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Doing Business in India

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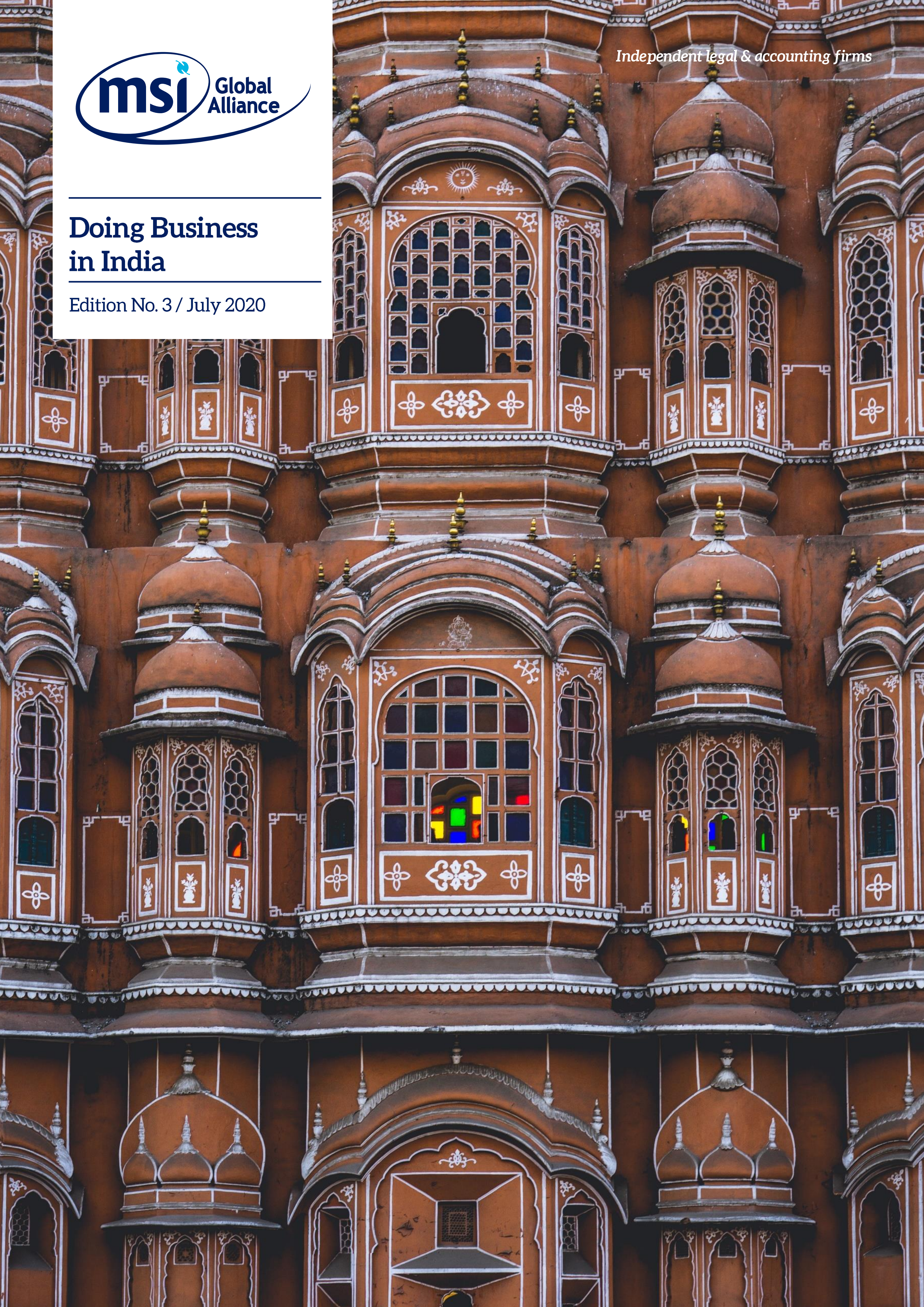

Doing business in India

MSI's guide on Doing Business in India provides current information about the financial, regulatory and legal considerations that could affect business dealings within India. For further assistance please contact our MSI member firms in India.

Country overview

Population
India has a total population of 1.36 billion inhabitants.

