Investments in India: A STRUCTRUAL STRATEGY

Written By Kegler Brown Associate, Vinita Bahri-Mehra

The Indian Market opened up for foreign investors with the liberalization of the Indian economy. Since the beginning of economic reforms in 1992, major reform initiatives have been taken in the fields of investment, trade, financial sector, exchange control simplification of procedures and enactment of competition law. India provides a liberal, alternative, and investor-friendly investment climate. There are various options available to a foreign enterprise, such as to a US company to set up an India operation.

A foreign company planning to set up business operations in India has following options:

Agency

An agency provides the foreign company an indirect presence in India. Under this, the foreign enterprise appoints an Indian entity as its agent and depending upon the scope of the agency agreement, the agent can buy or sell or provide any other service to the foreign enterprise. However, under this arrangement, the foreign enterprise is liable for the acts of the agent under the principles of "Principal-Agent" and is exposed to liability issues that may arise in India.

Association of Persons

As association of persons is a collection of different entities joined together for a common purpose. It can be formed by individuals, limited companies and others, and it need not register with the authorities in India. An association of persons is usually formed by the execution of an agreement between the participants. However, in certain cases where a formal relationship may not be evident from documents, the conduct of parties can give rise to a presumption of the existence of an association of persons. The association of persons is a recognized entity for tax purposes in India.

Liaison Office

The role of a liaison office is limited to collecting information about possible market opportunities and providing information about the foreign company and its products to prospective Indian customers. It can promote export/import from/to India and also facilitate technical/financial collaboration between parent companies and companies in India.

Liaison office can not undertake any commercial activity directly or indirectly and can not, therefore, earn any income in India.

Opening and operations of such office is regulated by the Foreign Exchange Management Act (FEMA) 1999 of India. Approval through an application process from Reserve Bank of India, Foreign Investment Division ("RBI") is required for opening such office. Generally, permission by RBI is granted for three (3) years subject to the conditions that the expenses of the liaison office are met exclusively by the foreign company situated outside India through inward remittance of foreign exchange.

Project Office

Foreign enterprises planning to execute specific projects in India can set up temporary project and site offices in India. RBI grants general permission to foreign entities to establish Project Offices, subject to specified conditions. Such offices can not undertake or carry on any activity other than activity relating to and incidental to execution of the project.

Project Office may remit outside India the surplus monies after the completion of the project, after meeting the tax liabilities, if any.

Branch Office

A Branch Office is basically an extended arm of foreign enterprise and can undertake the following activities:

- Export/import of goods;
- Rendering professional or consultancy services;
- Carrying out research work, in which the parent company is engaged;
- Promoting technical or financial collaboration between Indian companies and parent or overseas group company;
- Representing the parent company in India and acting as buying/selling agent in India;
- Rendering technical support to the product supplied by parent or group company; and
- Rendering services in information technology and development software in India.

However, branches are not allowed to undertake manufacturing activities. A Branch Office is treated as a Permanent Establishment (for tax purposes) of the foreign enterprise and is liable for higher Income Tax as compared to companies set up in India.

Approval through application process is required to be made to RBI for opening a Branch Office in India.

Joint Venture

This is the most sought after route for foreign enterprises wishing to establish a presence or base in India. For this purpose, generally an Indian company with limited liability is formed in India which then partners with a local partner (i.e. another Indian company). Forming a joint venture encompasses a number of stages and a number of factors, such as the following:

1. Choosing a Local Partner. The most important decision is choosing an appropriate local partner. A local partner can play a significant role in overcoming various legal complexities. It is very essential that there be honesty and integrity between the parties. Business synergies, which are complimentary for the venture, are also required.

2. Identifying a Location. The next step is to identify a location for the proposed project. Choice of location depends upon the type of activity to be undertaken. Important factors to be considered for this purpose are availability of infrastructural services and financial incentives, such as preferential tax treatment.

3. Negotiations. Prior to commencing negotiation, confidentiality/non-disclosure agreements should be entered into between parties for protection of strategic business information. Such agreements are enforceable in India. Another step taken at the initial stage of negotiation is to sign a Memorandum of Understanding (MoU). A MoU lays down the basic parameters of the project and contains the intention of the parties to enter into the Joint Venture. Generally, such MoUs in India are not legally binding.

4. Joint Venture Agreement. The Joint Venture Agreement/Shareholders' Agreement in India, along with the Articles of Association constitutes the by-laws of the Joint Venture Company in India. In order to give such agreement a binding effect, "Stamp Duty" (i.e. certain fees to the state government) has to be paid thereon. This document defines the mutual rights of parties and prescribes guidelines for efficient functioning of the Joint Venture Company.

Wholly Owned Subsidiaries (WOS) Venture

Foreign equity in Indian companies can be 100% depending on the requirements of the investor, subject to any equity caps prescribed in respect of the areas and sectors of activities under Foreign Direct Investment (FDI) policy. In sectors where government policy permits 100% FDI, in such cases, the foreign enterprise can set up its wholly-owned subsidiary. Investors prefer such a set up as they are able to exercise maximum control over its functioning and obtaining maximum gain therefrom.

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A wholly-owned subsidiary can be incorporated under the Indian Companies Act, 1956 ("COA") either as a Private Limited Company or Public Limited Company. Both options offer liability protection to its shareholders but have minimum capitalization requirements.

Formation of a Public Limited Company is suitable in case the proposed business requires:

- Large Capital Outlay;
- Raising of Equity or Debt;
- Wider distribution of shares and large number of shareholders; and
- Establishment of the securities of the company in Stock Exchanges in India.

Formation of a Private Limited Company is suitable in the following cases:

- Small to Medium Enterprises ("SMEs") with lower capital outlay;
- Promoter wants to retain shareholding and restrict transfer of shares;
- No intent of raising funds from public;
- Minimum number of shareholders; and
- Regulation of admission of new members.

A subsidiary of a foreign enterprise is treated in the same manner, in almost all respects, as a company that has resident Indian shareholders. The wholly-owned subsidiary in India presents certain advantages over a Branch Office structure, such as greater flexibility with respect to the activities carried out in India by the wholly-owned subsidiary. Furthermore, the branch may not be eligible for certain tax incentives available in India for incorporated companies.

Structuring Issues

Investing in an Indian company through an intermediate holding company in a tax-favorable jurisdiction may offer various advantages. It helps in pooling offshore investments and also helps in globalization of restructuring of a company at a later stage. India has favorable treatise with a few countries including Mauritius, Singapore, Cyprus and the Netherlands.

Even though India appears to be an attractive destination for foreign investment, another reality is that it is critical for every foreign company planning to set up operations or otherwise do business in India to comply with all relevant national and local laws that impact the business it plans to conduct in India. Therefore, it is important to develop a legal strategy that support's a company's business plans and objectives. This legal strategy should include doing proper due diligence on the company's prospective partners or others with whom the company plans to do business with, as well as on the specific conditions and prospects of the company's market. To that end, it is critical to obtain experience guidance before a company venture into this new and exciting market.

We are moving towards a global economy and the world is getting flatter. The vast and growing Indian market is indeed a reality.

For More Information:

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