

# **MANAGING SET-UP & POST SET-UP ISSUES**

10 common pitfalls to avoid

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*A member firm of NIS*

# PRESENTATION OUTLINE

- **INDIA TOUR**
- **KEY SET-UP ISSUES**
- **KEY POST SET-UP ISSUES**
- **ABOUT CCI**

# INDIA TOUR

# INDIA TOUR

- The 2<sup>nd</sup> **most attractive investment destination**  
*(source UNCTAD World Investment Report 2007)*
- Advantage - **low cost of production, large size domestic market**
- **Growth rate at 8.5%** considered sustainable
- Besides the service industry, evolving into a **manufacturing hub**
- India figures in the **Research and Development** strategy of global corporate

# FDI INFLOW

## Top Investing Countries

US\$ Million

Ranks	Country	2004-05	2005-06	2006-07	2007-08	Cumulative
1	Mauritius	1,129	2,570	6,363	9,463	18,481
2	USA	669	502	856	1,021	3,902
3	UK	101	266	1,878	1,117	3,390
4	Singapore	184	275	578	1,664	2,214
5	Netherlands	267	76	644	601	2,209
6	Japan	126	208	85	761	1,899
<b>7</b>	<b>Germany</b>	<b>145</b>	<b>303</b>	<b>120</b>	<b>440</b>	<b>1,298</b>
8	France	117	18	117	120	661
9	Switzerland	77	96	56	247	629
10	Cyprus	3	70	58	773	562
	Total	3,754	5,546	15,726	20,136	47,206

Source – Department of Industrial Policy & Promotion

# INDIA TOUR

## Understanding Regulatory Compliances

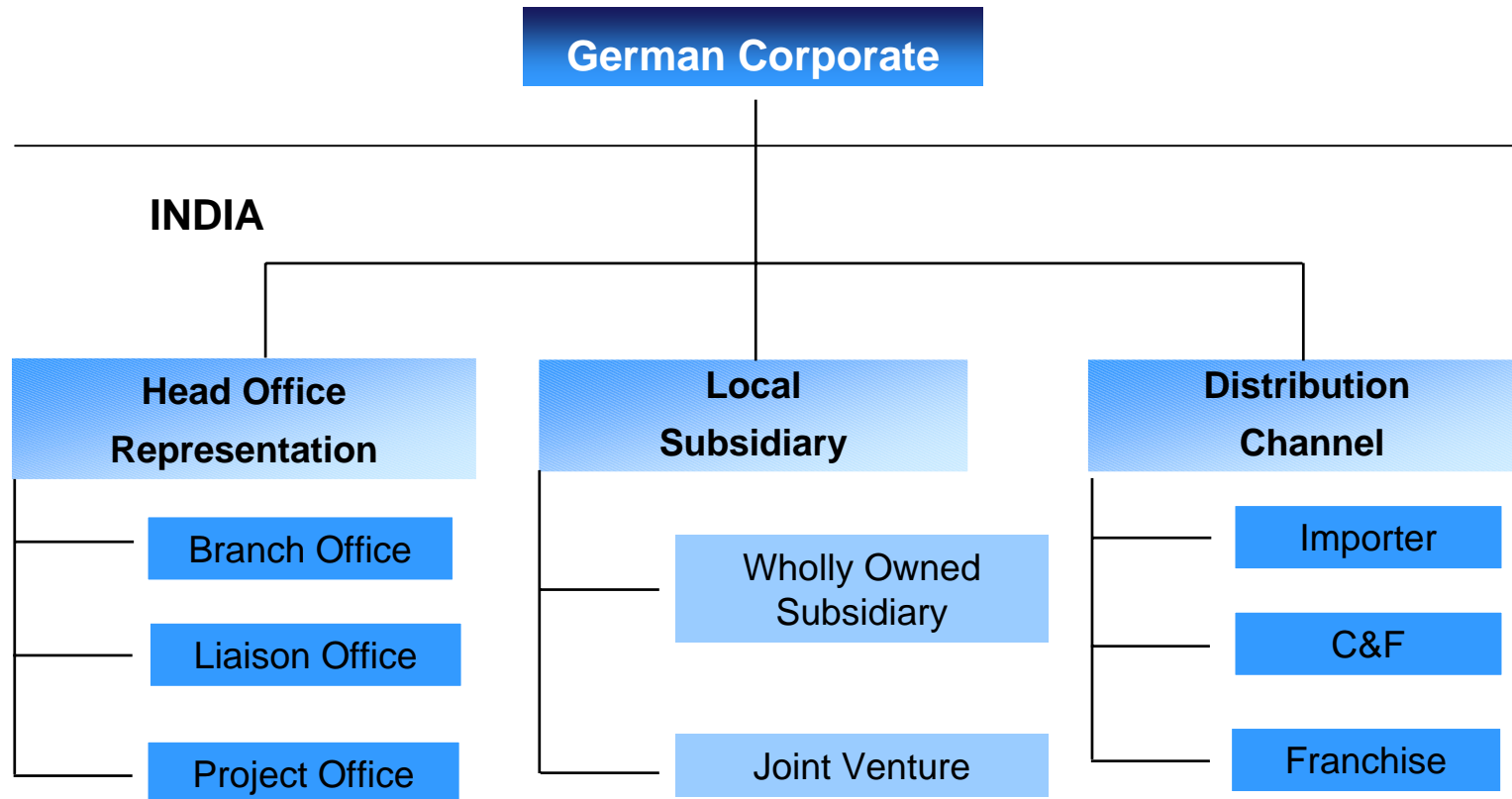
- Most laws originate from British Laws
- Procedure Driven
- Failures to comply usually leads to penalty and sometimes prosecution
- Stacked in favor of labour (*blue collar staff*)
- Fine reading and interpretation is the norm

