# STARTING AND GROWING A BUSINESS

Legal and tax issues around India

## 2021

2nd EDITION

A comprehensive guide written by practising professionals into the legal and tax considerations of forming and financing a business around India

A joint publication between the Interlegal association of law firms and the EAI International association of accountants and auditors

Interlegal
Route des Jeunes 4
1227 Genève
Suisse

EAI International
24 rue de Londres
75009 Paris
France

# India

Capital city:
New Delhi

Area:
3,287,263 km2

Population:
1,326,093,247

Language:
Hindi, English

Political System:
Federal and parliamentary republic

GDP/capita 2019:
USD 2,099

Currency:
Indian Rupia (INR)

ISO Code:
IND

Telephone code:
+91

National day:
15 August, 26 January, 2 October

# India

## Legal Overview

### Executive Summary

The Foreign Direct Investment (FDI) policy has been dramatically liberalized since the evolution of economic reforms in India.

FDI up to 100% is allowed under the automatic route in most sectors/ activities subject to certain recently imposed restrictions. However, for FDI in activities not covered under the automatic route, prior government approval is required to be obtained. Recently, the FDI norms have been tightened for the neighboring countries and now the investors from countries that share land border with India would be required to obtain prior government approval before infusing FDI in India.

### Registered Companies and Partnerships

A foreign body corporate can use the following corporate structures to enter the Indian market:

- Incorporating a wholly owned subsidiary or through a joint venture.
- Incorporating a Limited Liability Partnership; or
- Setting up a liaison office/project office/branch office.

A company that is incorporated in India is deemed as a resident of India for taxation purposes.

A foreign company is deemed as a resident of India for taxation purposes if its ‘Place of Effective Management’ is in India in a given financial year.

Some business trade as partnerships. Following the introduction into Indian law of Limited Liability Partnerships (LLPs) as a legal entity, traditional partnerships are, however, becoming less popular because of the unlimited liability leading to significant potential exposure of the individual partners.

LLPs enjoy various tax advantages such as lower tax rates, no dividend distribution tax or wealth tax, hence, it is more economical in comparison to a company.

## Classification of Registered Compagnies

In India, companies are incorporated under the following three broad categories:

Companies limited by shares can either be a private or a public company. The majority of companies registered in India are private companies limited by shares because of the exemptions available to them in comparison to public limited companies.

Companies limited by a guarantee. These companies are normally incorporated for non-profit making functions, with no share capital and members rather than shareholders. The members contribute a predetermined amount towards the assets of the company in the event of the company being wound up. Examples of companies which fall under this category are trade associations and co-operative societies for promoting social objects.

Companies with unlimited liability which may or may not have share capital. These companies are not very popular nor prevalent since the shareholders/members have unlimited liability in the event of the company being wound up.

## Memorandum and Articles of Association

The memorandum of association and the articles of association form the constitutional documents of a company. Recently as a part of ease of doing business, the government has mandated filing of eMoA (electronic memorandum of association) and eAoA (electronic articles of association), except in following cases:

- Section 8 company (non-profit organization), or
- Where all or any of the non-individual first subscribers are based outside India, or
- Part I Section 8 company (i.e. where any company is in the process of getting converted into a Section 8 company), or
- Number of subscribers are more than seven, or
- Individual foreign subscribers who are visiting India but do not possess a valid business visa.

The memorandum of association forms the foundation on which a company's structure is built. It defines the scope of a company's activities and provides basic details about the initial subscribers of the company.

The articles of association form the by-laws and rules which in turn de- fine the rights, duties and powers of the management of a company, the form in which the business of the company is to be carried on and how the shareholders can exert their control over the board of directors.

There are statutorily prescribed formats for the memorandum and the articles of association, however, companies can amend them according to their business requirements.

## Share Capital

Share Capital is categorized into authorized and paid-up/subscribed share capital.

The paid-up share capital of a company refers to the contribution in- vested by the shareholders from time to time. The subscribed share capital determines the liability of the shareholders towards the company.

