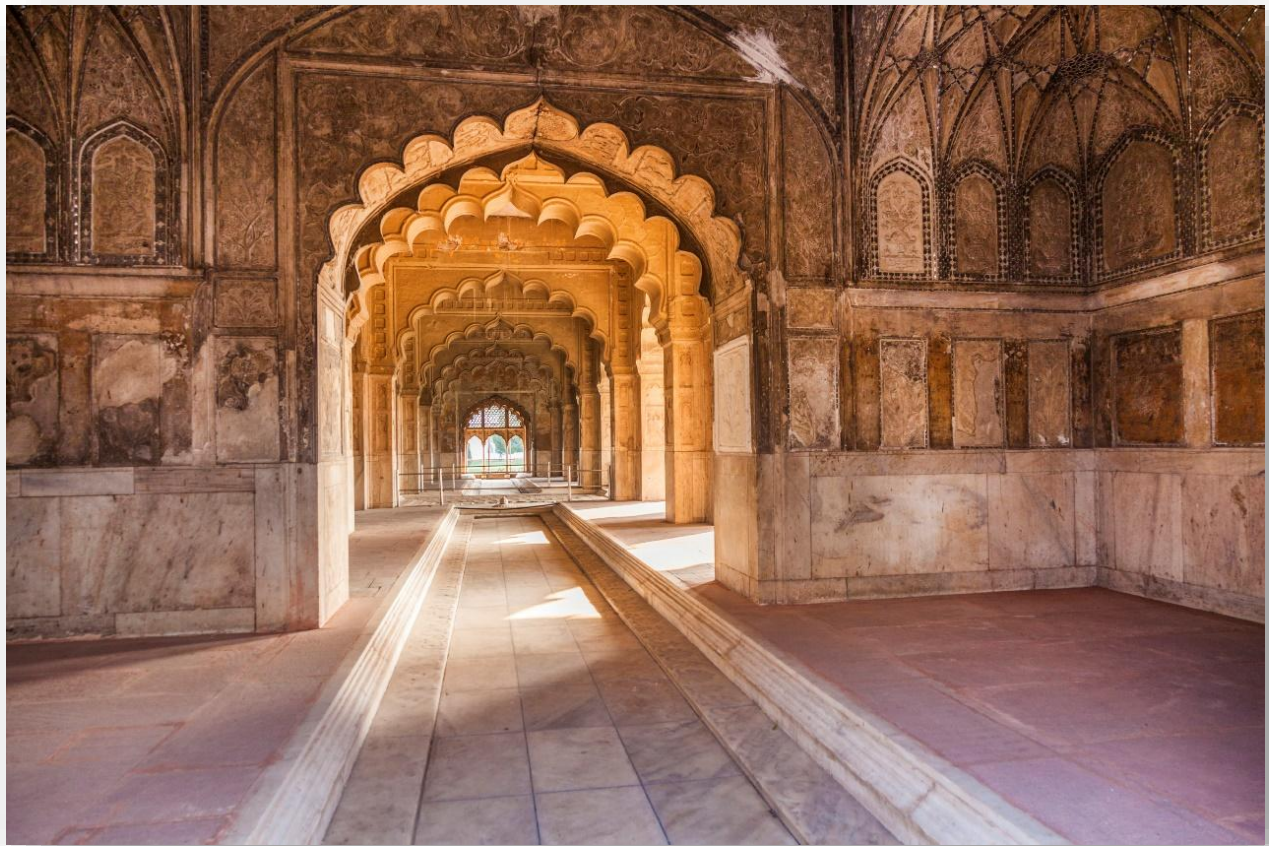




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# INTERNATIONAL LAWYERS NETWORK



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ESTABLISHING A BUSINESS ENTITY IN INDIA



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## ESTABLISHING A BUSINESS ENTITY IN INDIA



### ***“Establishing a Business Entity in India”***

Mr. Alishan Naqvee  
Partner  
LexCounsel Law Offices – New Delhi



### ***“Establishing a Business Entity in India”***

Mr. Abhijeet Das  
Partner  
LexCounsel Law Offices – New Delhi



### ***“Establishing a Business Entity in India”***

Ms. Pragya Jain  
Associate  
LexCounsel Law Offices – New Delhi

## **1. Types of Business Entities**

### **1.1 Description of the types of entities available in India through which to conduct business:**

A foreign entity may establish a business presence in India by:

- opening a liaison office, branch office or project office;
- appointing a distributor or franchisee;
- commencing its own operations in India by incorporating a legal entity under Indian law;
- forming a joint venture with an Indian entity to establish a new entity in India; or
- acquiring an existing business in India.