# SETTING UP THE BUSINESS

## Avoiding Pitfalls

# INDIA ENTRY

## Mode of Investment



# INDIA ENTRY

## Alternate Entity Comparison

	<b>Corporate [CO]</b>	<b>Liaison Office [LO]</b>	<b>Project Office [PO]</b>	<b>Branch Office [BO]</b>
<b>Characteristics</b>	Share capital owned by parent company	No commercial activities allowed	Temporary site office, specific projects	Commercial activities allowed
<b>Status</b>	Shareholders	Foreign Company	Foreign Company	Foreign Company
<b>Tax Rate</b>	30% +	Non Taxable	40% +	40% +
<b>Control</b>	Board of Directors	Parent Company	Parent Company	Parent Company
<b>Set-up</b>	FIPB Approval / Automatic Route (4-6 weeks)	RBI approval (4 weeks)	RBI approval (4 weeks)	RBI approval (4 weeks)
<b>Closure</b>	ROC (6-9 months)	RBI (3 months)	RBI (3 months)	RBI (3 months)

RBI – Reserve Bank of India

FIPB – Foreign Investment Promotion Board

ROC – Registrar of Companies

- **Negative List** - sectors where Foreign Direct Investment is not allowed e.g. betting, lottery business, atomic energy, retail trading (except 'Single Brand' product retailing)
- **Sectoral Caps** – foreign investment in certain industries governed by equity cap e.g. Insurance (26 %)
- A small list of activities is **reserved for the Small Scale Industries (SSI)**



Examine the Negative List, Sectoral caps and SSI reservations while conceptualizing investment into India

# CORPORATE SET-UP

## Existing Collaboration(s) in India can restrict your entry plans (#2)

- Do you have an **existing joint venture** with an Indian partner for the very field in which you now intend to set-up business in India?
- Do you have an **existing technology collaboration** with an Indian partner for the same field in which you intend to do business in India?

Press Note 1 (2005 Series)

If yes, a 'No Objection Certificate' is mandatory from the existing Indian Partner and prior approval is required from the Foreign Investment Promotion Board of India

# CORPORATE SET-UP

Pay attention to your Capital Structuring (#3)

- At least two Shareholders are required; and
- Capital structure will determine 'private' or 'deemed as public' company in India viz.

Case	Shareholding of the Indian Company	Status in India
1	Indian Individual Shareholder + Foreign Company (Public)	Public Company
2	Indian Company + Foreign Company (Public)	Public Company
3	Foreign Company (Public) + Foreign Individual Shareholder	Public Company
4	Foreign Company (Public) + Foreign Company (Public)	Private Company
5	Two or more Foreign Individual Shareholders	Private Company
6	Foreign Company (Private) + Foreign Company (Private)	Private Company
7	Foreign Company (Private) + Foreign Individual Shareholder	Private Company

*section 4(7), Indian Companies Act, 1956*

If a company is deemed a public company (listed or non-listed), it will attract higher compliance requirements

# CORPORATE SET-UP

## The confusion of 'Single Brand' Retailing (#4)

Though retailing is not allowed, 'Single Brand' retail can be done through a 51:49 joint venture with an Indian Partner

