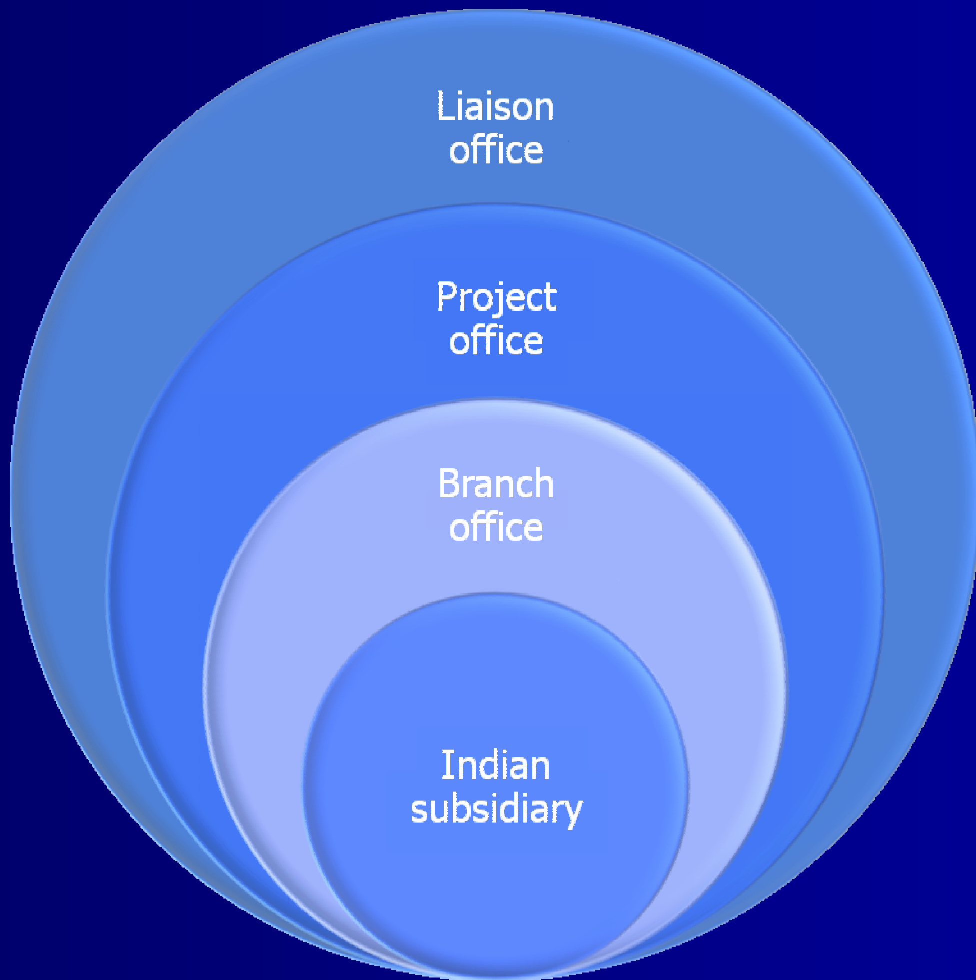
PGA

Regulatory & Tax Aspects for Establishment of Business Entity in India

For further information, please visit **PGA** at www.pgaindia.in or E-mail at: pargambhir@hotmail.com

TAX - AUDIT - ADVISORY

Structures available in India to setup a business entity



Liaison Office

- Companies incorporated outside India may establish liaison offices in India after obtaining prior approval from the Reserve Bank of India (RBI). Liaison office is also known as Representative Office.
- Normally initial permission is granted for 3 years, subsequent extensions are possible.
- Liaison office can undertake only liaison and related activities on behalf of its parent entity, like:
  - Representing the parent/group companies in India.
  - To act as a channel of communication between its head office and parties in India.
  - Collecting and/or providing business information.
  - Promoting export /import from/to India.
  - Promoting technical/financial collaborations between parent/group companies and Indian companies.
- Expenses of Liaison office are to be met entirely by inward foreign remittances from the head office out side India.
- For income tax purposes liaison office is treated as an extension of foreign company but not liable to pay income tax in India as it is not expected to make profits.

