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GICS IN INDIA –

LEGAL AND REGULATORY FRAMEWORK, AND FINANCE AND TAX STRUCTURE

A proper understanding of the legal and regulatory framework and the finance and tax structure of a GIC in India is critical to its successful establishment. Once fully informed about the intricacies of the regulations and policies in the country, the challenge of structuring the organization's framework to ensure maximum efficiency and compliance is far more approachable.
With that in mind, let's take a quick look at the activities and processes involved in the setting up of these frameworks.

Legal and Regulatory Framework for GICs in India

There are three major activities in the setting up of a legal and regulatory framework for GICs in India:

1. Corporate Structuring
The corporate structuring of a GIC will determine some of the laws and regulations that the establishment will be governed by, and how it will be operated.
Corporate structuring involves the identification of the shareholders of the entity and the board of directors of the GIC. In addition to this, the identification of the type of legal entity it will operate as will play a huge role in deciding how the establishment will function. While there are many forms of business presence, the two main options most suited for permanent business setups in India are Private Limited Companies (PLCs) and Limited Liability Partnerships (LLPs). They differ in some key areas like permitted activities, liabilities, law compliances, taxation, etc., and a choice needs to be made depending on the requirements of the organization.

2. Incorporation
The Indian entity must be incorporated, so that it is legally recognised as a separate entity from its owners, with its own rights and responsibilities.

- Application for Digital Signature Certificates (DSCs) and Digital Identification Numbers (DINs) for the directors
- Registration of the name of the Indian entity, as required by the Registrar of Companies (RoC)
- Creation of the Memorandum of Association (MoA) and Articles of Association (AoA) for the GIC, which outline the objectives of the entity, secretarial guidelines, and initial shareholding information
- Submission of the application for incorporation

  Obtaining the certificate of incorporation

3. Regulatory Approvals
Once the incorporation process is complete, the organization can begin applying for the regulatory approvals necessary to run a business in the country. Some of the key registrations are listed below:

- Permanent Account Number (PAN): Required for payment of taxes on income of a company, filing of returns, and as a unique identifier for the company
- Tax Account Number (TAN): Required to withhold tax on payments made by a company
- Value Added Tax (VAT): Required for commercial transactions such as procurement, sales etc.
- Importer Exporter Code (IEC): Required for any import/ export activities
- Service Tax (ST): Required for all commercial transactions involving procurement or rendering of services

Aside from the above regulations, the entity would also need to file for labour law registrations as they start onboarding team members.

Finance and Tax Structure of GICs in India

There are several factors that shape the finance and tax structure of a GIC in India:

1. Banking
The organization must consider which type of bank account to set up. Current accounts, Exchange Earners Foreign Currency (EEFC) accounts, and Special Foreign Currency (SPFC) accounts each have their advantages and restrictions, and their suitability depends on the type of business that will be conducted.
GICs are required to comply with provisions of certain acts laid out by the Central Treasury bodies. The key regulatory compliances with respect to banking are as follows:
The process of incorporation typically involves:

- All foreign currency receipts must be routed through designated banks. The company should obtain a Foreign Inward Remittance Certificate (FIRC) for all the amounts received. Copies of these FIRCs are to be submitted for further return filing.
- Foreign currency payments can't be routed through the general online banking mode. The authorized documentation for the payments has to be physically submitted to the banks in the prescribed formats.

- GICs must ensure that any foreign currency receivables or payables do not age beyond six months or any other limits prescribed by the relevant acts. Failing this, the GIC might require special approval from banks or central banking authorities before settling the transaction

- GICs are required to regularize exports. This means that a correlation between the revenue invoices raised and the FIRCs received must be made on an ongoing basis

- If funding plans include External Commercial Borrowing (ECB), the bankers play a key role in filing the ECB agreement and obtaining approvals. Once approved, the GIC is required to file ECB returns on a monthly basis

The GIC's banking partner acts as an authorized dealer, and represents the GIC in communications with the Central Treasury body.