Single Brand Retailing means

- You retail goods under one single brand, and
- The brand is well recognised, and
- It covers only products branded during manufacturing

*Press Note 3 (2006 Series)*

Applications for single brand retailing are processed by the Department of Industrial Policy & Promotion (DIPP) and is presently somewhat restrictive

# CORPORATE SET-UP

## Can we recognise contracts & expenses prior to incorporation? (#5)

- Pre-incorporation expenses are tax deductible, viz. preparation of feasibility report, engineering services relating to the business, legal charges for drafting any agreement etc.
- Pre-incorporation contracts are recognised if, the company had adopted the same post incorporation; and
- Contracts which are warranted by the terms of incorporation, or those entered before incorporation **and** adopted by the company, are legally valid e.g. office lease agreement ratified in the first board meeting, employment agreements etc

Unless the company adopts the contract, the other party cannot enforce the same against the company. However, promoters can become personally liable.



## SOME USEFUL TIPS

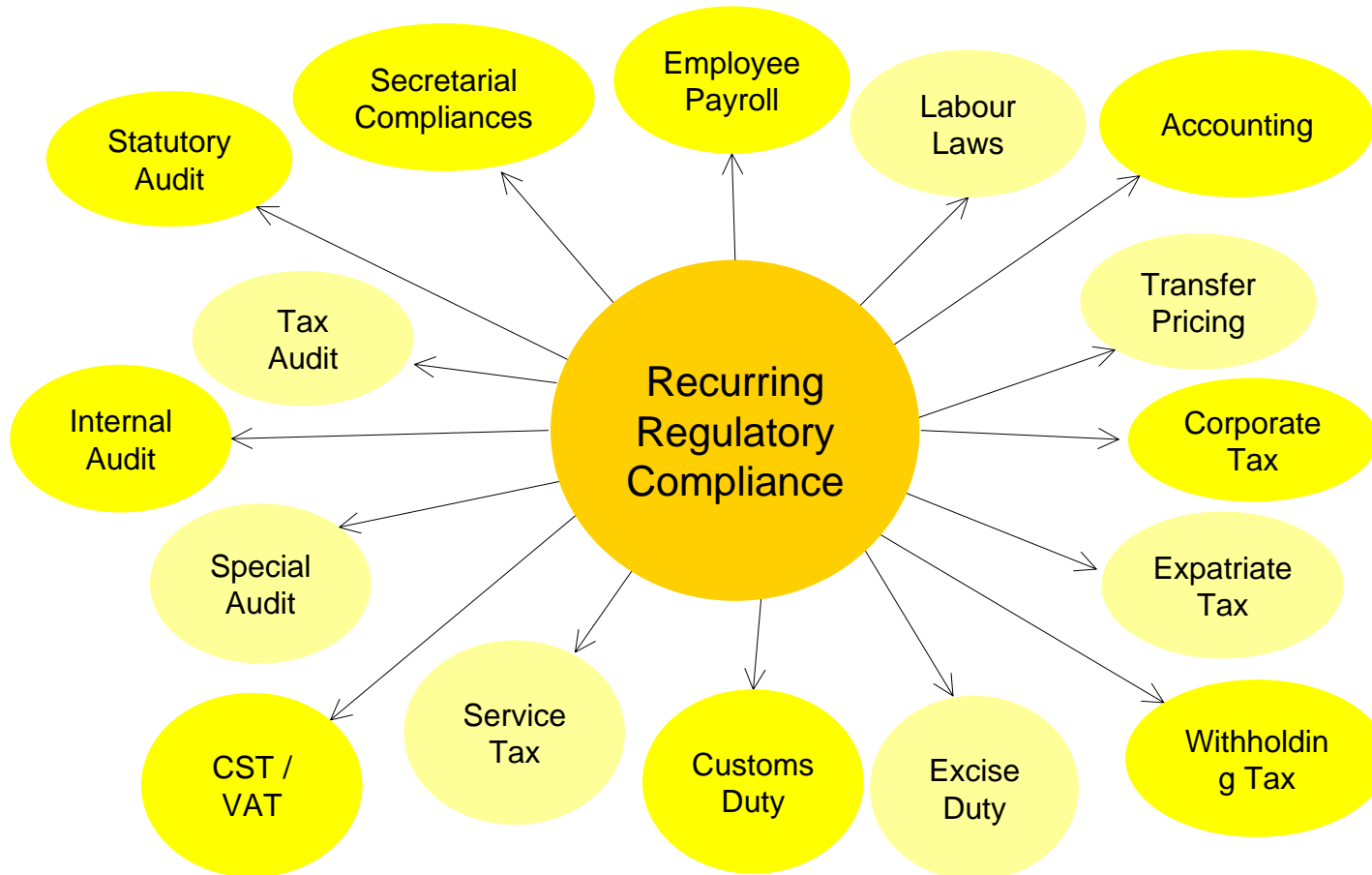
### Value Addition to the Feasibility Study

