



US to India : the legalities of setting up a business in India

About Us

Advani & Co. is one of the new generation law firms in India, poised to handle international legal work in terms of transactional work and dispute resolution.

We cater to a diverse set of clients from all walks of life. These range from major public and private corporations to financial institutions, Government, non-profit organizations, venture capitalists, many start-ups, small, and medium-sized businesses and individual entrepreneurs.

Our legal services to prominent overseas corporations have given us experience in large transactions with cross-border dimensions. Our periphery of services covers matters in India and across the world, interacting with international corporations and law firms. Our renowned arbitration practice has won record judgments for an eclectic mix of international clients.

We have been listed as the best law firm in Mumbai for commercial dis-

pute resolution in the "Asia Pacific Legal 500" and are highly rated for our transactional work.

We have strategically placed from our offices at Mumbai, Delhi and Pune to attend to challenging legal representations. Our lawyers work as a seamless team leveraging their local knowledge to client's advantage. We pride ourselves on being prompt with particular emphasis on quality.



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Entering the Market

Once a decision to set up business in India has been made, there are various legal structures that can be adopted to carry out work in India. The decision to choose one legal entity over another usually depends on a combination of commercial objectives, nature of the industry, legal and tax considerations. However, before diving into the various forms of businesses available, foreign

companies and entrepreneurs should be made aware that they can offer their goods and services in India directly, without setting up a business in India.

These are termed as import of services and goods in India and are done in accordance with the payment of local taxes and duties, including import/customs duty (for goods) and service tax (for ser-

vices). The model adopted for the offer of services and goods is usually through the appointment of a local agent, distributor or franchisee.

However, for a "stronger" presence and the ability to directly market and control operations, foreign companies need to set up business in India.

Business Entities : Different Structures

There are various forms of business entities legally permitted to exist and carry out business in India. These include, (a) sole proprietorships; (b) partnerships; (c) limited liability partnerships; (d) companies; and (d) liaison offices.

A sole proprietorship is a popular way of conducting business for individuals who are personally entitled to all the profits and responsible for all the losses arising from the business. Under law, Sole proprietorships are the simplest forms of entities to devise as no busi-

ness registration is required under Indian Law. Partnerships are a common way of running a business in which several members agree to run a business for profit. A partnership may be setup through an oral understanding or through a partnership deed registered with the registrar of firms. Partners of a firm are jointly entitled to the profits of the firm and are jointly and severally responsible for the liabilities. Companies are regulated in India by the Companies Act, 1956 which allows the for-

mation of public and private companies. There is also the option of setting up of liaison or branch offices which require prior approval from the Reserve Bank of India.

However, when choosing a business entity the laws governing foreign investment need to be reconciled with. In cases of certain sectors foreign investment and control is capped at a certain percentage which makes an Indian partner a necessity.

Foreign Direct Investment Policy and Regulation

Though India has substantially liberalized its policy on foreign investment there remain considerable fetters and procedural compliances. Foreign investment is primarily regulated by the policy statement on foreign investment, the press notes issued by the Ministry of Commerce, and regulations formed by the Reserve Bank. The nodal agency governing foreign investment in India is the Foreign Investment Promotion Board (FIPB) and Foreign Investment Implementation Authority (FIIA) facilitating approvals into implementation.

There are three popular means to route investment into Indian ventures by foreign investors, these are, (a) Foreign Direct Investment (FDI) either under the automatic route or after seeking prior regulatory approval as per the FDI policy; (b) Foreign Institutional Investor (FII) in the capital market after registration with SEBI and the Reserve Bank; and (c) Investment as a Foreign Venture Capital Investor (FVCI) registered with the SEBI and the Reserve Bank.

Out of this FDI through the automatic route has emerged as the preferred

choice for foreign investors. An investment by automatic route is permitted in several sectors and it does not require the approval of either the Reserve Bank or the FIPB, the body responsible for regulating foreign investment. However, in several sectors FDI is prohibited beyond certain limit. For example, investment in excess of 49% in telecommunications or investment in excess of 26% in insurance sector. These caps often make it mandatory to have an Indian company to partner in the business entity which is created. There are also certain reserved categories in which are classified for SME's and for which an Industrial License are required. In these categories, prior FIPB approval is required.

FII's such as pension funds, mutual funds, investment trusts, asset management companies and incorporated/ institutional portfolio managers or their power of attorney holders which are registered with the Securities and Exchange Board of India ('SEBI') may apply to the RBI for permission to purchase the shares and convertible debentures of an Indian company under Port-

folio Investment Scheme ('PIS'). The registered FII permitted by RBI shall purchase the shares/convertible debentures of an Indian company through registered brokers on recognised stock exchanges in India.

A FVCI which is registered with SEBI is permitted to purchase equity/ equity linked instruments, debentures of a Indian Venture Capital Undertaking ('IVCU') or of a Venture Capital Fund ('VCF') through Initial Public Offer or Private Placement or in units of schemes/ funds.

