

Modes of entry for Foreign Companies: Setting up a Subsidiary in India vs. Joint Venture in India

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Modes of Entry for Foreign Companies

SETTING UP A SUBSIDIARY IN INDIA VS. JOINT VENTURE IN INDIA

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Foreign companies often find it imperative to enter the Indian market by setting up a subsidiary due to its size and growth potential. India has a huge consumer market, a rapidly growing middle class, and supportive government policies. However, entering a foreign market can be a difficult process that requires careful consideration of various factors, including the mode of entry.

Two common modes of entry for foreign companies into India are through subsidiaries and joint ventures with Indian companies. A subsidiary is a separate legal entity wholly owned by a foreign company, while a joint venture is a partnership between two or more companies, usually a foreign company and a domestic company.

Establishing a subsidiary in India can provide a foreign company with complete control over its operations and strategy. The subsidiary is a distinct legal entity subject to Indian laws and regulations. This entry approach provides various benefits, including full ownership, minimal liability, and simpler finance access. However, it requires the foreign business to shoulder the whole cost of establishing and running the subsidiary, which might be substantial.

Following reasons make India an attractive investment for foreign companies:

1. Highest FDI inflow of \$83.57 bn during financial year 2021-22
2. World's largest youth population that shall be urbanized by 2030
3. 63rd in World Bank's Ease of Doing Business.
4. Greatest economic influence across the Asia-Pacific region.

Creating a joint venture with an Indian company allows a foreign company to share risks and costs with a local partner. A joint venture can take

advantage of the local partner's market knowledge and access to resources, while the foreign partner brings in the necessary capital, technology and expertise. This mode of access is particularly useful for understanding local regulations and cultural differences. However, it can also lead to a loss of control over the operations and strategy of the joint venture, as decisions are shared between the partners.

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- How can a foreign corporation ensure that Indian laws and regulations are followed?

Setting up a subsidiary in India

Benefits of Setting up Subsidiary in India

1. The subsidiary will receive significant financial and personal support from the parent company. Thus, the subsidiary will be able to benefit from technical know-how, training, advice, personnel, subscription fees, etc. The caution though shall be with respect to Transfer Pricing provisions and FPI/FDI FEMA regulations.

2. The parent company can open up new channels of capital by constantly subscribing to new subsidiary shares.

3. Subsidiaries can compensate the losses of the parent company that would be setting off provisions for purposes of the Income Tax Act. Many times, artificial transaction construct structuring can be so, to absorb a loss-making entity to reduce the tax burden.

4. Multiple companies can cooperate to form a joint venture as a subsidiary to get better revenue and market coverage

Tax Implications of Setting up Subsidiary in India

The taxation of foreign subsidiaries in India can have several implications for businesses. It is important to understand tax regulations to ensure compliance for your business.

One of the most significant effects is that foreign subsidiaries are subject to the branch profits tax. The tax is levied on the profits of subsidiaries that are attributable to Indian activities. The tax rate is 20%, which is paid based on net profit after deducting expenses.

Another implication is that dividends paid by a foreign subsidiary to its Indian parent company are subject to Dividend Distribution Tax (DDT). The DDT rate is 15%, paid on gross dividends declared by subsidiaries.

The taxation of foreign subsidiaries may also affect the overall tax liability of the Indian parent company. In effect, the income of the subsidiary will be included in the taxable income of the parent company. The tax payable by the parent company depends on its overall tax rate and the profits attributable to the Indian subsidiary.

Compliance Requirements Challenges in India

Compliance requirements for subsidiaries in India along with legal procedural aspects are primary challenges for setting up subsidiaries in India

1. Foreign Exchange Regulations for Subsidiaries – for a foreign entity to transmit funds in India, RBI and FEMA compliances would have to be followed along with Foreign Exchange Management (Non-Debt Instrument) and FPI regulations.
2. Consolidation & Accounting Statements - Ind AS is the Indian version of International Financial Reporting Standards (IFRS), issued by the Institute of Chartered Accountants of India (ICAI). Foreign subsidiaries in India are required to prepare and file financial statements under Ind AS.
3. Compliance with Foreign Jurisdiction of Parent Jurisdiction – The parent company would need to ensure compliance with its home jurisdiction. For instance, in the UK – Protected Cell Companies (PCCs) are permitted but the same isn't in Indian jurisdiction.