- Have you considered various Municipal Level Taxes?
- Have you considered effect of Fringe Benefit Tax, Pension Schemes etc?
- If land is required, have you considered future expansion plans?
- Logistics and easy access to resources taken into consideration?
- Does the paid-up capital of the Indian Company exceeding INR 20 million? *if yes, Company Secretary required*

# RECURRING REGULATORY COMPLIANCES

# COMPLIANCES

## Overview



# REGULATORY MATTERS

## Key Authorities

- Reserve Bank of India ('RBI')
- Registrar of Companies ('ROC')
- Income Tax Authorities
- Central Board of Excise and Customs ('CBEC')
- Labour Commissioner

# ACCOUNTING

## Key Laws in Focus

- Company Law
- Tax Laws (Income tax including tax treaties, Customs, Excise, VAT/Service Tax)
- Indian Generally Accepted Accounting Policies ('Indian GAAP')
- Labour Laws (Factories Act, Industrial Dispute Act, etc.)
- Employment Regulation (Social Security Regulations )

# ACCOUNTING

## Key Issues

- Financial Year - April 1<sup>st</sup> to March 31<sup>st</sup>
- Recording of transactions - per Indian GAAP
- Adequate provisioning and appropriate disclosure
- Compliances - Daily, Monthly, Quarterly, Annual

CO

LO

BO

PO

# PAYROLL MANAGEMENT

## Key Issues

- Employment Contracts
  - Regulated under labour laws
  - Income Tax Issues
  - Corporate Laws

CO

LO

PO

BO

### ■ Statutory Audits

CO

LO

PO

BO

- Annual Review and Reporting by an Indian firm of Chartered Accountants
- Indian Generally Accepted Accounting Policies ('Indian GAAP')
- Annual Reporting to Government Authorities

### ■ Tax Audits

CO

PO

BO

- Applicability – Annual Turnover INR 4 Million (USD 90,000 approx)
- Certification by an Indian firm of Chartered Accountants

### ■ Internal Audits

CO

- Applicability – Turnover INR 50 Million or Paid-up Capital INR 5 Million
- In-house Team or Outsource to Indian firm of Chartered Accountants

# DIRECT TAXES

## Overview

▪ Corporate Tax	CO		PO	BO
▪ Transfer Pricing	CO		PO	BO
▪ Withholding Tax	CO	LO	PO	BO
▪ Fringe Benefit Taxation	CO	LO	PO	BO
▪ Expatriate Taxation	CO	LO	PO	BO

# DIRECT TAXES

## Tax Withholding

PAYEE	WHEN	TAX WITHHOLDING (%) *	DATE OF DEPOSIT	REPORTING
Employee	If salary is taxable	Per prescribed slabs	Within 7 days of payment	Quarterly to Indian tax authorities
Contractor	Annual payment exceeds INR 20,000 (USD 500 approx)	2	7 <sup>th</sup> of the month succeeding payments	
Landlord	Annual rental exceeds INR 120,000 (USD 2,500 approx)	15/20		
Profession	Annual payment exceeds INR 20,000 (USD 500 approx)	10		

*\*Further enhanced by surcharge and education cess*

# INDIRECT TAXES

## Overview

▪ Excise Duty	CO		PO	BO
▪ Customs Duty	CO	LO	PO	BO
▪ Service Tax	CO		PO	BO
▪ Central Sales Tax	CO		PO	BO
▪ Value Added Tax	CO		PO	BO

# INDIRECT TAXES

## Excise Duty

- Applicability CO
- Definition of Goods
- Concept of Manufacture
- Proper Recoding of transactions
- Inspection by Excise Inspectors
- Complex Duty Structure and Calculation Mechanism
- Developed Case Laws

# INDIRECT TAXES

## Customs Duty

- Applicability CO LO PO BO
- To regulate imports of foreign goods into India
- Regulate supply of goods into domestic market
- Additional Duty of Customs – protective shield to domestic industry
- Methods of Valuation
- Classification of Goods – *99 Chapters*

