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India Is Ripe For Investment — 7 Key Issues For Investors

Law360, New York (September 29, 2014, 11:27 AM ET) --

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Concurrent with a new government forming in India in May 2014, a certain positive buzz is present in the international investor community, signifying renewed interest in focusing investments into India. With a headline growth rate that had touched 9 percent several years ago and a population of 1.2 billion, India's position as a truly dynamic marketplace was never in doubt. However, in the last few years, certain governance-related issues pertaining to foreign investors — obtaining licenses and consents to conduct business and tax controversies — dented the image of India as a serious magnet for foreign investment. Now it may be going the other way.

The new government has sparked hopes that many of the governance and investment issues that plagued foreign investors will be rectified. At only 100 days old, the new government has pushed ahead ambitious new projects, bolstering the confidence of the global investor community enough to return India to the center stage of investment committees of global corporates and banks.

If the track record of Narendra Modi in Gujarat, where he served as chief minister for over a decade, is any indicator, one can anticipate the next few months to be a blitzkrieg of activity for streamlining government processes for maximizing business efficacy. On his recent visit to Japan, Modi — alluding to the mercantile spirit of the Gujarati community to which he belongs — assured global investors that he understands the importance of money and will do all he can to lay out the red carpet and eliminate red tape. Replicating his Gujarat model of development on a national scale comes with several challenges, but for now, he seems to be walking the talk. It is this hope that makes the next several years a bundle of opportunity for global investors eyeing India as an investment destination.

This article will examine seven key issues from the perspective of foreign investors exploring doing business with India.

1. Foreign Investment Matrix

Given that capital inflows to and from India are tightly regulated by the Reserve Bank of India, the initial sanity check for any foreign investor looking at the Indian marketplace is to establish:

(1) whether the sector in which they propose to invest is open for foreign investment.

The Indian economy has seen progressive liberalization since 1991, and most sectors barring a select few, such as atomic energy, gaming and a couple of others, allow for some manner of foreign participation.

(2) whether the foreign investor can do business through a wholly owned subsidiary or would it mandatorily require a local partner.

Limits are in place for some sectors, which can cap the amount of foreign investment in telecommunications, insurance and some other areas. The new government has liberalized areas previously closed for foreign investment in any substantial manner, such as defense and railway infrastructure. That said, several sectors in India are now open for 100 percent foreign investment. This removes the need to have a local partner in those sectors for purely regulatory reasons, but economic and logistical reasons still remain for such an alliance.

(3) whether any prior government approval is needed to bring the foreign investment into the country. With respect to bringing foreign investment into India, there are two routes:

- The automatic route (where no prior government approval is required)

- The approval route (where prior government approval is required), which inter alia depends on the sector in which foreign investment is sought to be brought in.

2. Business Entity Formation

A number of business structures can be adopted for carrying out business activities in India, including:

- Liaison office
- Branch office
- Project office
- Limited liability partnership
- Subsidiary company, either a public limited company or a private limited company

Each of these entities has a differentiated set of permitted activities. Selecting one over the other is a complex process involving such factors as: (1) ease and cost of setting up; (2) ongoing regulatory interface; (3) permitted scope of activities, such as trading or mere information gathering; (4) ease of closing down; and (5) taxation.

3. Selection of Local Partners and Due Diligence

Even if the sector the foreign investor is entering does not mandatorily prescribe a local partner, often, strong local field know-how will be needed for a foreign investor to penetrate several market segments. A joint venture is often a recommended business tool for market entry into India. Although several joint ventures have ended in tears, others have stood the test of time and become case studies for cultural integration. For example, the Maruti-Suzuki joint venture brought the first rush of Japanese technology for the Indian automobile segment.

Needless to say, prior to embarking on a joint-venture arrangement, a thorough due diligence exercise on legal, tax and accounting fronts is vital. This allows the parties to identify and understand the issues and risks associated with a joint venture and to be better prepared to harness the opportunities. Existing Indian companies can bring their own baggage of liabilities and many foreign investors prefer to incorporate a new limited liability company to serve as the joint-venture vehicle.

4. Tax Planning

Early steps should be initiated by the foreign investor to fully comprehend India's network of tax treaties that play a key role in tax-efficient structuring of cross-border investments. As a rule of thumb, these tax treaties generally provide for source-country taxation of interest, dividends and capital gains. Divergence from this rule in some tax treaties offers several opportunities for tax planning.

For a long time, Mauritius, Cyprus and Singapore have enjoyed the distinction of being intermediate jurisdictions for routing investments into India, given that India has foregone its taxing right on capital gains of a resident of these countries. Most of India's tax treaties do not contain anti-treaty shopping provisions. However, the Singapore tax treaty includes a limitation-of-benefit provision to prevent abuse of the above capital gains benefit.

In the recent past, on a perception basis alone, several structures investing through Mauritius and Cyprus have had close scrutiny from the taxman in India — leading to considerable waste of management time for a business wishing to expand in India. It is therefore worthwhile to proactively determine the optimal way of routing investments to India with the aforementioned issues in mind.

5. Bilateral Investment Protection

Bilateral investment protection agreements (BIPA) provide foreign investors a valuable remedy to protect their investment broadly against any arbitrary state action that could jeopardize their investment. India has more than 70 BIPAs, but until recently, it has been fairly immune to arbitration proceedings. That is changing.

Recently, Australian firm White Industries won a verdict against India over a Coal India investment, under the India-Australia BIPA, while The Children's Investment Fund has raised the possibility of BIPA action over its investment in the same public-sector undertaking. Russian telecom Sistema and Norway's Telenor are also warning of action under various BIPAs over the telecom license cancellations. Along with the tax planning initiatives, foreign investors may want to analyze whether a BIPA exists with India from the jurisdiction where investment is routed to India, together with any jurisprudence of successful proceedings.

6. Intellectual Property Right Protection

Foreign investors also should consider looking at the bouquet of products and services they will offer in India and whether the intellectual property contained therein needs to be protected. In particular, counterfeiting and brand dilution for product-based companies has been fairly commonplace. Thus, taking steps to obtain necessary registrations in India in parallel with other strategic overtures is essential, also given the fairly protracted period (more than 12 months in many cases) for obtaining registrations. As with many of the previously enumerated concerns, top-flight legal counsel with specific knowledge of this area of law is indicated here.

7. Transfer of Key Personnel

It is vital for foreign investors to ensure that their key personnel traveling to India, either to initially gather market intelligence, etc., on a short-term basis or to relocate to work within the Indian venture on a longer-term basis, do so under the correct immigration categories. Also, early action should be taken to ensure that these personnel comply with the local registration requirements at the jurisdictional Foreigners Regional Registration Office, which usually needs to be done within 14 days of entering the country. It is also worth bearing in mind that Overseas Citizens of India (OCI) — usually those individuals who are of Indian origin though holding a foreign passport — have a lifelong visa to travel, work and live in India.

These seven issues provide a bird's eye view for foreign investors looking to enter the Indian market. However, investors should note the significant local regulations governing the actual conduct of business, including obtaining operational permits and consents that also vary depending on the state in which the business chooses to locate. (There are 29 states in India that may prescribe sector-specific permits to be obtained prior to commencing business.) Therefore, once the macro-level issues discussed above are considered, it may be worth seeking further counsel to examine sector- and state-specific regulations to complete the full life cycle of the business planning process.

Many more global corporates in the West are now looking eastward toward India when seeking out new markets for their business expansion, particularly in light of the encouraging tone emanating from the Modi-led National Democratic Alliance government. Despite the potential risks for the unwary, India is a compelling location from which a well-advised company can reap its reward.

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