Contd..

Liaison Office

- A Liaison office cannot enter into any commercial or business activity in India.
- Normally, the transactions between the liaison office and the parent/associated entities are not subject to Transfer Pricing (TP) Regulations.
- Liaison office is required to submit annual activity report from its chartered accountants to RBI to ensure that it has undertaken only those activities that have been permitted by the RBI.
- A liaison office is required to register itself with the Registrar of Companies (ROC) and to comply with certain procedural formalities, as prescribed under the Companies Act, 1956.
- Foreign Insurance Companies can establish liaison offices in India after obtaining necessary approval from the Insurance Regulatory and Development Authority of India (IRDA). Such companies enjoy general permission under RBI rules.
- Liaison office has advantages like easy operations, less formalities and simple closure process. Its role is limited to collection of market information and providing information about the company and its products to the prospective Indian customers. Liaison office is just an entry point for foreign companies who wish to explore Indian market.
- Formation time: 4-6 weeks after receipt of relevant information.

Project Office

- A foreign entity may open a project office in India to execute a contract awarded to it by an Indian Company.
- Such companies can open project offices under RBI General permission (Automatic route), subject to certain conditions. In all other cases prior permission of RBI is required.
- IT can execute only that specific project for which permission is granted. It cannot undertake any other activity like liaison, marketing, business or execute any other contract.
- Transactions between the project office and its parent/group entities are subject to Transfer Pricing Regulations.
- It is required to be registered with the Registrar of Companies (ROC) in India and to comply with certain procedural formalities, as prescribed in the Companies Act, 1956.
- Subject to rules and payment of taxes, it can remit profits earned by it. It is also required to submit annual activity report to RBI.
- It is treated as an extension of the foreign entity and liable to pay Income tax in India on the profits attributable to it at the rates prescribed for the foreign companies.
- Funding is possible from the receipts from the parent company and from the project.
- Project office has advantages like easy operations, simple formalities with easy exit route. It can handle only specific projects for which it has permission.
- Formation time: 4-6 weeks after receipt of relevant information.

PGA

Branch Office

- Companies incorporated outside India and engaged in manufacturing or trading activities are allowed to set up Branch Offices in India with specific approval of the Reserve Bank. A foreign company cannot undertake any activity in India that is not specifically permitted by the Reserve Bank.
- Branch offices are permitted to represent parent/group companies and undertake the following activities:
  - Export/Import of goods. Procurement of goods for exports and sale of goods after import are allowed only on wholesale basis.
  - Rendering of professional or consultancy services.
  - Carrying out of research work in the areas in which the parent company is engaged.
  - Promoting technical or financial collaborations between Indian companies and parent/group companies.
  - To act as buying/selling agent in India.
  - Rendering of IT & Software Development services in India.
  - Rendering technical support to the products supplied by the parent/group companies in India.
- Branches are not allowed to undertake retail trading activities in India of any nature. A branch office cannot carry out manufacturing and processing activities in India, directly or indirectly.
- Branch office is required to register itself with the Registrar of Companies (ROC) and to comply with certain procedural formalities, as prescribed under the Companies Act, 1956.

Contd..

Branch Office

- Foreign companies have general permission to establish branch/unit in SEZ (Special Economic Zones) to undertake manufacturing or service activities, subject to certain rules.
- Foreign Banks do not require FEMA approval, if such Bank has obtained necessary RBI approval under the Banking Regulations Act, 1949.
- Profits earned by the Branches can be freely remitted from India, subject to the payment of applicable taxes.
- Branch offices are required to submit annual activity report from its chartered accountants to RBI.
- For income tax purposes branch office is treated as an extension of foreign company and taxed accordingly. Branch is liable to pay income tax in India on the profits attributable to it.
- Transactions between the branches and its parent/group entities are subject to Transfer Pricing Regulations.
- Funding is possible from the receipts from the parent company and from the Indian business operations.
- Branch offices have also advantages like easy operations, less formalities & simple exit process. However, its operations are restricted and may not provide flexibility in terms of expansion and diversification.
- Formation time: 4-6 weeks after receipt of relevant information.