### **1.2 Matters to be considered when choosing a particular business entity type:**

A liaison office acts as a representative office for the foreign parent company and can only be established to primarily explore and understand business opportunities and climate in India for the foreign parent entity. A liaison office is not permitted to earn any income in India by conducting any business or commercial activities in India.

A branch office can carry on business activities while a project office can be established to execute a specific project. However, since a branch office or a project office is an extension of the foreign parent company and would not be considered a legal entity separate from its parent company, the business income generated by them would be taxable at the rate of tax applicable to foreign companies (40% plus surcharge and cess) which is higher than the rate of tax applicable to companies incorporated in India (ranging from 25% to 30% plus applicable surcharge and cess).

Applications for establishment of a liaison or branch office in India are considered by designated authorized dealer banks (“**AD Bank**”) in accordance with guidelines issued by Reserve Bank of India (“**RBI**”). However, prior approval of RBI may also be required in certain cases such as where the applicant is a citizen or registered/incorporated in certain notified countries or where the principal business of the applicant falls in certain notified sectors such as defence, telecom, private security and information and broadcasting.

In view of restrictions on the activities and tax implications for liaison, branch and project offices, the establishment of a wholly owned subsidiary or strategic alliances through joint



ventures, technical collaborations or distributorship arrangements with existing Indian companies by and large remain the preferred options for foreign entities to establish a long-term presence in India.

## **2. Steps and Timing to Establish**

### **2.1 Brief overview of steps to incorporate/constitute each:**

Companies incorporated outside India, desirous of opening a Liaison/Branch office in India are required to submit an application to the RBI in prescribed form through the AD Bank, along with prescribed documents including the English version of the certificate of incorporation/registration or Memorandum & Articles of Association attested by Indian Embassy/Notary Public in the country of registration and audited balance sheet of the applicant entity for the last three/five years in case of branch office/liaison office respectively.

Incorporation of a company or a Limited Liability Partnership (LLP) in India is an administrative process which takes approximately 15 (fifteen) to 20 (twenty) working days from filing of incorporation related documents (“off the shelf” companies are not recommended in view of related due diligence issues and liabilities). The MCA21 e-Governance programme by the Government of India has simplified the entire incorporation process and the process may be completed online. For e-filing of forms, a digital signature certificate has to be obtained from the concerned authority without which e-filing cannot be done. The purpose of the digital signature is to ensure the security and authenticity of documents filed electronically. It generally takes only 1 (one) working day to obtain a digital signature. Also, persons seeking appointment as directors of an Indian company or designated partners in the case of an LLP are

mandatorily required to obtain director identification number (“**DIN**”) or Designated Partner Identification Number (“**DPIN**”) respectively, without which such appointment would be invalid. The DIN or DPIN, as the case may be, is specific to each individual and there is no requirement of a fresh DIN or DPIN for appointment as a director of other Indian company(ies) or LLP(s). A company or LLP incorporated anywhere in India is entitled to carry on business activities throughout India.

Joint ventures other than by way of incorporating a new company (i.e., other than by way of investment in a new company jointly with the Indian partner) may be formalized by way of a simple transfer of shares. Further, depending on the percentage of foreign direct investment contemplated, prior approval of the concerned ministry/department may be required if the business of the new company falls in a sector, where 100% foreign direct investment is not permitted under the automatic route (i.e., without prior government approval).

Other contractual arrangements such as distributorship/franchise agreements or trademark/brand licensing agreements etc., for doing business in India can be formalized in 1 (one) to 2 (two) days, except where sector specific licenses are involved. India does not have any standard regulations for protection of franchisees, and thus the relationships are broadly governed by the contracts between the parties.

### **2.2. Shares Swap Transaction**

A share swap transaction is one in which consideration for the deal is not cash, but the issuance to the other party the shares of the acquiring entity. The Foreign Exchange Management (Non-debt Instruments) Rules, 2019, permits swap of equity instruments of an





Indian company and/ or equity capital of a foreign entity against transaction involving transfer of equity instruments of an Indian company between person resident in India and a person resident outside India or issue of equity instruments of an Indian company to a person resident outside India.