## Public offer of Shares

A public offer is the offer of shares of a company to the general public and can be initiated through an Initial Public Offer. A public company can offer to sell its shares in the primary market by listing its shares on recognized stock exchanges, such as the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE). The listing of shares helps to enhance the company's value in the long term; however, the company must comply with detailed listing regulations if it wishes to publicly list its shares.

Overall, listing is an expensive and extensive process, which involves many complex legal rules and procedures that must be followed in or- der to sustain in the public share market.

## General Meetings

There are various decisions relating to a company that require the assent of the shareholders, particularly matters which directly concern the interests of the shareholders. Therefore, it is necessary to hold a general meeting/shareholder meeting to approve such decisions.

Each financial year, every company is required to hold an annual general meeting (AGM) in order for financial statements to be approved by the shareholders. The quorum of a valid AGM varies depending on whether the company is public or private. In a public company the mandatory quorum is 5/15/30 members (on the basis of the total number of members), however in a private company it is only 2 members.

In addition to the AGM, the board of directors may, whenever it deems necessary, call an extraordinary general meeting (EGM), so that the members of the company can approve specific matters. However, over the past few years, private companies have been exempted from obtaining shareholders' approval in an EGM, for certain decisions and these can be approved in a board meeting.

Given the difficulties faced by the stakeholders on account of the threat posed by COVID-19, the Government has allowed conducting general meetings through video conferencing (VC) or other audiovisual means (OAVM) till December 31, 2021. It is a possibility that to ease the difficulties in relation to conduct of meetings, this requirement may get introduced as a provision under the Indian Companies Act.

## Directors

A public company must have a minimum of three directors and a private company must have a minimum of two directors.

Each director owes a fiduciary duty towards the company. Fiduciary duties are established under law and in the articles of association of each company.

In India, foreign residents can also become directors of a company. However, the company must have at least one director who, during a given financial year, has been staying in India for a total period of not less than 182 days. Every director who has been allotted Director Identification Number (DIN), is now mandatorily required to file his KYC with the Ministry of Corporate Affairs.

## Financing of a company

There are different ways to finance a company which are as follows:

- Investment in the share capital by shareholders or preferred investors.
- Issuing debentures or convertible note.
- Unsecured loans from directors and their relatives.
- Inter-corporate deposits.
- Bank finance; and/or
- Grants from the government in case of NPOs and start-up companies.

Before availing any financial facility, a company should, however, ensure that it complies with the applicable laws.

Directors may be required to give personal guarantees, in order for the company to take loans from banks and financial institutions. In these cases, the advantage of limited liability is negated.

## Commencement of Business

In India, before a company may commence its business, it needs to fulfil various statutory requirements, such as obtaining a Certificate for Commencement of Business from Registrar of Companies along with other relevant licenses for operating its business, applying for tax registrations and opening a corporate bank account.

To make the process smoother, tax registrations are issued along with the Certificate of Incorporation. It takes a maximum of 7 days to register a company in India.

For an overseas company to commence its business in India, the entire process of attaining operational status in the market takes around 4 to 8 weeks.

Within 180 days post incorporation, a company (including a foreign subsidiary) is required to file an application for commencement of business, certifying that the share subscription amount from the initial subscribers has been received and the e-form for verification of registered office has been duly filed with the Registrar of Companies.

## Mergers and acquisitions

Over the last few years, merger procedures have been simplified and the courts are no longer involved to approve mergers, as all mergers are now approved by the tribunal established by the Central Government. Fast track mergers have been introduced for mergers of two or more small companies and mergers of subsidiaries with their holding company. Companies, other than small companies and wholly owned subsidiaries, must follow a slightly more extensive process.

Private limited companies are usually sold or acquired through private negotiations. Share-purchases are where one entity acquires the shares of another. Sometimes it is preferable to purchase the business of another entity, leaving liabilities with the target corporate entity and this is referred to as an 'asset-purchase'. The sale of shares in a private company are usually conducted confidentially with a small number of interested parties on a preferential basis.

In contrast, takeovers of public listed companies in India are strictly governed by the Takeover Code.

