BRANCH OFFICE AND INDIAN SUBSIDIARY COMPANY: AN OVERVIEW

A. BRANCH OFFICE AND INDIAN SUBSIDIARY COMPANY: INTRODUCTION

BRANCH OFFICE:

· A Branch office (BO) is a representative office setup by a foreign company in India to carry out business activities, as permitted by the Reserve Bank of India (RBI) and is a suitable business model for foreign companies looking to establish a **temporary presence** in India. The branch office serves as an extension of the foreign parent companies' business and carries on the same business activity as that of its parent company.

Branch office is suitable for a foreign company to test and understand the Indian markets but with an extremely strict control by the Reserve Bank of India, as it allows the companies to do the business activity only which are permitted by the RBI and is mentioned in the application of Branch office. Any additional activity to be carried by the Branch office shall be illegal. Branch office can carry additional business activities only with the prior approval from the Reserve Bank of India.

The Foreign parent Company must meet the prescribed eligibility criteria and conditions in order to set up a Branch Office in India, which shall include-

a. The name of the Branch Office must be the same as the parent company.

b. The foreign parent company shall have a profitable track record during immediately preceding five years in the home country.

c. The Net Worth i.e. total of paid-up capital and free reserves, less intangible assets as per the latest Audited Balance Sheet or Account Statement certified by a Certified Public Accountant or any Registered Accounts Practitioner, shall be not less than or equal to USD 100,000.

INDIAN SUBSIDIARY COMPANY:

· The Indian subsidiary Company is the Company formed and incorporated under the Indian Companies laws, having a separate legal entity and whose interests are held and controlled by another company (i.e holding/parent company) partially or fully. The Indian subsidiary company is obligated to function under the rules and compliances of the Indian corporate laws, where it is situated or registered.Indian Subsidiary Company is a suitable and most preferred business structure for a foreign company to expand or diversify its business activities in the Indian markets.

B. ADVANTAGES & DISADVANTAGES OF SETTING UP A BRANCH OFFICE IN INDIA

ADVANTAGES:

1. **Direct Control:** The branch office offers a greater level of control to the parent company. A branch office is considered as an extension of foreign parent company, which means that its activities are entirely managed by the parent company in terms of the decision-making process.

2. **Brand Value:** The branch office in India maintains the brand value of the parent company as it shall use the same name as that of the Parent company.

3. **Cost Effective:** Compliance cost of a branch office is comparatively low. Also, there will be no requirement of infusion of equity, only the funds for operational requirements are needed.

4. **Access to new market:** Branch Office is a suitable model for a foreign company to enter India and understand the Indian market as it allows the foreign companies to test and do business in India, subject to certain conditions, and allows access to the new market.

5. **Repatriation of Funds to the Parent Company:** Profits can be freely repatriated to the parent Company subject to payment of applicable taxes in India.

DISADVANTAGES:

1. **Restricted Business Activities:** The branch office, as an extension of its foreign parent company, is only allowed to conduct activities permitted by the RBI. There are several restrictions on the activities of Branch Office. Branch offices are still generally forbidden from engaging in retail trading, manufacturing or processing activities within India.

2. **Eligibility Criteria:** Companies incorporated outside India can only set up a branch office in India, if it meets the eligibility criteria of profitable and steady financial track record and sound net worth as prescribed by the RBI.

3. **Approvals:** For setting up a Branch office in India, to take prior approval of RBI (Reserve Bank of India) is mandatory. Requirement for Documents is much more stringent for opening a Branch Office in India.

4. **Taxability:** Branch Office treated as a foreign company and compared to Indian Subsidiary, the tax rate for the Branch Office is higher.

5. **Expenses:** If the Branch Office in India does not generate any revenue and is unable to meet its expenses, then all of their financial obligations need to be fulfilled by the foreign parent company.

6. **Setting-up:** Branch Office can take 4-6 months to setup in India, as permissions from RBI take time. The actual registration process for the Branch office starts post approval.

C. ADVANTAGES & DISADVANTAGES OF SETTING UP SUBSIDIARY COMPANY IN INDIA

ADVANTAGES:

1. **Separate Legal Identity:** An Indian Subsidiary Company enjoys the benefits of Separate Legal Identity in the eyes of law. Indian subsidiaries have a management structure and shareholding pattern of its own, different from the parent company.

2. **Foreign Direct Investments:** In case of Indian Subsidiary, FDI is allowed 100% without any prior permission. However, it requires posts facto filing/intimation to the Reserve Bank of India.

3. **Control:** Foreign Parent Company can retain a 100% effective ownership of its Indian Counter-part by incorporating a wholly owned subsidiary and hence, can indirectly control the Indian subsidiary.

4. **Business Activities:** An Indian subsidiary can undertake all the business activities as permitted and mentioned in its Memorandum of Association.
5. **Taxation:** The Indian subsidiary will have the same tax structure as any domestic company in India.
6. **Financial Assistance from parent Company:** The Parent company can provide continuous inflow of funds by subscribing to new shares of subsidiary company and thus save it from cost of debt. The parent company can provide the monetary means and capability to its subsidiary.
7. **Lesser Setting up Cost:** Time and money consumed in registering an Indian Subsidiary is lesser compared to the Branch office registration.

DISADVANTAGES:

1. **Setting up and Running Cost:** Establishing an Indian subsidiary business initially requires the financial assistance of a parent company. The costs are to get the subsidiary up and running and the cost in the next few years to sustain that subsidiary, based on various economic factors.
2. **Annual Compliance Cost:** Annual Compliance cost in case of a subsidiary company is slightly high in comparison to the annual cost of Branch office.
3. **Risk and Liabilities to the Foreign Parent Company:** The parent company may need to guarantee the loans of its subsidiaries, thereby directly exposing itself to the liabilities of its subsidiaries.

OIPL's Inference:

The Foreign Company may enter the Indian markets in the form of a Branch office or Indian subsidiary company keeping in mind the pros and cons of both the models and their respective business plans. Generally, Foreign Companies prefer Branch office in cases where they are establishing a temporary presence in India or a presence only for handling simple transactions not including manufacturing activities and Indian subsidiary company, in case of permanent presence in India.

Further, there is no provision under the Indian laws to convert an existing Indian subsidiary to a Branch office since Primary Regulators in both cases are different. <u>The Indian Company will first have to be closed under Voluntary Liquidation which is a very time and cost intensive process and generally takes around 2 years to complete.</u>

As mentioned above, the requirement for documents in case of Branch Office is much more stringent and hence, separately starting the process of opening Branch office will also need investment of substantial amount of money as well as time.

<u>If the Company decides to go ahead with Voluntary Liquidation, the Board of the Company will freeze and it cannot perform any function. Meanwhile if the Branch office is also not operative then the Company may face a non-operational transition phase where it cannot function at all.</u>

It is worth considering that the Brand name "Myrtha" cannot be used for Branch office as it has to be the Parent Company's name, whereas operating as Myrtha India will enhance the visibility of Brand in the market.

<u>Considering the business model of Myrtha and the above factors, it would be in the best interest of Myrtha to continue as a wholly owned subsidiary and to increase the accountability of the Parent Company for the decision making in Indian entity, a Nominee Director of A&T Europe may be appointed on the Board.</u>

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