Government
India is a federation with a parliamentary system governed under the Constitution of India, which serves as the country's supreme legal document. Federalism in India defines the power distribution between the Union or Central and the State Government. The Centre is represented by the elected Prime Minister of the nation whereas the States are represented by the Chief Ministers. The President has a restricted role in day to day governance.

India is the world's largest democracy and the approach of governance is a socialistic and capitalistic mix; a parliamentary republic with a multi-party system, the largest ones being Bharatiya Janata Party (BJP) and Indian National Congress (Congress). The Congress is considered centre-left in Indian political culture, and the BJP right-wing. There are 07 national and 64 regional parties.

Languages
There is no existing national language followed country-wide, though Hindi and English are most prominently spoken. Each region has its own language that is used by the majority of residents there.

Currency
The national currency is the Indian Rupee.

Economic summary
GDP: 2020 Estimates $3.202 trillion (Nominal) and $11.3213 trillion (PPP)
Real GDP Growth Rate: -4.5% (2020 Forecast)
Inflation: 3.2%

Main sectors of the economy
India's diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of services. Slightly less than half of the workforce is in agriculture, but services are the major source of economic growth, accounting for nearly two-thirds of India's output but employing less than one-third of its labour force. India has capitalized on its large educated population to become a major exporter of information technology services, business outsourcing services and software workers.

The main sectors of the Indian economy comprises of the services sector (62%), industry sector (22%) and the agriculture sector (16%).

Major sectors attracting the highest FDI equity inflows: services sector (18%), computer software and hardware (10%), telecommunications (8%), trading (6%), construction development (5%), automobile (5%), drugs and pharmaceuticals (4%), chemicals (4%), construction activities (4%), hotel & tourism (3%).

Indian Exports
Indian overall exports (merchandise) in June 2020 were USD$ 21.91 billion (Rs. 1,65,898.85 crore) registering a negative growth of 12.41% in dollar terms, compared to June 2019. Major commodity groups of export that recorded positive growth in June 2020 over the corresponding month of last year included iron ore, oil seeds, rice, oil meals, spices, other cereals, organic & inorganic chemicals, cereal preparations & miscellaneous processed items, fruits & vegetables, drugs & pharmaceuticals, tobacco and coffee.

Setting up a business

In general, there are two types of entry strategies for foreign businesses in India: registration of a company or establishing a branch/liaison office in India. The first step is to register a private limited company which is considered to be the easiest and fastest way of entry in India for foreign nationals and also for foreign companies. The foreign direct investment which ranges up to 100% in a private limited company happen under the automatic route for certain sectors and in such case no special permission is required from the Central Government in India.

Secondly, one can opt to register a branch office, project office or liaison office which necessarily requires RBI and/or Government approval.

Legal types of business entities
1. Private Ltd Company
2. Public Ltd Company
3. Limited Liability Partnership
4. Partnership
5. Cooperatives
6. Branch Office
7. Subsidiary Company

In international business, the private limited company by way of a subsidiary company and branch office entity types are most commonly used. The private limited company restricts the rights of the shareholders to transfer the shares of the company and has a minimum of 2 and a maximum of 200 members. The minimum paid up share capital for such an entity is Rs. 100,000.

Process of how to set up a business

A start up or a company is incorporated by registration with the Ministry of Corporate Affairs (MCA). The registration includes 'must follow rules' and certain preliminary registrations like Digital Signature (DSC), Director Identity Number (DIN) and filing for e-form(s) which one can get after submission of various documentary evidences with respect to address and identity proof of promoters.

Financial year of taxes and financial accounts

The tax year and the fiscal year are similar i.e. from 1 April to 31 March.

Accounting and auditing

In India, audits are conducted for each fiscal year (April 1 to March 31). The two most common types of statutory audits in India are:

1) Tax Audits
2) Company Audits

Tax Audits

Tax Audits are required under Section 44AB of Income tax Act, 1961. This section mandates every person whose business turnover exceeds Rs. 5 Crore (subject to certain thresholds on cash transactions) and every person working in a profession with gross receipts exceeding Rs. 50 lakh must have their accounts audited by an independent chartered accountant.

Company Audits

The provisions for a company audit are contained in the Companies Act, 2013. Every company, irrespective of the nature of its business or turnover, must have its annual accounts audited each financial year. Only an independent chartered accountant or a partnership firm of chartered accountants can be appointed as the statutory auditor of the company.