PGA

Wholly Owned Subsidiary/Joint Venture

- Foreign entity may set up subsidiary companies in India which can be private or public limited, with or without limited liability.
- In India companies are incorporated and regulated under the provisions of the Companies Act, 1956 and are subject to certain procedural formalities under the Act.
- The liability of the members can be limited by shares or guarantee. In the former, the personal liability of members is limited to the amount unpaid on their shares while in the latter; it is limited by a pre-decided amount. For companies with unlimited liability, the liability of its members is unlimited.
- Subsidiaries can either be wholly owned or in joint venture with some Indian partner, as per RBI (FDI) rules. Except in few sectors where foreign direct investment cap is applicable, foreign entity can have 100% subsidiary.
- It can undertake all types of business activities, as may be permitted by its Charter, which may include marketing, manufacturing, providing services, etc.
- No RBI approval is needed where 100% direct investment is permissible.
- It is treated as domestic company under Indian tax law and is eligible for all the tax deductions and benefits as provided to any other Indian company.
- Individual directors are required to obtain DIN (Directors Unique Identification Number) from the Ministry of Company Affairs.
- Funding can be in the form of share capital, loans and business operations. Thin capital rule applies in India.
- Transactions between the subsidiary and parent/ group entities are subject to Transfer Pricing Regulations.
- Formation time: 2-3 weeks after receipt of the relevant information.

PGA

Broad Comparison: Private & Public - Subsidiary

PARTICULARS	PRIVATE LIMITED	PUBLIC LIMITED
MINIMUM / MAXIMUM NUMBER OF SHAREHOLDERS	Two/Fifty	Seven/Number of shares
MINIMUM DIRECTORS	Two	Three
LIABILITY OF SHAREHOLDERS	In both the cases, limited to the extent they have subscribed to the share capital unless agreed otherwise.	
MINIMUM PAID-UP CAPITAL	INR 100,000	INR 500,000
BASIC FEATURES	-No offer can be made to public to subscription to its shares - Right to transfer shares is restricted -Cannot invite or accept deposits from public other than its members, directors or their relatives.	No such restrictions but subject to some other compliances.
WHEN IT CAN START BUSINESS	On incorporation	On obtaining certificate of commencement of business from ROC after incorporation.
SUITABILITY	Closely held entity with minimum procedural, reporting, compliances, etc.	- For widely held entity. -If planning to go for a public issue. - Listing of shares.

General

- Partnership and proprietary concerns set up abroad are not allowed to open branch or liaison offices in India.
- Indian/domestic companies and foreign companies having offices in India are regulated under the Companies Act, 1956. The law requires such entities to file their papers/forms/documents electronically. The directors or the authorized representatives, as the case may be, are required to obtain their digital signature to sign and file e-forms.
- Unlike subsidiaries others have simple exit route.
- Foreign entities are required to appoint their representatives in India to receive notices and other communications from the Government and other agencies.
- Subsidiaries enjoy greater flexibility and operational freedom.
- Branch, liaison and project offices are allowed to open non-interest bearing current accounts in India.
- Subject to the rules, PO can open non-interest bearing foreign currency account in India.
- Transfer of assets by branch/liaison offices to subsidiaries or other liaison/branch offices are allowed subject to RBI prior approval.
- Inter project transfers of funds are also allowed, subject to the rules.

PGA

Indian Taxation System

- Direct Taxes:
  - Are charged on Income/wealth/expenditure.
  - Are outflow from profits.

- Indirect Taxes:
  - Are charged on imports/production/sales/services.
  - Are not an item of expense but added to the cost of Production and recovered from the customers.

