

STARTING OPERATIONS IN INDIA

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

- 1. AS AN INDIAN COMPANY or**
- 2. AS A FOREIGN COMPANY**

As an Indian Company,

A foreign company can commence operations in India by incorporating a company under the Companies Act, 1956 through

- Joint Ventures; or
- Wholly Owned Subsidiaries

Foreign equity in such Indian companies can be up to 100% depending on the requirements of the investor, subject to equity caps in respect of the area of activities under the Foreign Direct Investment (FDI) policy.

- **Joint Venture With An Indian Partner**

Foreign Companies can set up their operations in India by forming strategic alliances with Indian partners.

Joint Venture may lead to the following advantages for a foreign investor:

1. Established distribution! Marketing set up of the Indian partner.
2. Established contacts of the Indian partners which could help the process of setting up of operations

- **Wholly Owned Subsidiary Company**

Foreign companies can also to set up wholly-owned subsidiary in sectors where 100% foreign direct investment is permitted under the FDI policy.

For registration and incorporation, an application has to be filed with Registrar of Companies (ROC).

AS A FOREIGN COMPANY

Foreign Companies can set up their operations in India through

- Liaison Office/Representative Office
- Project Office
- Branch Office

Such offices can undertake any permitted activities. Companies have to register themselves with Registrar of Companies (ROC) within 30 days of setting up a place of business in India.

- **Liaison Office/Representative Office**

Liaison office acts as a channel of communication between the principal place of business or head office and entities in India. Liaison office can not undertake any commercial activity directly or indirectly and can not, therefore, earn any income in India. Its role is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian customers. It can promote export/import from/to India and also facilitate technical/financial collaboration between parent company and companies in India.

- **Branch Office on “Stand Alone Basis”**

Such Branch Offices would be isolated and restricted to the Special Economic zone (SEZ) alone and no business activity/transaction will be allowed outside the SEZs in India, which include branches/subsidiaries of its parent office in India.

FOREIGN DIRECT INVESTMENT (FDI) POLICY

FDI under automatic route is now allowed in all sectors, including the services sector, except a few sectors where the existing and notified sectoral policy does not permit FDI beyond a ceiling.

Automatic Route

No prior approval is required for FDI under the Automatic Route. Only information to the RBI within 30 days of inward remittances or issue of shares to Non Residents is required.

Government Approval

Foreign Investment proposed not covered under the ‘Automatic Route’ are considered for Governmental Approval on the recommendations of the Foreign Investment Promotion Board (FIPB)

TAXATION IN INDIA

The corporate tax rate for foreign companies is 40%. The net tax rate is far lower than this on account of various deductions and exemptions available under the tax laws. Tax Incentives are available in Special Economic Zones Infrastructure Sector Projects enjoy special tax treatment/Incentives.

Tax Evaluation

As far as the taxation is concerned, you need to know the following to evaluate your case:

1. Whether the office in India will just do the marketing job for the US co. or will enter into a contract on its own for sale in India.
2. Whether you want to take back the entire earnings in India to US or keep it in India.

The following are the tax consequences of doing businesses in India

1. Liaison office: No tax to be paid to India but US Co. will have to pay tax in US on the earnings- Marketing Margin.
2. Branch office: Tax to be paid to India on earnings in India. US co. will pay tax on the earnings @ the normal rate applicable to the. Us Co., However it can claim tax credit on taxes paid in India.
3. Subsidy Company: Tax to be paid to India on earnings in India. No tax need to be paid in US however as per the rules before any repatriation to US the Indian Co. will have to transfer a portion of the earnings to reserves and can only repatriate the balance after paying Dividend distribution tax.

REPORTING IN USA

U.S. persons, including resident aliens, are taxed on their worldwide income at graduated rates regardless of whether the income is U.S. or foreign source. Income derived from a foreign country is taxed by the United States without regard to whether it is earned income, income from a trade or business, or investment-based income.

Reporting your Income in U.S. Currency

You must express the amounts you report on your U.S. tax return in U.S. dollars. If you receive all or part of your income, or pay some or all of your expenses in foreign currency, you must translate the foreign currency into US dollars. In addition, a taxpayer is required to translate foreign taxes paid into dollars to claim the foreign tax credit (or a deduction for those taxes).

FORM 5471: Information Return of U.S. Persons With Respect to Certain Foreign Corporations.

Certain U.S. citizens and U.S. residents who are officers, directors, or shareholders in certain foreign corporations are responsible for filing Form 5471. Substantial penalties exist for U.S. citizens and U.S. residents who are liable for filing Form 5471 and who fail to do so.

The categories of persons potentially liable for filing Form 5471 include U.S. citizen and resident alien individuals, U.S. domestic corporations, U.S. domestic partnerships, and U.S. domestic trusts. The filing requirements for Form 5471 relate to persons who have a certain level of control in certain foreign corporations. Please refer to form instructions for the details about who is liable for filing Form 5471. Form 5471 should be filed as an attachment to the taxpayer's federal income tax return; and a duplicate copy should be filed with the Internal Revenue Service Center in Philadelphia. Form 5471 may be filed electronically.

Form TD F 90-22. Report of Foreign Bank and Financial Accounts:

This form is filed by a U.S. person who has a financial interest in or signature authority over, bank, securities, or other financial accounts in excess of \$10,000 in a foreign country at any time during a calendar year.

Bank accounts subject to reporting include accounts with foreign branches of U.S. banks but do not include accounts with U.S. branches of foreign banks. A financial interest exists when a U.S. person is the owner of record of, or has legal title to or a beneficial interest in, a bank or securities account. Signature authority includes the power to control disposition of the funds or

account by delivery of a document containing his or her signature, or comparable authority exercised orally or by other means. A U.S. person, who owns directly or indirectly more than 50% in value of the shares of stock of a corporation, more than 50% of a distributive share interest in a partnership, or a present beneficial interest in more than 50% of the assets of a trust, must file on behalf of the entity.

Form TD F 90-22.1 must be filed by mail with the Treasury Department, not the IRS, on or before June 30 of the year following the reporting year. (The report, however, may be carried by hand to an IRS office for forwarding to the Treasury Department.) In certain cases, consolidated reporting may be allowed.

Form 926: Return by a U.S. Transferor of Property to a Foreign Corporation

This form is used to report all transfers of property to a foreign corporation. The form must be filed by a U.S. person who transfers property to a foreign corporation as a contribution to capital, or any other transfer of property to the entities mentioned above. The form must be filed with the income tax return of the U.S. transferor for the tax year of the transfer.

The person could be subject to a penalty for failure to file equaling 10% of the fair market value of the property at the time of the exchange/transfer if the taxpayer fails to comply with the filing requirement. The penalty will not apply if the failure to comply is due to reasonable cause and not willful neglect. The penalty is limited to \$100,000 unless the failure to comply was due to intentional disregard. Moreover, the period of limitations for assessment of tax upon the exchange/transfer of that property is extended to the date that is 3 years after the date on which the information required to be reported is provided.

Form 8865 Ownership Changes in Foreign Partnerships:

Effective for ownership changes occurring after December 31, 1999, a U.S. person must report certain ownership changes in a foreign partnership on Form 8865 . The form is generally filed to report the acquisition, disposition, or change in, a 10% or greater ownership interest in a foreign partnership. The form is filed with the owner's income tax return for the tax year in which the ownership change occurs. The IRS issued final regulations clarifying that the U.S. partner must include the foreign partnership's name, address and TEIN or Form 8865.