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MVDCO ADVISORY SERVICES

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FEMA & INTERNATIONAL TAX

Liaison Office (LO) in India:

A foreign entity can establish a Liaison Office in India in accordance with Section 6(6) of The Foreign Exchange Management Act (FEMA) read with notification no. FEMA 22(R) /2016-RB dated 31st March 2016.

Eligible entity:

A foreign Company which can be a body corporate incorporated outside India including a firm or association of individuals may make an application to establish a LO in India.

Permission route:

AD Category I bank has the power to permit the establishment of LO in India. The AD bank shall check out on applicant's background, adherence to the eligibility criteria, antecedents of promoters, nature and location of activities of the applicant, sources of funds, compliance with the KYC norms before granting the approval.

However, **specific RBI permission** is required in the following cases:

- The applicant is a citizen of India or is registered in Pakistan;

- The applicant is a citizen of India or is registered in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau AND the application is for opening a LO in Jammu & Kashmir, North East region and Andaman and Nicobar Islands;

- The principal business of the applicant falls in the four sectors namely Defence, Telecom, Private security and Information and Broadcasting;

- The applicant is a Non-Government Organisation (NGO), Non-Profit Organisation, Body/Agency/Department of a foreign government.

The validity period of a LO is generally **three years**. For NBFCs and entities engaged in construction and development sectors, the validity period is two years.

Financial track record:

The nonresident entity applying for a LO in India should have profit making track record during preceding three financial years in the home country and **net worth of at least USD 50,000** or its equivalent. If the applicant entity is financially not sound, RBI may consider a Letter of Comfort from its parent/group Company.

Bank Account:

An LO should maintain only one bank account in India. The permitted credits in this account are:

- Funds received from Head Office through normal banking channel;
- Refund of security deposits;
- Refund of taxes, duties from tax authorities;
- Sale proceeds of assets of the LO.

The permitted debits in this account are for meeting the local expenses of the office. Banks are not allowed to extend any fund or non-fund based facilities to the LO. The entire operations of the LO must be funded by the foreign parent entity.

Permitted activities:

LO in India is allowed to perform only the following activities:

- Representing in India the parent company/group companies.
- Promoting export import from/to India.
- Promoting technical/financial collaborations between parent/group companies and companies in India.
- Acting as a communication channel between the parent company and the Indian Companies

Basically, a Liaison office is only a Representative Office and is not expected to carry out any activity that earns revenue for the company.

A Liaison office can only act only as a **communication channel** between the Parent company and Indian companies. It can only gather and pass on the information to the Parent company for them to take the entire decisions base on the information pass on to them. They on their own cannot conclude any sale transaction.

Annual Activity Certificate (AAC):

Every year an LO in India needs to submit AAC along with audited accounts and other requisite documents to the AD bank as well as Director General of Income Tax (International Taxation), New Delhi.

Additional offices and activities:

An LO may seek fresh permission in case of establishing additional offices. If the number of offices exceed 4, the applicant has to justify the need for such additional office and it shall also require prior approval of RBI. Further, in case of multiple offices, the applicant may identify one of its offices as "Nodal office" which will coordinate activities of all of its offices in India.

Wherever the existing LO is shifted to another city, prior approval of AD is required. However, no approval is necessary in case of change in address in the same city.

Closure of Liaison Office:

For winding up of a LO, following documents needs to be complied with:

- Confirmation from the Company that no legal proceedings in any court in India are pending against the LO and that there is no legal impediment if the residual amount from LO is remitted back to the parent Company;

- Auditors' need to certify-

    - A statement of assets and liabilities indicating the manner in which assets are disposed off and basis of arriving at the remittable amount;

    - Confirming that all the liabilities in India are either fully paid or provided for;

    - Confirming that no income from source outside India (ex: export proceeds) have remained unrepatriated to India.

- A report from the Registrar of Companies that all the provisions of the Companies' Act, 2013 have been duly complied with.

- Confirmation from the AD bank that all the AACs have been filed by the LO.

On compliance with all of the above requirements, the LO can be wind up and residual balance in the bank account of the LO, if any, can be remitted back to the parent Company account.

Transfer of Assets of the Liaison Office:

- Transfer of assets by way of sale to JV/WOS when the parent Company intends to close their LO;
- The Statutory auditor must certify the date of acquisition, original price, depreciation till date, present book value and sale consideration to be obtained. He must also certify that the assets were not re-valued after their acquisition. The sale consideration should not be more than the book value in each case.
- The LO cannot capitalize any intangible asset such as Goodwill, pre-operative expense or leasehold improvements as fixed assets eligible for such transfer.
- The AD bank must ensure payment of all the taxes before permitting any remittance

- Donations of old furniture, vehicles, computers and other office equipment to NGOs or nonprofit organisations may be permitted by the AD bank after satisfying itself about the bonafide of the transaction.

Other General directives:

- LO shall obtain a PAN card from Income Tax authority;
- When LO is upgraded to a Branch Office, the same PAN card and bank account can continue;
- Each LO is required to transact through single AD bank only;
- LO is not allowed to buy a property. It can lease a property for a period not exceeding 5 years;
- AD bank can allow term deposit for a period of only up to 6 months provided the bank is satisfied that the deposit is out of the temporary surplus funds and the LO furnishes an undertaking that the maturity amount shall be utilized for its business purpose within 3 months of its maturity.
- Where change in name is requested due to acquisition or merger of foreign entities involving change in ownership, the acquired entity is required to apply a fresh by closing the existing entity.
- LO must intimate the AD bank in case of any change in top management or CEO/MD/CMD of the LO.

Annual Statement to be filed with Tax authority:

In accordance with Rule 114DA of the Income Rules read with **Form 49C,** every foreign Company having an LO in India will have to file an **Annual Statement** with the jurisdictional Assessing Officer **within 60 days** from the end of the financial year. This Statement has to be verified by a Chartered Accountant or by an authorised representative of the foreign Company.

The details required to be given in this Annual Statement is as follows:

- Nature of activities undertaken by the LO
- Date of opening and registration number granted by the RBI.
- Details of receipts, income and expenditure from India centric activity of foreign Company in addition to that of the LO.
- Details of purchase and sales of materials from/to Indian parties directly by foreign Company.
- Details of services provided to or received from Indian parties directly by foreign Company.
- Details of agent/distributors of foreign Company in India.
- Details of top 5 parties with whom the LO is doing liaising activity in India.

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- Number of employees working in LO along with the details of those drawing salary in excess of Rs. 50,000/- per month.
- Details of presence of group entities in any form in India.

However, if the RBI or Income Tax department takes a view that the Liaison office is carrying out activities beyond their defined scope of "permitted activities", the Profits that attribute to the activity that is being carried out in India becomes subject to Income Tax.

Although this is a structure which does not attract any tax liability in India due to its limited permitted activity, foreign Company needs to be extremely clear and careful as regards the nature of activity it proposes to carry out in India. It must be strictly in accordance with the permitted activities as prescribed by RBI to avoid any kind of inquiry and penal consequences at a later stage.