Direct Taxes

- **Income Tax for corporate assessee, known as Corporate Tax**
- **Minimum Alternate Tax (MAT)**
- **Fringe Benefit Tax (FBT)**
- **Dividend Distribution Tax (DDT)**
- **Wealth Tax (WT)**

Direct Taxes in General

General

- Union Government of India charges two types of taxes direct and indirect. There are few types of taxes which are the subject matter of State Governments and are not material in nature.
- Direct Taxes are charged on the income or wealth and profits.
- Indirect Taxes are charged by Union Government on imports/production/sales/services. These are not items of expense but added to the cost of production and recovered from the customers.
- Indian tax (financial) year starts from 1st April and ends on 31st March of the subsequent year. All tax assessees are required to follow financial year as their tax year but may have different accounting year.
- All tax assessees are required to obtain unique tax identification number, called Permanent Account Number (PAN).
- All resident corporate tax assessees are supposed to file their tax returns by 31st September of every year even in the event of loss. Non resident corporate are also required to file tax returns if they have business entity or office in India or have income from any Indian source, asset, business, etc.
- Tax rates in India are on the reducing trend.

PGA

Corporate and Fringe Benefit Tax

Corporate/Income Tax

- It is charged on the net annual total taxable income which is computed under the provisions of Income Tax Act, 1961. Depreciation is allowed as an expense at specified rates on tangible and intangible assets.
- Losses can be carried forward for set-off. Unabsorbed depreciation can be carried forward for set-off for indefinite period.
- Subsidiary of a foreign entity is treated as domestic company that enjoys minimum corporate tax rates and all other tax exemptions and deductions like any Indian company.
- Branch/project office is charged to tax on the profits attributable to it and is treated as an extension of a foreign company and taxed accordingly.

Fringe Benefit Tax (FBT)

- It is an additional (income) tax payable on the value of fringe benefits provided and deemed to be provided.
- Value of fringe benefits is taken as certain specific percentages of selected expenses.
- Benefits or perquisites on which FBT is paid by the employer are not taxed again in the hands of employees or vice versa.

PGA

MAT, DDT and WT

Minimum Alternate Tax (MAT)

- It is an extension of Corporate/Income tax . It intends to bring into tax net, the companies showing profits in their accounts but paying nil or little tax.
- It is levied if tax liability under the Income Tax Act (taxable profits X applicable tax rate) is lower than 10% of the Book Profits.
- Taxable profits means profits as computed under the Income tax Act after granting all eligible deductions and exemptions. Book profits means profits (after few adjustments) as per accounts.
- Scheme of tax credit (MAT minus normal tax) is applicable in India as per the rules.

Dividend Distribution Tax (DDT)

- It is levied on the amount paid, declared or distributed as dividend by a domestic company. It is not payable by Branch or Project office.
- Once domestic company has paid DDT, dividend received by the shareholders is totally tax free.

Wealth Tax (WT)

- Wealth tax is payable on the market value of certain assets (basically guest house, motor cars, boats, aircrafts, jewellery, urban land, etc.) owned by a company.
- Payable @1% (no surcharge and education cess) of the amount by which net wealth exceeds 1.5 Million INR.
- While computing net wealth, debts owned in connection with taxable assets are reduced.

Direct Tax rates for assessment year 2010-11 (Financial year 2009-10)

Particulars	Tax rate (inclusive of surcharge & Education Cess)			
	Subsidiary/Domestic Company		Foreign Company (PO & BO)	
	Where total income is equal to or less than 10 million INR	Where total income exceeds 10 million INR	Where total income is equal to or less than 10 million INR	Where total income exceeds 10 million INR
Income Tax	30.9%	33.99%	41.2%	42.23%
Minimum Alternate Tax (MAT)	10.3%	11.33%	10.3%	10.5575%
Dividend Distribution Tax (DDT)	16.995%		Nil	
Fringe Benefit Tax (FBT)	33.99%		31.6725%	

Notes:

- LO is not liable to pay income tax, as it is not expected to make any income but liable to pay FBT @ 31.6725%
- Dividend is not taxable in the hands of shareholders.