### **3. Governance, Regulation, and Ongoing Maintenance**

#### **3.1 Brief summary of regulation of each type and ongoing maintenance, reporting requirements:**

Primary regulations under Indian laws:

- i. Companies Act, 2013;
- ii. Foreign Exchange Management Act, 1999, Foreign Direct Investment Policy of India and RBI regulations governing establishment and operations of Branch Office/Liaison Office/Project Office (as updated from time to time);
- iii. Income Tax Act, 1961; and
- iv. In addition, an Indian company would also require obtaining common licenses and registrations, such as Goods and Services Tax registration.

#### **3.2 Immediate Requirement: Setting Up – Compliances usually on-going/time based:**

- A. Under the Income Tax Act, 1961, every entity (including a company and an LLP) is required to have a Permanent Account Number (“**PAN**”), Tax Deduction and Collection Account Number (“**TAN**”) and deduct tax at source (“**TDS**”) for all the payments made to its employees at the percentage given under the relevant provisions of the Income Tax Act, 1961.
- B. Declaration of Commencement of Business – Every company is mandatorily

required to file a certificate of commencement of business within 180 (One Hundred and Eighty) days from the date of incorporation of the company. There is no such requirement for an LLP.

- C. Board Meetings/Annual General Meeting (“**AGM**”)/ Resident Director – Every company is mandatorily required to hold 4 (four) Board meetings and 1 (one) AGM in a year while there is no such requirement for an LLP. It is also mandatory for every company and LLP to have at least 1 (one) resident director or designated partner, respectively.
- D. Every Listed Company /Public Company with paid up share capital of INR 100 Crores (Indian Rupees One Hundred Crores) or more / Public Company with turnover of INR 300 Crores (Indian Rupees Three Hundred Crores) or more shall have at least 1 (one) woman director.
- E. Listed Company are also required to appoint at least 1/3 (one third) of total number of directors on their Board of Directors as independent directors. Further, certain classes of public companies such as public companies with paid up share capital of INR 10 crore (Indian Rupees Ten Crores) or more and public companies having turnover of INR 100 crore (Indian Rupees One Hundred Crore), or more are also mandated to have at least 2 (two) independent directors.

#### **3.3 Filings with the registrar/reporting requirements:**

Example:



- A. Annual Filing e-Forms: Form for filing annual return by a company having a share capital, particulars of annual return for the company not having share capital, form for filing annual return by an LLP, form for statement of account and solvency by an LLP, form for filing balance sheet and other documents, form for filing Profit and Loss account and other documents, etc., have to be filed with the jurisdictional Registrar of Companies annually;
- B. Return of Particulars of Directors and Key-Manual Personnel's ("KMP") – Return containing such particulars and documents of the director and other KMP shall be filed with the Registrar within 30 (thirty) days from the date of appointment/resignation of every director and KMP and also within 30 (thirty) days of any change taking place;
- C. Return of appointment of Managing Director ("MD"), Whole Time Director ("WTD") and Manager, Chief Executive Officer ("CEO"), Company Secretary ("CS") and Chief Financial Officer ("CFO")– Company is required to file a return within 60 (sixty) days of the appointment of a MD, WTD or Manager, CEO, CS or CFO;
- D. Filing of Income Tax returns is required to be done every year by the entity operating in India in addition to the TDS return which is also required to be submitted with the tax authorities annually;
- E. Filing of returns with the Goods and Services Tax Department is required to be done periodically by the Indian entity

in addition to deposit of the Goods and Services Tax with the tax authorities;

- F. Other periodical filings under different legislations such as labour laws, professional tax and municipal laws.

Relatively, the operational on-going and maintenance requirements with respect to companies incorporated under Indian laws are quantifiably more than LLPs as well as Liaison Office/Branch Office/Project Office. That said compliances for companies also defer based on their classifications. For example: Public Limited companies have more compliance in general as compared to Private companies. Small companies and one-person companies do not have so many compliances, as compared with the larger/more traditional forms of companies etc.