Economic and fiscal incentives

The Indian Government offers a number of incentive schemes in various sectors to support companies in their business operations. Foreign entrepreneurs who set up companies in India and who register their companies with MCA can also apply for a number of incentive schemes.

India offers location-based incentives such as Special Economic Zones (SEZ) and International Financial Services Centre (IFSC) which provide tax benefits for setting up in businesses in notified areas.

Tax incentives are also offered based on the activities of businesses such as Export oriented units (EOU), start-ups, new manufacturing entities and entities engaged in research and development.

To step up investments in research and related infrastructure in premier educational institutions, including health institutions, a major initiative named "Revitalising Infrastructure and Systems in Education (RISE) by 2022" with a total investment of Rs.100,000 crore in next four years has been announced.

Revised definition for Classification of MSMEs:

In order to improve the ease of doing business for MSMEs, the definition of MSMEs were revised as part of the economic package announced amid the pandemic. Unlike the erstwhile definition, the revised criteria categorises manufacturing and service enterprises similarly. Accordingly, the basis for classifying MSMEs w.e.f. July 1st, 2020 are as follows:

1) Micro: Investment to be less than Rs.1 crore and annual turnover to be less than Rs.5 crores
2) Small: Investment to be less than Rs.10 crores and annual turnover to be less than Rs.50 crores
3) Medium: Investment to be less than Rs.50 crores and annual turnover to be less than Rs.250 crores

Taxation

The tax system in any given country is invariably an extremely important criterion when it comes to companies finding a country of incorporation. The view taken by the Indian Government is that the tax system may under no circumstances form an impediment for entities wishing to incorporate a company in India.

In that framework, it is possible to obtain advance certainty regarding the fiscal qualification of international corporate structures in the form of so-called Advance Tax Rulings. In addition, India has also signed tax treaties with many other countries to prevent the occurrence of double taxation.

Taxable income

Tax is imposed on a company's profits, which consist of business/trading income, passive income and capital gains. Income resulting from the indirect transfer of assets located in India is included. Normal business expenses, as well as other specified items, may be deducted in computing taxable income.

Taxation of dividends

Dividends received from a foreign company generally are subject to corporation tax, with a credit for any foreign tax paid. However, dividends received by an Indian Company from a foreign company in which the Indian Company holds at least 26% of the equity shares are subject to tax at a reduced base rate of 15% on the gross income. An additional surcharge and cess are imposed.

Capital gains

The tax treatment depends on whether gains are long or short term. Gains are long term if the asset is held for more than three years (one year in the case of listed shares and specified securities, and two years in the case of unlisted shares and immovable property). Both unlisted and listed domestic companies are liable to pay an additional tax of 20% on income distributed to a shareholder on account of a buyback of the company's share.

Losses

Business losses and capital losses may be carried forward for eight years, with short term capital losses offsetting capital gains on both long and short-terms capital assets, and long-term capital losses offsetting only long-term capital gains. Unabsorbed depreciation may be offset against any income, whereas business losses may be offset only against business profits in subsequent years.

Rate

The standard rate is 30% for domestic companies and 40% for foreign companies and branches of foreign companies.

Recent Announcements

a. In order to promote growth and investment, with effect from FY 2019-20, all domestic company shall have an option to pay income-tax at the rate of 22% subject to condition that they will not avail any exemption/incentive.
b. In order to provide boost to "Make-in-India" initiative of the Government, with effect from FY 2019-20, any new domestic company incorporated on or after 1 October 2019 making fresh investment in manufacturing, shall have an option to pay income-tax at the rate of 15%. This benefit is available to companies which do not avail any exemption/incentive and commences their production on or before 31 March 2023.

Surcharge

A 2% surcharge applies to foreign companies if income exceeds Rs. 10 million, and a 5% surcharge applies if income exceeds Rs. 100 million. An additional 4% cess is payable in all cases.

Minimum Alternative Tax

Minimum Alternate Tax (MAT) is imposed at 15% (plus any applicable surcharge and cess) on the adjusted book profits of corporations whose tax liability is less than 15% of their book profits. MAT is not leviable on companies opting for 22% tax regime or new manufacturing companies. Further, MAT does not apply to certain income of foreign companies, including capital gains on transactions involving securities, interest, royalties and fees for technical services. The MAT credit may be carried forward for up to 15 years.