When a foreign company decides to enter the Indian market, two general modes of entry are generally considered: the establishment of a subsidiary or a joint venture with a local partner. Both entry types have their pros and cons, and it's important to carefully consider the differences between them before making a decision.

Ownership and Control: One of the most important differences between a subsidiary and a joint venture is ownership and control. In the subsidiary, the foreign company owns 100% of the shares, giving it full control over the business in India. In contrast, the foreign company in a joint venture usually owns a lower percentage of the shares, which means it has less control over the business.

Sharing of responsibilities and risks: Sharing of responsibilities and risks is another important difference between a subsidiary and a joint venture.

Risk mitigation with a local partner allows a foreign entity to have minimized risk sharing as compared to subsidiary.

Compliance with taxes and regulations: When it comes to tax and regulatory compliance, there are also distinctions between subsidiaries and joint ventures. The foreign firm in a subsidiary is subject to all taxes and laws applicable to Indian companies, which can be complex and difficult to comprehend

Factors to consider when choosing between a subsidiary and joint venture

Considerations in the Industry and Market: One of the most important variables to examine is the industry and market in which the company intends to operate. In highly regulated areas such as healthcare or energy, for example, it may be easier to enter the market as a joint venture with a local partner who is more familiar with the regulatory environment. A joint venture can also offer a business with an established network and client base in a highly competitive field.

Factors Unique to Parent Company

Certain firm objectives should be considered when considering whether to establish a subsidiary or joint venture. A subsidiary, for example, maybe a better alternative if the corporation wants complete control over its operations in India.

Strategic Considerations: The company's long-term strategic goals are another significant issue to examine. For example, if the company intends to expand into other areas in the future, a subsidiary may be a better option because

it will be easier to expand into multiple markets. A joint venture, on the other hand, maybe more appropriate if the company desires to specialise in a specific location or market.

Financial Considerations: Finally, businesses should weigh the cost ramifications of both solutions. Joint ventures are less expensive to establish, but they result in a lesser proportion of profits. Affiliates, on the other hand, may need a larger initial investment but can provide higher long-term profits.

Conclusion

Ultimately, when a foreign firm wishes to enter the Indian market, there are normally two options: establish a subsidiary or form a joint venture with a local partner. All means of entry have advantages and disadvantages, and the choice will be influenced by a variety of factors such as industry and business aspects, company-specific factors, strategic considerations, and financial considerations.

Subsidiaries provide international corporations with total ownership and control over their Indian activities, but they also increase risk and liability. A joint venture, on the other hand, may provide access to local knowledge and infrastructure as well as the potential to share risk, but the foreign business may have less operational control.

FAQs

What is a subsidiary in India?

A subsidiary is a separate legal entity wholly owned and controlled by a foreign company. In such subsidiaries, the parent company owns 50% of the subsidiary's shares. Before setting up a subsidiary in India, it is important to get approval from the Reserve Bank of India.

What are the benefits of setting up a joint venture in India?

Some of the benefits of setting up a Joint Venture in India are:

1. Capacity Enter new markets and distribution networks.
2. Increased appetite Share risks and costs (i.e., liability) with partners.
3. Gain new knowledge and expertise, including professionals.
4. Access to additional resources such as technology and funding.

What are the foreign exchange regulations for Indian subsidiaries?

Foreign Exchange Management Act and Foreign Exchange Management (Non-Debt Instruments) and regulations are applicable for Indian Subsidiaries that impose restrictions on repatriation of profit and provide for a mechanism of doing so in terms of payment of dividends or transmission of capital from one entity to another.

How can a foreign corporation ensure that Indian laws and regulations are followed?

Legal Due Diligence from experts, to check compliance of entities' regulations with RBI, FEMA, Income Tax and other regulations is necessary. Further, it is not only Indian regulations that are to be looked upon, but even the foreign entity jurisdiction that needs to be looked upon.

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