with Parent Company;
- repatriation of full dividend after payment of applicable tax;
- payment to Parent Company for the usage of Intellectual Property by it , if any;
- repatriation of the capital, after winding up of the operations of the Indian Company;
- availability of full legal recourse under Companies Act, 1956 and other applicable laws;
- limited exposure to financial liability in case of losses;
- benefit under Double Taxation Avoidance Agreement between India and other countries;
- easy clearances for technical staff coming to work in India;
- payment to technical staff posted to India by the Indian Company.

Procedure for the Formation of a Legal Entity

Liaison Office/Branch Office / Project Office

Necessary application in prescribed form is required to be filed with Reserve Bank of India (RBI) along with the necessary Annexure and the requisite fees. RBI after considering the facts and figures provided for, decide to grant the approval. However, the branch/project/liaison office could undertake the permitted activities only.

Indian Company

Although the Certificate of incorporation of Company is granted by Offices of Registrar of Companies, however, the procedure followed for incorporation may vary depending on the type of the company.

Type of Companies

Mainly, two types of companies could be incorporated in India, which are used for the business purposes:

- Private Limited Company
- Public Limited Company

Apart from the above, an Indian Company may also be incorporated as a 'company limited by guarantee', 'government company' and "non-profit company."

Main Features

Private Limited Company

- Restriction on the right of its members to transfer shares
- Limitation on the number of its members to fifty
- Prohibition on any invitation to the public to subscribe to its shares and debentures
- Prohibition on any invitation/acceptance of deposits from persons other than its members, directors or their relatives
- Minimum paid up capital requirement should be Rs. 100,000/-
- Minimum number of members/shareholders should be two
- Minimum number of directors should be two

Public Limited Company

- A public limited company does not suffer with any restrictions/limitation or prohibition as mentioned in case of a private limited company
- Public company can be listed on the stock exchanges in India and abroad
- Minimum paid up capital requirement is Rs. 500,000/-
- Minimum number of members/shareholders should be seven
- Minimum number of directors should be three

Other Types of Companies

Other than the above two, following are other types of companies, which could be incorporated for undertaking business in India by a Foreign Company.

Company Limited by Guarantee

Such companies are generally non-profit making bodies and may or may not have a share capital. Unlike a company limited by shares, where the liability to pay the share money can be enforced during the life time of a company, in a guarantee company not having a share capital, the guarantee money can be recovered in the winding up of the company. It makes up its funds through donations etc. and is a suitable choice for all kinds of educational, charitable, research, training and scientific development institutions.

Government Company

A Government company is a company in which not less than 51% of the paid up share capital is held by the Central Government or by the State Government(s) or partly by one and partly by the other. Such companies enjoy certain exemptions granted by the Central government and subject to such exemptions the provisions of the Companies Act, 1956, apply upon them. This becomes relevant where a Foreign Company enters into joint venture with either State Government or Central Government.

Non-Profit Company under Section 25

This is confined to companies, which would not distribute their profits among its members. Hence this privilege is frequently used by bodies, which pursue charitable objects as identified under the said section. Other associations, like chambers, clubs, etc. also make use of this privilege. All the advantages of incorporation are enjoyed by such bodies and yet they are free from indicating through their name that they are incorporated with limited liability. Such a company is allowed to admit to membership even a partnership firm. They also enjoy many other exemptions from the operative provisions of the Companies Act, 1956.

Mainly, two types of companies could be incorporated in India, which are used for the business purposes: a Private Limited Company and a Public Limited Company

Incorporation of an Indian Company

The incorporation of an Indian company is governed by the Companies Act, 1956.

The incorporation of a company in India requires filing of certain documents with the Registrar of Companies of the concerned State or Union Territory, including Memorandum and Articles of Association of the company with the prescribed fee.

The incorporation generally takes not more than 1-2 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.

Important Formalities Pertaining to Incorporation:

- Ascertaining the availability of the desired name
- Drafting of Memorandum of Association (MOA)

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This is the constitution of the company, which defines and confines the scope of the company and contains the following statutory details:

- Name of the Company
- Situation of the Registered Office (Name of the State/Union Territory)
- Objects of the Company
- Statement that the liability of the members is limited
- Authorized Share Capital
- Names and details of Subscribers to it.

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.

Drafting of Articles of Association (AOA)

The AOA contains the rules and regulations of the company framed for the purpose of internal management. It is generally prepared to suit specific requirements of the company.

The AOA normally contains the following information and the related procedure:

- Share Capital
- Transfer of shares
- General Meeting of shareholders
- Voting Rights of shareholders
- Board of Directors and its Meetings
- Dividends and Reserves
- Winding up

Stamping and signing of MOA and AOA

The MOA and AOA are to be signed by at least: In case of a public company: 7 subscribers. In case of a private company: 2 subscribers.