In the latest review of consolidated FDI Policy vide Circular 1 of 2011, the DIPP has brought major changes in the FDI Policy. These changes include the provisions on pricing of convertible instruments, issue shares against non cash consideration, removal of the requirement of no objection certificate from previous ventures, simplification of downstream investments, opening and broadening of certain sectors for FI.

Mergers and Acquisitions

There are various ways in which of mergers and acquisitions are conducted in Indian. They can be firstly be classified into acquisitions by private arrangement and court based restructurings. Here the acquisitions by private arrangement are through contractual agreements governed by the Indian contract law.

Such agreements are usually in the form of (i) share acquisitions; (ii) asset trans-

fers; or (iii) spin offs or “slump sales”. Here the most popular ways of foreign investment are in the form of subscription to or purchase of equity shares and/or convertible preference shares/debentures of the company.

Court based restructurings involve the formulation of a scheme of restructuring primarily for the purpose of merger, amalgamation, demerger or slump sale.

Here a foreign company is permitted to enter into a restructuring or acquisition transaction in India subject to compliance with various regulatory requirements such as the exchange control restrictions on pricing and payments, the need for prior consents and waivers and in many cases, obtaining the approval (s) of the Reserve Bank and the FIPB.

Getting the Land

An important consideration which weighs in the mind of the foreign entrepreneur or business is its ability to acquire land in India.

Presently a non-resident is not permitted to acquire immovable property in India (other than through a lease for a term of less than 5 years) without the prior permission of the Reserve Bank. An Indian

subsidiary set up by a foreign company would be an Indian resident and is permitted to acquire movable and immovable property incidental to its business.

Further, a person who has established a branch office or other place of business (other than a liaison office) for carrying on any activity in India can acquire immovable property in India which is nec-

essary for or incidental to the carrying on of such activity.

The process of acquisition of land in India requires permissions and clearances from the state governments within the Indian Republic and no land can be purchased in India without such prior approval and clearance.

Employment Contracts

There are numerous legislations both at the central as well as state level which regulate employment in India. These statutes broadly make a differentiation between an employee, a workman and an apprentice based on specified income levels. These labor laws most often focus on the protection of workmen leaving companies to freely regulate their relations with employees through contract. However, the nature of the busi-

ness establishment also determines the form of the legal regulation.

The form of the legal regulation differs for a factory, a shop or other forms of commercial/ industrial establishments. With respect to workmen there are statutes which govern Industrial Relations and Disputes, Working Conditions, Terms of Service, Remuneration and Termination. In terms of employment contracts it is important to note that

Indian Contract law does not generally recognize negative covenants after the termination of the employee's service.

Indian Law also regulates the employment of foreign nationals. Indian firms / companies may engage the services of foreign nationals (including non-resident persons of Indian nationality / origin) without prior approval of Reserve Bank of India.

Protecting Intellectual Property

India has several legislations to protect IP rights which include Copyright, Designs, Patents, Trademarks. In addition to these legislations as India is a common law jurisdiction it recognizes claims of passing off, brand dilution and

infringement over and above the statutory claims. The IP regime in India also highlights India's compliance with its international commitments under the TRIPs Agreement following which substantial amendments have been made in

the Patents Act. Above and beyond the statutory protections companies usually sign confidentiality agreement or have clauses in their employment contracts to check leakages.

Enforcing Contracts and Dispute Resolution

The legal system in India is based upon English common law as well statutory law. To adjudicate disputes on this law there exists a system of centralized courts which are hierarchically placed.

Depending on the subject matter, pecuniary and territorial jurisdiction of a dispute it is filed in a district or a court from which an appeal may be preferred to the designated High Court of the state. The Supreme Court of India is the

ultimate court of appeals and it also exercises original jurisdiction in some cases.

In addition to this regular system of adjudication there is a movement towards adjudication through tribunals, where disputes for the sake of expediency and specialization are adjudicated by specialized quasi-judicial tribunals.

Parties may also through agreement resolve their disputes through arbitra-

tion. Arbitrations are conducted in several models in India based on the type of parties and the dispute at hand.

The first and the most popular method of conducting arbitrations remains, ad-hoc arbitration. Most parties omit to specify arbitrators or institutions in their arbitration clauses and only approach courts for the appointment of arbitrators post-dispute.. In these cases the proceedings are conducted ad-hoc.

Taxation

The incidence of Direct Tax or Tax arising from income in India is determined on the basis of the income accruing to business on the basis of its "residential status".

However, this determination is superfluous in the case of an Indian Company or a Company whose management and control wholly lies in India. Such companies are naturally liable to pay tax in India on its global profits unless they

are exempted under a Double Taxation Avoidance Agreement. In case a company is determined to be a non-resident then it will be broadly taxed only on its income accruing in India.

With reference to Indirect Taxes, presently India does not have a central value added tax regime and the rate of the various indirect taxes are determined by the respective state within

India in which the business operates its economic activity.

In addition to this there is a Central Sales Tax ("CST") which is levied on the movement of goods between states, and a Central Value Added Tax ("CENVAT") that is levied on the production or manufacture of goods in India there are state based sales (the Value Added Tax) and service taxes.

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