### **3.4 Requirements for local shareholding/directors:**

It is mandatory for every company and LLP to have at least 1 (one) resident director or designated partner, respectively, i.e., a person who has stayed in India for a total period of not less than 182 (one hundred and eighty-two) days during the financial year/immediately preceding 1 (one) year, as specified by the law.

However, there is no such requirement in the case of shareholders, and all the shareholders can be non-resident. However, if the shareholder is a non-resident, then the FDI rules and regulations are to be complied with and appropriate FDI reporting is required to be done before RBI.

### **3.5 Minority shareholders' rights and protection:**

Companies Act, 2013 has sought to empower the minority shareholders in many ways including the class action suit. Under the



concept of a class action suit, a suit may be instituted against the company as well as the auditors of the company by the minority shareholders. The Companies Act, 2013 further provides for provisions relating to oppression and mismanagement which empowers minority shareholders to file an application for relief to the Tribunal in case of oppression and mismanagement. Under Companies Act, 2013, the Tribunal may also waive any or all the requirements given under Companies Act, 2013 and allow any number of shareholders and/or members to apply for relief, though this power to waive is rarely exercised by the Tribunal.

### 3.6 Mandatory Dematerialization of Securities:

The Ministry of Corporate Affairs on October 27, 2023, notified Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 ("**Prospectus Amendment Rules**") vide notification no. G.S.R. 802(E) mandating private companies, other than small companies, to issue the securities only in dematerialized form and facilitate the dematerialization of all its existing securities. While dematerialization of securities is being mandated under the Prospectus Amendment Rules, it does not bar the security holder from continuing to hold his/her existing securities in a physical form. However, after September 30, 2024, when the security holder decides to transfer these securities, dematerialization would be mandatory prior to initiating the transaction. Further, the shareholders will be able to subscribe to any further issue only after dematerializing the securities.

## 4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

### 4.1 Any significant barriers to entry for an offshore party:

The Foreign Exchange Management Act, 1999 and the rules and regulations framed thereunder provide the basic legal framework for foreign investments in India. The RBI together with the Department for Promotion of Industry & Internal Trade, Ministry of Commerce and Industry and various other ministries and departments of the Central Government contribute to framing and modifying sector specific regulatory framework and are involved in granting of approvals for foreign investments in India depending upon the sector in which the operations of the target entity falls.

#### 4.1.1 Financial Collaboration:

In terms of the current Foreign Direct Investment ("**FDI**") policy, foreign investment up to 100% (hundred percent) of the securities (including shares and fully and mandatorily convertible preference shares and debentures) of Indian companies is freely permitted in most sectors ("**Unregulated Sectors**"). However:

- Foreign investment beyond prescribed percentages is not permitted without prior government approval in a few sectors/activities, such as insurance, scheduled/regional air transport services, banking, telecom, defense, and multi-brand retail trading etc. ("**Regulated Sectors**"). A financial collaboration in the Regulated Sectors ordinarily requires the presence of an Indian equity partner to hold the remaining equity and compliance with the relevant sectoral conditions on entry route, conditionalities and caps.
- Foreign investment is prohibited in certain sectors including atomic energy, lottery, gambling, trading in transferable development rights, manufacturing of



tobacco products or substitutes, railway operations (except for permitted operations), etc.

- FDI in LLPs is permitted, subject to certain conditions e.g., the FDI is allowed, under the automatic route, in LLPs operating in sectors/activities where 100% (hundred percent) FDI is permitted and there are no FDI linked performance conditions. Investment in LLPs either by Foreign Portfolio Investors (“FPIs”) or Foreign Venture Capital Investors (“FVCI”) is not permitted.
- A foreign investor can, without prior government approval, invest in unlisted securities of an existing Indian company in Unregulated Sectors, in accordance with the pricing guidelines, and subject to overall compliance with the FDI policy, and accordingly such securities can also be issued/ transferred to it by Indian or foreign shareholders.
- Earlier, aggregate investments by FPIs under the automatic route (i.e., without prior regulatory approval) was permitted up to 49% of the shareholding of the Indian company, or the sectoral cap, whichever was lower, provided that there was no transfer of ownership and control of the Indian company from an Indian resident to the FPI.