It also requires stamping by the authority concerned after paying the requisite fees.

Filing of Documents with the Registrar of Companies (ROC)

The following documents are to be filed with the concerned ROC with necessary registration and filing fees:

- Memorandum and Articles of Association duly stamped
- Copy of the name approval letter issued by ROC
- Form 18 containing the particulars of the location of its registered office
- Form 32 containing the particulars of appointment of Directors
- Form No.1 under which a declaration regarding compliance with all the provisions of the Companies Act, 1956 has to be given by the Director/Manager/Secretary of the proposed Company so named in the Articles of Association of the Company or any Advocate of the Supreme Court or of the High Court or a Pleader entitled to appear before the High Court or a Company Secretary in practice or a Chartered Accountant practicing in India, who is engaged in the formation of the proposed Company.

Certificate of Incorporation and/or Certificate of Commencement of Business

- ROC after scrutinizing the documents filed issues a Certificate of Incorporation.
- Private Company may commence its business immediately after obtaining the same.
- Public Company however cannot commence its business before obtaining Certificate of Commencement of Business. The same is issued by the ROC after the amount of minimum subscription on allotment of shares is received by the Company and certain other formalities are fulfilled

Cost of Incorporation

On page 7, is the list of statutory fees payable at various selected levels of authorized capital.

Other than above several other statutory fees for filing the above-mentioned forms are also to be paid.

Further, there are guidelines for minimum Authorized Share Capital with which a company shall be incorporated in case certain key words for instance ‘Corporation’, ‘international’, ‘India’,’ Industries’, ‘Enterprises’ etc. are used in the name of the Company.

Management to the Company

The ultimate management of a company lies in the hands of its general body of shareholders. The day to day affairs are managed by the Board of Directors. The authorities and responsibilities of the Board of Directors are contained in the Articles of Association of the company and the Companies Act, 1956. At least four Board meeting, one in each quarter and One Shareholders’ meeting at the end of the year is compulsory.

Authorized Capital (INR)	Registration Fee (INR)
0.1 million	4000
1 million	26000
5 million	106,000
10 million	156,000
20 million	206,000
30 million	256,000
40 million	306,000
50 million	356,000
100 million	606,000
500 million	2,606,000

Compliance Under the Various Laws

Once a company is formed and starts its operations it has to do certain compliances under the Acts and laws applicable upon it:

Under Companies Act, 1956

Under the Companies Act, 1956 the basic corporate rules of governance are covered including the following:

- Maintenance of Statutory Books
- Holding of meetings of the Board of Directors and Shareholders
- Maintenance of Accounts
- Audit of Accounts
- Filing of Annual Accounts with the ROC etc.
- Filing of Annual Return with the ROC containing specified particulars about the Company.

Under Foreign Exchange Laws

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. RBI allows 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.

Under the automatic route, for making Foreign Direct Investment:

- no prior permission is required under FEMA in case the investment in Indian company falls within the sectoral limits prescribed for the particular sector. In case of investment beyond the sectoral limits, prior permission from the Central Government through Foreign Investment Promotion Board/Secretariat for Industrial Assistance shall be required;
- only post investment formalities are required to be complied with upon remittance of funds in India.

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.

Compliance with the Taxation Laws

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.

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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 Indian resident to a non-resident, or paid by one non-resident to another for the purpose of business of the payer in India.

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.

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

Tax Liabilities and Rate of Tax Under Income Tax Act, 1961

Foreign Company

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

S. No.	Taxable Entity	Taxable Income	Rate of Tax (Assessment Year 2003-04)
1.	Domestic company	Income, when it commences its commercial operations	35% Surcharge: 5%
2.	Parent/ Foreign company	i. Dividend received from the domestic company. ii. Royalty or fees for technical know how or service iii. Interest on foreign currency loan advanced by a foreign company to an Indian concern.	20% Surcharge: 5% 20% Surcharge: 5% 20% Surcharge: 5%

S. No	Type of Sales Tax	Tax Levied On	Tax Rate
	State Sales Tax *Additional Levies* may include:	Sale of goods/articles within the State.	Generally taken as 10%, as high as 16% on certain items
	a. Works Contract Tax	Imposed on the contractor for manufacture, erection, repairs etc.	Varies from State to State, generally 4%
	b. Purchase Tax	Imposed on the value of goods purchased from suppliers not registered under the sales tax laws	Generally, 1% to 2%
2.	Central Sales Tax	Inter-state sale of goods i.e. sale in the course of inter-state trade/commerce	4% 10% if the parties are not registered with the sales tax authorities.

office. A deduction of up to 5% of gross taxable income (calculated in specified manner) towards head office expenditure is also available to foreign companies.