INDIRECT TAXES

- Service Tax (ST)
- Central Sales Tax (CST) & State Value Added Tax (VAT) *(Service tax and VAT planned to be merged into GST from 01.04.2010.)*
- Customs Duty
- Excise Duty

PGA

Service tax and sales tax

SERVICE TAX

- Entities providing taxable services are required to charge service tax from their customers.
- Export of services is tax free but import of taxable services are taxed.
- Service tax paid on input services can be set-off against the service tax payable on output services.

CST & VAT

- CST is levied on Inter State Sales (from one State to another) within India. It co-exists with State VAT (Sales Tax). VAT is levied on local (intra-state) or sales within a State.
- Inter State Branch transfers are not charged to CST.
- Exports and imports of goods are exempt from CST.
- *Service Tax and VAT are planned to be merged by 2010.*

Custom & Excise Duty

Custom Duty

- Levied on import and export of selected goods at the rates specified in the Customs Tariff on the 'Value' of products.
- It is treated as cost of production and recovered from the sales.
- Government may impose anti-dumping/safeguard duties on specific products.

Excise Duty

- Levied on 'excisable goods' manufactured or produced in India at the specified rates. It is normally, levied on the value of 'excisable goods' unless administered.
- Exemption for goods manufactured in Special Economic Zones (SEZ) or for Exports.
- Excise paid is recovered from the buyers as part of the sale consideration.
- Manufacturer can claim credit of Duties paid on specified goods including capital goods used in manufacturing. Service Tax paid on input services can also be set off form the Excise Duty payable on the finished excisable goods.

PGA

Brief note on Transfer Pricing

- Every country tries to protect its revenue.
- Indian TP rules are in conformity with the international practises and conventions.
- Indian entity will be treated as related/associated concern.
- TP rules apply to all international transactions resulting into an income or expense between the associated concerns.
- All international transactions with associated concerns should take place at arm's length price.
- Arm's length price is a price that would be charged by unrelated parties in similar conditions.
- Indian Tax Act prescribes following methods by which arm's length price can be determined:
  - Comparable uncontrolled price method.
  - Resale price method.
  - Cost plus method.
  - Profit split method. and
  - Transactional net margin method.
- Such transactions are subject to special audit, reporting, etc. as per rules.

PGA

Brief note on Tax Treaties (DTAA)

- Foreign entities and expatriate employees may opt for the respective tax treaties, if found more beneficial in comparison to Indian tax laws.
- India has tax treaties with most of the countries.
- Treaty provisions shall prevail upon Indian tax provisions.
- Indian subsidiary shall be governed by Indian tax laws like any other domestic company.
- Credit available for the taxes paid outside India.
- Tax treaties cover basically direct taxes.

PGA

Registrations Required

- **Permanent Account Number (PAN)**: Income tax law requires every assessee to apply and obtain PAN which is a unique tax identification number.
- **Tax Deduction Account Number (TAN)**: India has tax deduction at source and withholding rules. Every company, branch, project and liaison office while making payments/expenses is required to deduct tax and deposit it with the Govt. It is a unique tax identification number for TDS purposes.
- **Service Tax Code (STC)**: It is a PAN based service tax code which every company providing taxable services is required to obtain. It is a unique service tax identification number of the Company.
- **Value Added Tax (VAT)/ Sales/Works Contract Tax:** The entity will also be required to obtain such number, if it enters into sale and purchase of physical goods.
- **Import Export Number**: It is required before entering into import or export of goods.
- **Shop & Establishment Act**: In certain states entities are required to register their offices with the State Govt. under the rules.
- **Other Registrations**: May be required in future under different laws like Employees State Insurance, Provident Fund, etc. which will depend on various factors.

PGA

Thanks

CA. Parveen Gambhir

For any further information, please visit
PGA at www.pgaindia.in or E-mail: pargambhir@hotmail.com
or contact at:

87-B, Masjid Moth – II, DDA Flats, Greater Kailash - III
New Delhi - 110 048 (INDIA)
Tel/Fax: +91 11 2922 3838, +91 98112 52946