Transfer pricing

International transactions between Associated Enterprises are expected to happen at Arm's Length Price (ALP). Primary adjustment is made for the difference between the transfer price and ALP and tax is payable on such adjustment. Such amount is required to be repatriated to India within 90 days, on failure of which Secondary Adjustment would be made and imputed interest would be chargeable to tax. However, taxpayers have an option of paying one-time additional tax of 18% (plus surcharge and cess) instead of repatriation.

Compliance and Assessment

Individual taxpayers are required to file income-tax return before 31st July of the Assessment Year (AY) (the year after the FY). Whereas, corporate assesses not covered under Transfer Pricing are required to file their return by 30th September of the AY. In case where Transfer pricing is applicable, the Due Date is 30th November of the AY. Assessment of returns filed by tax-payers from the Income Tax Department is required to be completed generally within 2 years from the end of FY and in cases where Transfer Pricing is applicable, the time limit is 3 years.

Foreign tax credits

Foreign tax paid may be credited against Indian tax on the same profits, but the credit is limited to the amount of Indian Tax payable on the foreign income. Specific rules have been introduced regarding the mechanism for granting a foreign tax credit.

Withholding taxes

a) Dividends - Dividends are not subject to withholding tax. Pursuant to recent amendments, the domestic company paying the dividends is not subject to DDT and dividend shall now be taxable in the hands of shareholders /unit holders at applicable slab rate.

b) Interest - Interest paid to a non-resident on a foreign currency borrowing or debt generally is subject to a 20% withholding tax, plus the applicable surcharge and cess. A 5% withholding tax rate, plus the applicable surcharge and cess, applies to certain types of Interest paid to a non-resident, including interest paid on specific borrowings in foreign currency and interest on investments made by a foreign institutional investor or a qualified foreign investor in a rupee-denominated bond of an Indian company, or in a government security. The rates may be reduced under a tax treaty.

c) Royalties & Technical Services - Royalties & Fees for technical services paid to a non- resident are subject to 10% withholding tax, plus the applicable surcharge and cess. The rate is in line with most of the tax treaties entered by India.

Avoidance of double taxation

India has entered into 95 bilateral tax treaties known as Double taxation avoidance agreements (DTAA) with various countries to prevent the double taxation of same income being taxed in two jurisdictions for a same person.

Multilateral instrument (MLI)

MLI implements treaty related Base Erosion and Profit Sharing (BEPS) measures, envisaged by Organisation of Economic Commerce and Development (OECD), in tax treaties. India is a party to MLI and provisions relating to MLI came into force on 1st October 2019. It shall not amend the DTAAs but shall work in tandem to analyse the taxability and related aspects for a given transaction.

Goods and service tax

Goods and Service Tax (GST) was introduced in India on 1st July, 2017. GST replaces a complex system of various indirect tax levies such as value added tax (VAT), central sales tax and central excise duty (except for a few specified non-GST goods); service tax; entry tax; entertainment tax; and various other local taxes previously levied on most goods and services.

Rates - Goods and Services are categorised under a structure with five different rates; 0%, 5%, 12%, 18% and 28%. Generally, rate of tax for services is 18%.

Exports, Supply to Special Economic Zones (SEZ), Sale of Land, Completed Buildings and sale of specified food products are outside the ambit of GST.

Filings – Taxpayer has to file

(i) GSTR 1 (Return for outward supply) – monthly or Quarterly at the option of the taxpayer
(ii) GSTR 3B (Monthly return for payment)
(iii) GSTR 9 – Annual Return
(iv) GSTR 9C - Every taxpayer person whose turnover during a financial year exceeds the prescribed limit shall get his accounts audited by a chartered accountant or a cost accountant.

HR/ Labour Law

Matters related to employment in India are primarily governed by the Constitution of India, specific laws framed by the Central and State Governments, municipal laws, collective and individual agreements, as well as judicial precedents.