Indian/Domestic Company (WOS or JV Company)

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.

Minimum Alternate Tax (MAT)

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.

Other Taxes

Sales Tax

This tax is attracted upon the sale of goods and can be broadly categorized into two categories:
- State Sales Tax
- Central Sales Tax

Excise Duty
- This is leviable on the excisable goods produced or manufactured in India at the rates provided in the Central Excise Tariff Act.
- Rates of duty may be revised by the Annual Budget as well as through Government Notifications.
- In certain specified cases, State Governments are also empowered to levy the excise duty.

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Customs Duty

- Levied by the Central Government on the import of certain goods and commodities into India.
- The rates of duty along with the classification of imported goods are contained in the Customs Tariff Act.
- The rates of duty may be revised by the annual Finance Acts.

Various tax exemptions and deductions are available to Foreign and Indian Companies carrying on business in India.

Service Tax

- It is levied on the taxable services provided by specified categories of persons.
- Rate of tax: 5% of the value of taxable services.

Research and Development (R&D) Tax

- It is levied on an industrial concern on all payments made by it for importing technology into India at the rate not exceeding 5%, as may be notified by Central Government from time to time.
- Industrial concern is a very exhaustive term and virtually covers all kinds of commercial establishment, which import technology into India.
- Term 'technology' is very wide and mean special or technical knowledge or any special service required for any purpose whatsoever by an industrial concern under any foreign collaboration, and includes designs, drawings, publications and technical personnel.

Apart from the above, there may be several other central as well as state taxes applicable, depending on the activities undertaken by the company and location of the company operations.

Incentives Under Taxation Laws

Various tax exemptions and deductions are available to Foreign and Indian Companies carrying on business in India. Areas of activity wherein such incentives are given include:

- development, maintenance or operation of specified infrastructural facilities;
- provision of telecommunication services, including domestic satellite services, internet services, etc.;
- power generation, transmission and/or distribution;
- production or refining of mineral oil; and
- exports by operations located in Free Trade Zones (FTZs), Technology Parks for Hardware and Software (HTPs/STPs) or Special Economic Zones (SEZs), or by Export Oriented Undertakings (EOUs).

In addition to the above, various other deductions are available to resident companies which include:

- income from exports of goods and merchandise;
- profits from exports of software, including film, television and music software, and customized electronic data, and from "on site" development of computer software outside India;
- profits from the execution of foreign projects; and
- profits of a hotel or tour operator from services provided to foreign tourists.

Remittances of Funds Abroad

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 and accordingly the following treatment, shown in the chart on page 11, is given to the specified remittances.

In conclusion, it could be asserted that the Government of India has made/is making continuous efforts to make the aforesaid laws and procedures, commensurate with the second generation of market-oriented reforms so that India could emerge as an attractive business destination. Further the sound macroeconomic fundamentals and other advantages of the Indian economy undoubtedly act as an impetus for those seeking business opportunities in India.

The information contained in this article is of general nature and shall not be intended to constitute as a legal advice. However 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. The author cannot accept any responsibility towards those who rely solely on the con-

	Nature of Remittance	Approval	Limit
1.	Dividend	No approval required from RBI/Government. Only application to the authorized dealer along with particulars of the non-resident shareholding	No limit except in case of 22 consumer goods industries.
2.	Royalty and Fee for technical know how	Permitted under Automatic Route if either: i. the technical collaboration agreement is registered with RBI, or ii. the said remittance is made out of the EEFC (Exchange Earner's Foreign Currency) Account of the domestic company.	Up to 5% on local sales and 8% on exports and lump sum payment up to US $ 2 million (USD 2,000,000); Remittances exceeding the above mentioned limit are not covered under the Automatic Route of RBI and therefore, shall also require the prior approval from Ministry of Industry and Commerce, Government of India.
3.	Remittances for use and/or purchase of Trade mark and brand name in India of the foreign collaborator without technology transfer	No approval under the Automatic Route.	Up to 2% for exports and 1% for domestic sales. Remittances exceeding the above limit shall also require the approval from the Ministry of Industry and Commerce, Government of India.
4.	Reimbursement of Pre-Incorporation Expenses	No approval required	Up to USD 100,000 Remittances exceeding the above limit shall require the prior approval of RBI.

tents of this Article without taking further specialist advice. The reader should always consult with legal counsel before taking action on matters covered by this article. The author welcomes any comments or suggestions that the readers of this Article may have. ❏

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