However, now the Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024 have removed this 49% threshold, and now investments by FPIs are permitted up till the sectoral cap limits, provided that there is no transfer of ownership and/or control of the Indian company from an Indian resident to the FPI. This change will essentially allow

FPIs to invest in sectors which had a sectoral cap higher than 49%, thus opening up the Indian economy for further FPI inflows.

Furthermore, the FPIs can hold up to the sectoral cap in case of a transfer of shares of an Indian company from a non-resident to the FPI, even if such investment leads to the transfer of ownership and/or control of the Indian company.

#### 4.2 Any capitalisation obligations:

Presently, there is no requirement for incorporation of companies with any minimum paid up share capital under the Companies Act, 2013. However, from a foreign investment perspective, any foreign investment beyond prescribed percentages is not permitted without prior government approval in Regulated Sectors. Further, depending upon the sector of investment, there could be certain minimum capitalization norms applicable under the prevailing foreign direct investment policy.

#### 4.3 Any special business or investment visa issues:

Foreign nationals are allowed to come to India on business or employment visas, depending on the nature of their deployment and other similar factors.

For reasons of taxation, deputation of employees of foreign parent companies to their Indian subsidiaries is ordinarily avoided.

As per the Ministry of Home Affairs, Government of India latest guidelines, employment visas are only granted to foreign nationals drawing salaries in excess of a prescribed amount per annum. The salary threshold limit is worked out considering the salary and all other allowances paid to the foreign national in cash and also perquisites like rent free accommodation etc. which are





included in the salary for the purpose of calculating income tax. The minimum salary stipulation however does not apply to ethnic cooks, translators and language teachers brought for project related work in India. The employment visa has to be issued from the country of origin or domicile of the foreigner. Foreign nationals may also use the 'Project' visa regime for coming to India for execution of specific projects in the power and steel sectors subject to fulfillment of conditions as may be specified.

Persons travelling to India on long term employment visas i.e., for a period of more than 180 (one hundred eighty) days will need to register themselves with the jurisdictional Foreigners Regional Registration Office within specified time (ordinarily fourteen days) of arrival in India.

#### **4.4 Any restrictions on remitting funds out of India (withholdings, etc.):**

Foreign investors can repatriate funds out of India through a number of options including dividends, fees for technical and administrative services, royalties, interest, capital appreciation, etc., after payment of applicable taxes. India also has double taxation avoidance agreements ("DTAA") with all major economies of the world including Australia, China, Germany, France, Spain, Singapore, USA, UK and Japan to name a few.

##### **4.4.1 Repatriation of Profits:**

Indian companies can remit their profits to a foreign investor by way of dividends subject to dividend distribution tax at 20.00% (twenty percent) plus applicable surcharge and cess, subject to beneficial tax rates as provided under DTAA, if availed.

##### **4.4.2 Repatriation of Fees and Royalties:**

The royalties/fees for technical services can be remitted to non-residents subject to deduction of withholding tax at rates prescribed under the Income Tax Act, 1961. If the foreign collaborator belongs to a country having a DTAA with India providing for a lower withholding tax, it can avail the benefit of lower withholding taxes paid in India by furnishing certain additional information and documents in the manner prescribed under law.

As discussed above, the lump sum technical know-how fee and/or royalty may also be converted into shares of the Indian company, subject to regulatory compliances.

##### **4.4.3 Renunciation of Rights of Equity Instruments held on Repatriable Basis:**

Foreign investors can acquire equity instruments (other than share warrants) on repatriable basis based on the right renounced by a person resident in India and by a person resident outside India holding equity instruments on a non-repatriation basis. The investment would, however, need to adhere with entry routes, sectoral caps or investment limits, pricing guidelines and other attendant conditions as applicable for investment by a person resident outside India.

##### **4.4.4 Capital Gains:**

In the absence of stipulation of a lower rate of tax by the DTAA, capital gains can be repatriated out of India subject to withholding tax between 10% (ten percent) to 20% (twenty percent) (plus applicable surcharge and cess), depending on their nature.

##### **4.4.5 Capital Repatriation on Disinvestment:**



AD Banks ordinarily allow repatriation of sale proceeds of a security (net of applicable taxes) provided the security is held on repatriation basis and the sale has been made in accordance with prescribed guidelines and tax clearance/'no objection' certificate from Indian tax authorities has been produced. Repatriation may be made through normal banking channels.