# INDIRECT TAXES

## Service Tax

- Applicability CO PO BO
- Voluntary compliance
- Services defined – *Over 100 categories*
- Services provided from outside of India and received in India
- Proper Recording of transactions
- Developed Case Laws

# INDIRECT TAXES

## Central Sales Tax/ VAT

- Central Sales Tax
 

CO		PO		BO
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  - Non Vatable
  - Under phase out by 2010
  
- Value Added Tax
 

CO		PO		BO
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  - Includes goods sold within a particular Indian state
  - Goods sold from outside of India and title transferred in India
  - Proper Recording of transactions
  - Developed Case Laws

# INDIRECT TAXES

## VAT Case Study

<b>Purchase Price</b>	<b>Rs 100</b>
Tax paid on purchase	Rs 10 (input tax)
Sale price	Rs 120
Tax payable on sale price	Rs 12 (output tax)
Input tax credit	Rs 10
VAT payable	Rs 2

# INDIRECT TAXES

Flag This

- Central Sales Tax/ VAT & Service Tax – to be merged into a single Goods & Service Tax ('GST') by 2010

## Overview

EVENT	Applicability			
Office shifting	CO	LO	PO	BO
Change in Director / Authorised Representative	CO	LO	PO	BO
Board Meetings & Annual Shareholders Meeting	CO			
Maintain Statutory Records	CO			
Annual Return to ROC	CO	LO	PO	BO
Annual Return to RBI		LO	PO	BO

# POST SET-UP

## Avoidable Pitfalls

# POST SET-UP – Recurring Compliance

## Key Dates

REGULATORY MATTER	DUE DATE
<b>CORPORATE LAW</b>	
Board Meeting	Quarterly (calendar year basis)
Annual General Meeting	Within 180 days of closing the accounts
<b>INCOME TAX</b>	
Corporate Tax Return	September 30 <sup>th</sup>
Tax Audit Report	September 30 <sup>th</sup>
Fringe Benefit Tax Return	September 30 <sup>th</sup>
Transfer Pricing Report	September 30 <sup>th</sup>
TDS Returns ( <i>Tax Withholding</i> )	Quarterly
Employee Tax Return	July 31 <sup>st</sup>
<b>SERVICE TAX</b>	October 25 <sup>th</sup> & April 25 <sup>th</sup>

Ensuring that transactions between group companies are at market price? (#6)

- **Arm's Length price ('ALP')**

Any income arising from an international transaction between associated parties to be computed having regard to ALP

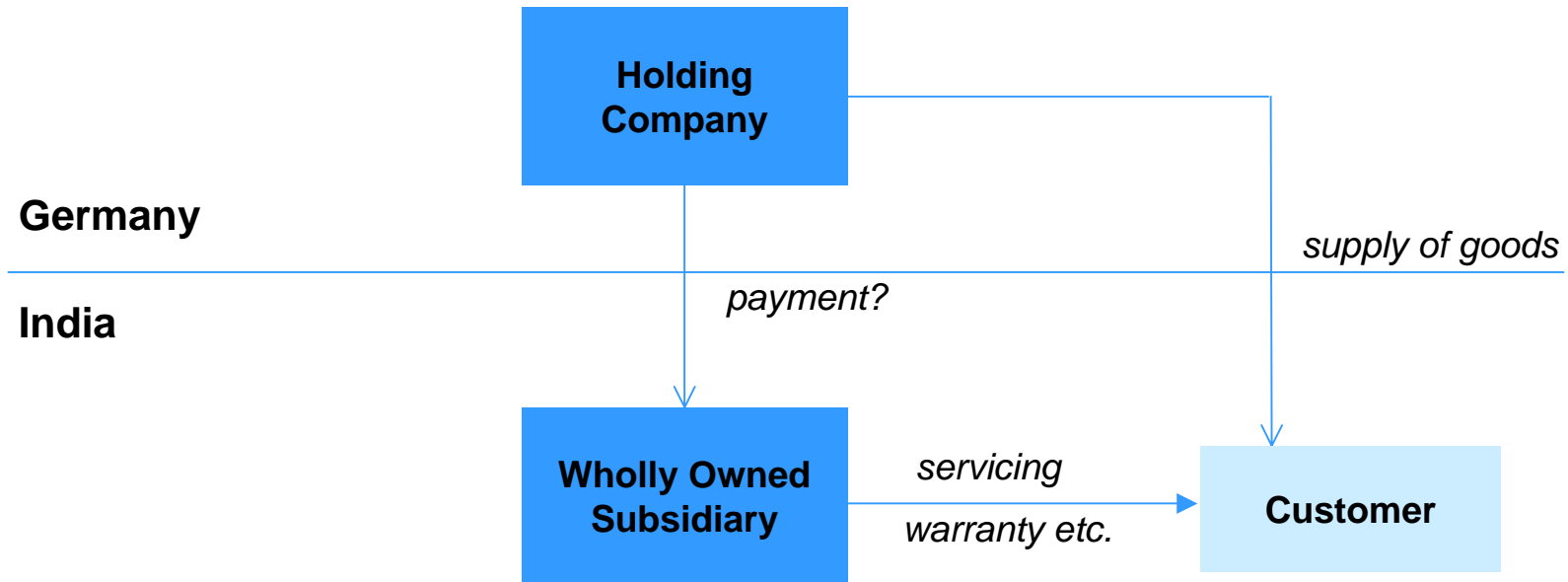
ALP means a price which is applied in a transaction between persons other than associated enterprises

