Going global

For the Indian gems and jewellery industry today, expansion of business overseas is fast becoming a norm. Acquainting oneself with certain key aspects of FEMA and IT Act, therefore, becomes crucial and invaluable in ensuring smooth operations abroad, say **Ravindra Jain** and **Amol Bongale.**

© shutterstock.com

RAVINDRA JAIN is Senior Principal Consultant, Corporate Advisory & Taxation Services at RSM Astute Consulting Pvt. Ltd.

AMOL BONGALE is Consultant, Taxation at RSM Astute Consulting Pvt Ltd.

Globally, the gems and jewellery retail industry is on a major expansion spree. Indian jewellery retailers too are moving ahead, spreading their operations across several countries in the Middle East, South East Asia, European Union and the USA — mainly to capture the non-resident Indian market.

With economies growing closer because of pro-business government policies, setting up of operations outside India has become relatively easy — at least from the regulatory point of view. However, to ensure smooth functioning of businesses outside India, one must understand the legal intricacies involved. Mistakes and non-compliance could cost the business dearly since penal provisions under the Foreign Exchange Management Act (FEMA) and Income-tax Act (1961) are extremely stringent.

India is the world's largest cutting and polishing centre for diamonds and exports 95 per cent of the world's diamonds, according

Non-compliance could cost the business dearly since penal provisions under FEMA and Income-tax Act are extremely stringent.

to Gem & Jewellery Export Promotion Council (GJEPC) statistics. In order to raise the economies of doing business and also expand operations, Indian entities consider exploring markets outside the country. However, a preliminary background in setting up of overseas operations — at least from the Indian regulatory perspective, keeping FEMA and Income-tax regulations in mind — is essential.

What are the forms in which business operations can be set up abroad?

An Indian company or a partnership firm registered under the Indian Partnership Act, 1932 or a Limited Liability Partnership (LLP) incorporated under the LLP Act, 2008 (Indian Entity) can set up a Wholly Owned Subsidiary (WOS) outside India. Where business is to be carried out jointly in association with a local resident of the host country or any other Indian entity, the investor can set up a Joint Venture (JV). The Indian entity can also set up a branch office (BO) which can act as the foreign arm of the Indian entity.

What are the regulatory provisions governing the setting up of WOS/JV abroad?

Foreign Exchange Management Act, 1999 (FEMA) is one of the vital Indian legislations that governs the setting up of overseas entities. The important provisions in relation to the setting up of a WOS/JV are:

- The total financial commitment of the Indian entity shall not exceed 400 per cent of net worth as per last audited financial statements.
- Financial commitment shall include all types of investment such as equity, loan, preference shares, debentures and guarantees issued on behalf of WOS/JV.
- The limit of 400 per cent shall be applicable to Indian investors as a whole and not separate to each WOS/JV of the same Indian entity.

What are the regulatory provisions governing the setting up of a BO outside India?

FEMA does not contain specific regulations with respect to the setting up of overseas BOs. However, it does provide an overall limit on remittance of funds to BOs as under:

- **To meet initial expenses of BO:** Fifteen per cent of average annual sales/ income or turnover of the Indian entity during the last two financial years or up to 25 per cent of net worth, whichever is higher.
- **To meet recurring expenses of BO:** Ten per cent of such average annual sales/ income or turnover of the Indian entity during the last financial year.

The BO also needs to adhere to certain other specified conditions.

What are the reporting requirements applicable to Indian investors in respect of WOS/JV and BO abroad under FEMA?

In respect of a JV/WOS, the Indian investor is required to submit annual performance reports (APR) on or before June 30 every year. The Indian investor needs to obtain share certificate/s confirming investment in JV/WOS and submit the same to the Reserve Bank of India (RBI) through AD (authorized dealer) banks within six months. Further, it needs to report the details of the decisions taken by a JV/WOS regarding diversification of its activities/setting up of step down subsidiaries/alteration in its share holding pattern within 30 days of the approval of those decisions by the competent authority concerned of such JV/WOS.

No specific reporting requirements exist in case of a BO under FEMA regulations.

What is the tax implication on profits of JV/WOS and dividend received from JV/WOS?

The profits of the JV/WOS will be taxed in the host country as per local laws and no tax credit will be available for the same in India. Further, any dividend declared by the JV/WOS shall be subject to tax in host country as per local laws.

As per provisions of the Income-tax Act, 1961 (IT Act), dividend received by an Indian company from JV/WOS shall be subject to tax at the rate of 15 per cent, plus applicable surcharge and education cess. In case of an Indian investor being a firm or LLP, the dividend shall be subject to normal tax rate.

In both the above cases, the Indian investor, while computing the Indian tax liability on dividend income, shall be eligible for tax credit of taxes withheld, if any, on such dividend income in the host country.

What is the tax implication on profits earned by BOs?

Any profits earned by a BO shall be subject to tax in India with benefit of credit of taxes paid in the host country in respect of such profits.

Will transfer pricing provisions be applicable in respect of transactions entered with JV/WOS and/or BO?

In case of transactions entered into with JV/WOS, Indian Transfer Pricing (TP) provisions shall be applicable as the JV/WOS falls within the definition of an associated enterprise. In such cases, all transactions need to be entered into at Arms' Length Price (ALP).

As a BO is the extended arm of an Indian company overseas, TP provisions may not be applicable in case of transactions entered into by it.

An appropriate structure needs to be analysed for carrying on business outside India, considering various objectives such as commercial feasibility, tax efficiency, regulatory implications, potential market and other business factors. ■

© shutterstock.com