## Corporate Insolvency

In India, the law in relation to insolvency and bankruptcy of a company has seen a tremendous change over the last few years with the intro- duction of the concept of 'creditor in possession' instead of 'debtor in possession' which basically implies that the control with respect to the insolvency proceedings lies with the creditor instead of the deb- tor. Furthermore, more emphasis is now given to reviving an insolvent company and that too in a time bound manner. Under the Insolvency and Bankruptcy Code, 2016 ("IBC"), debtor i.e. a defaulting company and creditor both can initiate 'insolvency' proceedings. Once a default in repayment occurs, creditors can gain control over company's assets and take decisions to resolve insolvency of such company by initiating corporate insolvency resolution proceedings ("CIRP") against the defaulting company.

If a company is under financial losses or unable to pay of their debts, the procedures include reviving such company by the creditors through a qualified insolvency resolution professional ("RP") and liquidation in the event it is impossible to revive the company.

Upon commencement of the CIRP, the management of the company is taken over by the RP and such company is given breathing space called a moratorium, during which no alienation of assets or initiation of proceedings or any enforcement action may be initiated against the company.

During CIRP, steps are taken to keep the company as a going concern and eventually revive the company. If RP is of the opinion that the business of the company was conducted with the intent of defrauding its creditors or for any other fraudulent purpose, then persons, including directors who were knowingly party to such business, may be directed by the adjudicating authority to reverse the preferential transactions and impose penalty on the officers involved in such transactions. Moreover, parties may face imprisonment in cases of non-cooperation, submission of false information and/or the concealment of facts by the officers/managers of the company during the CIRP.

Hence, it is advisable that a director demonstrates that he took diligence of the affairs of the company and took decisions that were intended to minimize the losses or damages to the creditors of the company.

As a part of its Covid relief package, Indian Government had announced suspension of commencement of CIRP which disallowed the lenders to drag a company to bankruptcy court for any defaults that arose during this period. However, this relief ended in the last week of March, 2021, leaving all subsequent defaults open to insolvency proceedings.

Recently, the Government has introduced “pre-pack” as an insolvency resolution mechanism for Micro, Small and Medium Enterprises (MSMEs) which envisages the resolution of the debt of a distressed company through a direct agreement between secured creditors and the existing owners or outside investors, instead of a public bidding process.

## Winding up of companies

There are two types of liquidation, either compulsory liquidation by or- der of tribunal in cases where a company has defaulted in payment of its debts, or a voluntary liquidation by resolution of the company in the event there is no default committed by the company and it is in position to repay its debts. Recent changes in India’s law have made the process of voluntary winding up and compulsory winding up more streamlined.

Voluntary liquidation by the company requires the members as well as creditors, if any, of the company who represent two-thirds in value of the debt, to approve the resolution to wind up the company. The main objective of voluntary winding up is to suspend all business operations and dispense its assets, while also disbursing its debts and arrears.

The appointed qualified insolvency RP shall endeavor to complete the liquidation process within 12 months.

*Uday Ahlawat*

## Contact

**Sheena Ogra**
sheena.ogra@ahlawatassociates.in

**Gitika Kohli**
gitika.kohli@ahlawatassociates.in

New Delhi
Ahlawat & Associates
uday@ahlawatassociates.in
Tel: +91 11 41023400
Tel: +91 11 41012214
**Uday Ahlawat**

# Tax overview

### Company/Firm registration

Every new business, whatever its legal form, must register with the Related Governing Body. Companies or Limited Liability Partnerships (LLPs) are required to register with the Registrar of Companies (pursuant to provisions of the Companies Act 2013). Partnerships are re- quired to register pursuant to the Partnership Act 1932.

### Setting-up Costs

The statutory cost of registering a company/LLP can start from two thousand Indian rupees. The cost depends upon various factors such as the authorized share capital and the state in which the registered office is located. There are no statutory registration costs in terms of taxation (PAN, TAN & GST) for a company/LLP except in case of partnerships where a nominal fee payable.