- **Associated Enterprise ('AE')**

Participation in management or control or capital of other enterprise  
Directly through intermediaries

# TRANSFER PRICING

Determining the appropriate pricing for group companies transactions



Transfer Pricing Issue –  
what should be the profit  
margin of the Wholly  
Owned Subsidiary?

# LIAISON OFFICE

## The PE Trap (#7)

- Does the India Liaison Office ('LO') sign direct contracts in India ?
- Is the LO deeply involved in price negotiations?
- Are the employees of the LO paid incentives on sales ?
- Does the LO raise Purchase Orders on the Head Office ?

An affirmation to any of the above – LO regarded as a Permanent Establishment of the parent company in India. This is a high risk of exposure to taxation

# TAX COMPLIANCES

## Charging the Head Office Expenses

(#8)

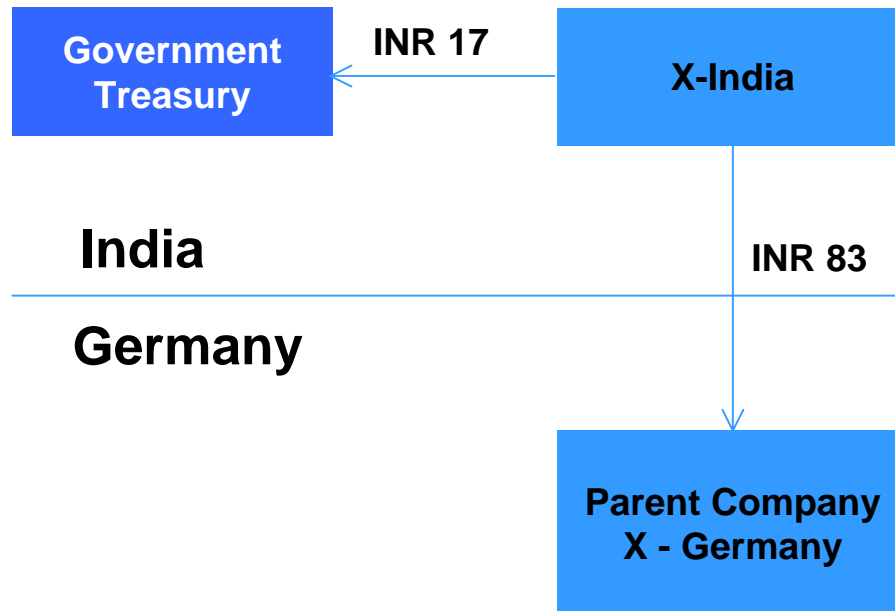
The lower of the following are tax deductible expenses by the HO

- An amount equal to 5 per cent of the total income of Indian entity, or
- Actual expenses

Plan your future Head Office (HO) expenses allocations carefully to avoid disallowance by the Indian Tax Officer

# REPATRIATING PROFITS

The menace of Dividend Distribution Tax (#9)



Amount in INR	
<b>Net Profit</b>	<b>133</b>
Tax on Profit	33
Distributable Profit	100

Whether the credit in respect of Dividend Distribution Tax (DDT) of INR 17 is available in the Parent Country?

# EXPATRIATE TAX MATTER

## Social Security Payment (#10)

- Does the parent company pay
- For the pension funds maintained outside India by the expatriate?
- His/her internationally valid medical insurance?

Social security payments made outside India, are taxable in India where a right immediately vests to the expatriate

**THANK YOU**

**Ajay Sethi**