The Changing Face of Doing Business in India

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Flashback Year 2019

We were contacted by a Middle East company dealing in electricals (let's call it "ME Electricals" for confidentiality reasons). They wanted to have a subsidiary company in India which would be involved in manufacturing, marketing, and trading of electric products. They put us with responsibility to deliver a feasibility report to them stating how to enter the Indian markets and Cost-Volume-Benefit analysis. We delivered the report stating that their business strategy on India should be to enter in Indian markets firstly through trading and then manufacturing their own products in India.

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Happy with our report, their CEO and team members came down for a meeting for understanding the complex nature of Indian Taxation. We met them at their hotel and started briefing about Indian Tax Structure and the elements involved in it. At that time, there were multiple taxes for various activities subject to minimum 5 different taxes for each activity in a manufacturing unit like they were desiring.

When we had completed 25% of our briefing, their team stopped us. They said they need time to process all this data and details. We restarted after a small tea break. After an hour or so, we completed the briefing and left, leaving them satisfied with the information we provided. Later, when we followed up with their Indian representative, we came to know that this company ME Electricals, recalled their plans to set up the company in India.

Apparently, they became skeptical after seeing the volume and complexity of taxes in India. Middle East countries and companies were not used to such high rates of corporate taxes (such as 35%). They were also not used to this kind of heavy tax compliance and structure. As a result, they backed off.

Cut to Year 2021

We were approached by a USA-Sino electrical company seeking solution for their major problem related to the costing. Now, the operative conditions of this company and ME Electricals were the same. Let's call this company "US-Sino Company". They had pre-established a market in India for their products and already had several distributors and marketing/sales team. The problem they were facing was very peculiar. They used to export their product in India to their distributors for selling it to the ultimate customers. However, the custom duty on their product was as high as 30%. As a result, the distributors of the US-Sino company were having very less margin and were not happy with them. Consequently, they were losing the hold in the Indian market. At the same time, they could see the huge demand for their product. But due to the costing constraint, they were somehow struggling. They approached us for finding some feasible solution for this problem.

We studied their product. We found that their product was listed under "Make in India" scheme declared by the Indian government, and manufacturing of the same was encouraged by the government, which is why, obviously, there was high import duty on the same. We further analysed the government benefits where we found that the government is offering a good amount of subsidy in taxes to the manufacturing units of this product (40% of the capital investment on notified items). We observed that the entire product, if imported, attracted 30% import duty, but if the parts of the same were imported, say in Completely Knocked Down (CKD) condition, then the import duty was reduced to almost 7.50%.

Now imagine the change of the perspective and turn in the events. We advised this company to set up a manufacturing unit in India, subsidiary of the main company and supply the key parts of their products through import and assemble the entire product in their Indian manufacturing facility, buying the other ancillary parts from Indian local market, which were easily accessible. We were aware that the next set of question from this company would be directed towards legal and tax structure of India. But this time, the situation was different and much pleasant than 6 years ago.

Due to introduction of Goods and Services Tax in 2017, all the other taxes which were levied on various activities of a manufacturing company were subsumed into GST. Also, the effective rate of GST is quite low as compared to effective rate of earlier tax structure. GST has mitigated the cascading effect of tax thereby allowing the manufacturers to sell their products at much competitive prices. Another welcome change in Indian taxation was brought by reducing the corporate tax rate to 22% from 35%. Further, the dividend distribution tax of 18.50% is now abolished by the government of India. That means, this company can take out the more profits from their subsidiary unit.

So, subsidies from government, reduced tax compliance, reduced tax rates, ease of taking out profits from their company, everything was win-win situation. Their parent company gave the assent to establish manufacturing company in India. With faster procedure of company incorporation, we registered the subsidiary company of a foreign company in 15 working days with Indian Company law authorities and Income Tax authorities. Immediately after incorporation, we opened the bank account with a renowned Multi-National Bank and applied for Goods and Services Tax Registration and Import-Export code.

The company was ready to operate in literally 25 days from the date of the parent company's decision to establish manufacturing unit in India. The company had already located a place to establish the manufacturing facility near Mumbai. They started building the factory on the land they had finalised. At the same time, we were recruiting the teams for handling their day-to-day operations in various departments like operations, production, HR, accounts/ finance etc.
The factory was built in no more than 6 months along with import and installation of machinery and first lot of assembly material, the man-power recruitment was complete before the factory was built up on a vast area of 51,000 square feet (fifty-one thousand square feet).

The company is operating at 100% capacity as on date and estimated to post a turnover of USD 6.00 million by the end of FY 2020-21. The parent company have successfully invested USD 4.65 million in this venture.

The story does not stop here. This company has applied for subsidy of 40% of their capital investment and the application is in process. Further, we are applying for GST refund due to inverted duty structure which can get them USD 464 thousand as cash refund, to help them out in this difficult period of cash crunch, which will be credited in 45-60 days from the date of application.

This is the story of changing business environment in India, especially for the manufacturing industry. After a long wait, Indian government have made multiple and positive changes in the industrial and business norms, the ease in doing business, offering subsidies, cuts in tax rates and what not!

One can say India is truly changing its perspective towards foreign investments and welcoming the global players and embracing them with open arms!!