# National current benefit tax

## Direct Tax

#### Income tax for Body Corporates

Taxable profits of both companies and branches carrying out business in India are subject to a corporate income tax rate of 25% if the turnover or gross receipt doesn't exceed Rs.50 Cr. otherwise the corporate income tax rate is 30%. The corporate income tax rate on foreign companies is 40%. Education cess and SHEC is charged at 4% over and above tax. A surcharge is also applicable and this may vary from 3% to 10%, depending upon the taxable income.
Income tax for Individuals

#### Income tax for Individuals

Every Individual is liable to pay income tax (on income accrued or received in India). Individuals with an income up to INR 2,500,000 is not liable to tax. The income tax on any income above INR 2,500,000 is 5%. For an income of INR 10,000,000 the tax rate is 20% and for an income of above INR 10,000,000 the income tax rate is 30%. A surcharge is also applicable for in comes which exceed INR 50,000,000.

## Indirect Tax

### Goods & Services Tax

On 1 July 2017, India successfully implemented the “Goods & Services Tax”. This has altered the entire indirect taxation system. GST was implemented to reduce the occurrence of double taxation. GST includes several indirect taxes, such as central excise duty, service tax and VAT.

Tax rates on various services and products range from 0% to 28%. For organizations where the turnover exceeds the amount prescribed, GST registration is mandatory. If an organization is operating in different states of India, it is required to have GST registration in every particular state.

### Value Added Tax (VAT)

Alcohol for human consumption, petrol and petroleum products and natural gas are do not fall under the scope of goods and service tax. However, VAT is still applicable on some specific products.

### Securities Transaction Tax (STT)

STT is an indirect tax, which is levied at the time of sale and purchase of securities through the Indian Stock Exchanges. These securities include shares, mutual funds and F&O transactions.

### Stamp Duty

Stamp Duty is an Indirect Tax levied by the State Government on the transfer of immovable property located in their state. It is also levied by the government on all legal documents. The Stamp Duty Tax may vary from state to state.

## Treaties for the avoidance of double taxation

India has a wide range of double tax treaties. The double taxation treaty cover almost all the industrialised countries and a number of others. The rates negotiated for withholding tax rates are often lower than other countries manage to obtain.

## Benefit distribution (National withholding taxes)

India charges a dividend distribution tax on profit distributions by resident companies. The dividend distribution tax rate is 20.36% (including surcharge and cess). A distribution of dividends by an Indian company to a shareholder is exempt from taxation in the hands of Shareholder.

## Tax treatment of losses

Pursuant to the Income Tax Act 1961, losses may be carried forward for eight years, subject to certain conditions. Restrictions apply to losses that are classified as business losses. These business losses can be set- off against business profits of future years and are also subject to other conditions.

Furthermore, in the event of a major change of the ultimate shareholder, losses that have been incurred before the moment of the change cannot be offset against future profits unless certain conditions are met.

## **Employer obligations** (salary taxes, social security)

In general, an employer is obliged to pay professional tax to the tax authorities (in specific states of India). In relation to payment of salary and wages, various laws must be complied with such as the Payment of Wages Act, the Payment of Bonus Act and the Payment of Gratuity Act. Organizations are also required to register itself under Employee Provident Fund Organization pursuant to the Employees' Provident Funds and Miscellaneous Provisions Act. Registration under Employees' State Insurance Corporation is also required.

In cases of Employee State Insurance and Provident Fund, both employer and employee contribute a specific percentage of an employee's salary and an employer must deposit the same within a specified time. Companies are also liable to comply with Corporate Social Responsibility pursuant to the Companies Act.

*Sameer Mittal*

## Contacts

### New Dehli

**Sameer Mittal & Associates,**
Chartered Associates K-10/40,
Lower Ground Floor,
DLF City Phase –II Gurugram, Haryana, 122008
www.casameermittal.com
Tel. +91 971 131 24 53
sameer@casameermittal.com
Sameer Mittal, Sakshi Agarwal

**VJM & Associates LLP**
405-406, 4th Floor, Raja house, Nehru Place
Delhi-110019
Tel. +91 11 417 151 18
Cell. +91 98 915 764 41
www.vjmglobal.com
Sachin Jindal sachin@vjmglobal.com

### Mumbai

**Bansal Bansal & Co**
6/120, Mittal Industrial Estate Andheri Kurla Road
Andheri East Mumbai – 400059
Tel. +91 224 22 24 444
cell. +91 982 02 44 284
www.bansalbansal.com
Jatin Bansal jatin@bansalbansal.com