Employment Conditions

a) Factories Act, 1948 - To provide for health, safety, welfare, working hours and leave of workers in factories (manufacturing units).

b) Shops & Establishment Acts (State Wise) - To regulate the payment of wages, terms of services, holidays, leaves, work conditions, hours of work, overtime, etc. for people employed in shops and commercial establishments.

c) Contract Labour (Regulation & Abolition) Act, 1970 - To regulate the engagement of contractor and contract labour by the principal employer.

d) Industrial Employment Standing Order Act, 1946 - Any establishment employing 100 or more workmen is required to regulate and codify conditions of service and obtain certification from the concerned regulatory authority.

e) Building and other construction workers (Regulation of employment and conditions of service) Act, 1996 - For the benefit of workers engaged in building and construction activities to regulate matters related to their safety, health and welfare and any other matter incidental thereto.

f) The Sexual Harassment of Women at Workplace Act, 2013 - An Act to provide protection against sexual harassment of women at workplace and for the prevention and redressal of complaints of sexual harassment and for matters connected therewith or incidental thereto.

Industrial Relations

a) Industrial Disputes Act, 1947 - To provide a mechanism for regulating the rights of the employees and settlement of industrial disputes in a peaceful and harmonious manner.
b) Trade Unions Act, 1926 - To establish the rights, duties and obligations of trade unions and facilitate their registration.

Remuneration

a) Code on Wages, 2019 – To universalise the provisions of minimum wages and timely payment of wages and to simplify and rationalise the methodology to fix the minimum wages. It subsumes the erstwhile laws such as:

i. The Minimum Wages Act, 1948
ii. The Payment of Wages Act,1936
iii. Payment of Bonus Act,1965
iv. Equal Remuneration Act, 1976

Social security

a) Payment of Gratuity Act, 1972 - To provide for the payment of gratuity, a retirement benefit paid upon cessation of employment.

b) Workmen's Compensation Act, 1923 - To provide workmen and/or their dependents relief in case of accidents arising out of or during employment and causing either death or disablement.

c) Employees Provident Fund and Miscellaneous Provisions Act, 1952 - To provide for a scheme wherein both the employee and employer make an equal contribution into a national fund which attracts a stipulated interest per annum and the accumulated amount is paid on retirement to the employee along with the interest that has accrued.

d) Employees' State Insurance Act, 1948 - To provide for a scheme wherein the employer and the employee must contribute a certain percentage of the monthly wages to the Insurance Corporation.

e) Social Security Agreements (SSAs) – Social Security Agreements are bilateral instruments to protect the social security interests of workers posted in another country. There are 18 operational SSAs entered by India with various countries which ensure the avoidance of double coverage under social security regulations for International workers. It further enables India to protect the interests of cross border workers by negotiating SSAs with other countries which have a significant inbound population into India.

Dispute Resolution

Collective bargaining is an effective technique to resolve labour disputes in India and is utilised in cases wherein the number of employees are large and represented by trade unions which can be formed at company level, regional level or industry level. A collective bargaining agreement provides for terms and conditions of employment pertaining to wages, working hours, obligation of workmen and the employer, dispute resolution, leave, holidays, benefits and more.

Pension

In India there is an Act called "The Employees' Pension Scheme, 1955" which is applicable to all factories and other establishments to which the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 applies. This Scheme is meant for members of the Provident Funds Scheme or any scheme exempted thereunder. The pension policy is introduced as a social policy to the employees to survive their livelihood after the age of retirement.

Visa and Work permits

Employment visas are issued to foreigners who are working in India, for an organisation registered in India. Employment visas are generally granted for one year, or for the term of the contract. The visa duration starts from the day of issuance and not from the day of entry in India. Foreign technician may get visa for period of five years or for a period the bilateral agreement between Indian and Foreign Government, whichever is less, with multiple entries. For highly skilled IT person visa validity is up to 3 years with multiple entries. Others can be granted visa with validity of two years with multiple entries.

Corporate Governance and Social Responsibilities

Corporate governance is the combination of rules, processes or laws by which businesses are operated, regulated or controlled.

Every company having net worth of Rs. 500 crore or more, or turnover of Rs. 1000 crore or more or a net profit of Rs. 5 crore or more during 3 immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

A company must spend, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years as its obligation towards corporate and social responsibility. The expenditure incurred on account of CSR is not allowed as deduction against the income of corporates.

Contact us

The information provided in this guide cannot be exhaustive and we recommend anyone considering doing business in India should seek professional advice from our member firms before making any business or investment decision.

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