2. Capitalization

There are a number of funding instruments that can be explored by GICs like equity, ECB, advance against services, debentures, debt securities, and more. Each of these have differing eligibility requirements, utilization restrictions, sources, interest rates, repatriation practices, etc. It is vital to use an appropriate combination of these funding options available to the organization in order to ensure ease of funding, tax efficiency of funding and repatriation, and ease of management and compliance with laws and regulations.

3. Corporate Tax Rates

Direct tax – The effective tax rate for an Indian company is 30%, increased by applicable surcharge and education cess of 3%. The rate of applicable surcharge for FY 2016-17 for an organization whose income lies between INR 1-10 crore is 7%. If the organization's income is above INR 10 crore, the applicable surcharge is 12%.
However, tax laws also state that if the total tax liability of a company computed at the rate mentioned above is less than tax computed at 18.5% of the 'book profits' of the company, the company would be required to pay a tax of 18.5% on its 'book profits,' increased by applicable surcharge and education cess. This is referred to as Minimum Alternate Tax (MAT). Excess of MAT paid over normal tax liability can be claimed by the taxpayer in 10 subsequent years as per the credit mechanism prescribed for the same. Profits distributed by a company are liable to dividend distribution tax at approximately 20%.
Indirect tax – Organizations in India are also subject to a number of indirect taxes. These are a mix of central and state levies, such as customs duty, excise duty, sales tax, value added tax, etc. This indirect tax regime is set to be replaced by the Goods and Services Tax (GST) – proposed to be implemented from 1 April 2017.

4. Benefiting from Tax Incentives

In order to encourage foreign investments and exports, the Indian government offers incentives to organizations that set up shop in Special Economic Zones (SEZs) or Software Technology Parks of India (STPI) units. However, to avail these benefits, the entity needs prior approval, and has to regularly file compliances.
SEZ and STPI establishments differ in sectors benefited, regulatory bodies, location restrictions, direct and indirect tax incentives, and compliances, so these factors must be kept in mind when choosing a location.

5. Transfer Pricing

The margins that Indian GICs charge for services contracts with the home-office/parent organization should be compliant with the transfer pricing regulations. Typically, GICs adopt the transactional net margin method to compute the transfer pricing markup, resulting in a markup of 17-20% for a technology focused GIC.
The regulations also permit for Advance Pricing of Agreements (APAs) for a maximum period of 5 years, with an option to roll back up to 4 years.

6. Financial Systems

According to Indian law, a GIC needs a financial system (ERP or accounting tools) in order to have control over financial reporting. Compliances specific to India with regards to the financial reporting are as follows:

- Statutory audit to be completed within six months of the fiscal year end

- Tax audit to be completed before income tax return filing

- Audits by tax authorities (like service tax, VAT, transfer pricing authorities)

In addition to the above, GICs have to adhere to the Group Consolidation Standards and book close timelines.
As part of the annual director's report, the directors of the company have to ensure that the financial controls laid out by the company are commensurate to its size, and the financial reporting done by the company is true and fair.
Some considerations that must be addressed during the setup of financial systems in the Indian GIC include:

- Identification of the accounting package to be implemented. It is important to consider if the accounting package used in the home office can be implemented in the Indian entity within stipulated timelines.

- Customization of the accounting package to meet the Indian statutory requirements and the group reporting requirements.

- Customization of the delegation of authority to ensure compliance with Indian laws.

- Customization of financial processes. This would include understanding the group level policies and customizing them to Indian requirements.

Clearly, the structuring of the legal and regulatory framework and finance and tax framework of a GIC in India is a complicated matter. However, unless the process is executed effectively and intelligently, the organization will never realise its full potential. Fortunately, with a plethora of experience in setting up GICs in India, ANSR is perfectly capable of doing exactly that - equipping GICs with all the tools necessary to succeed in this country.