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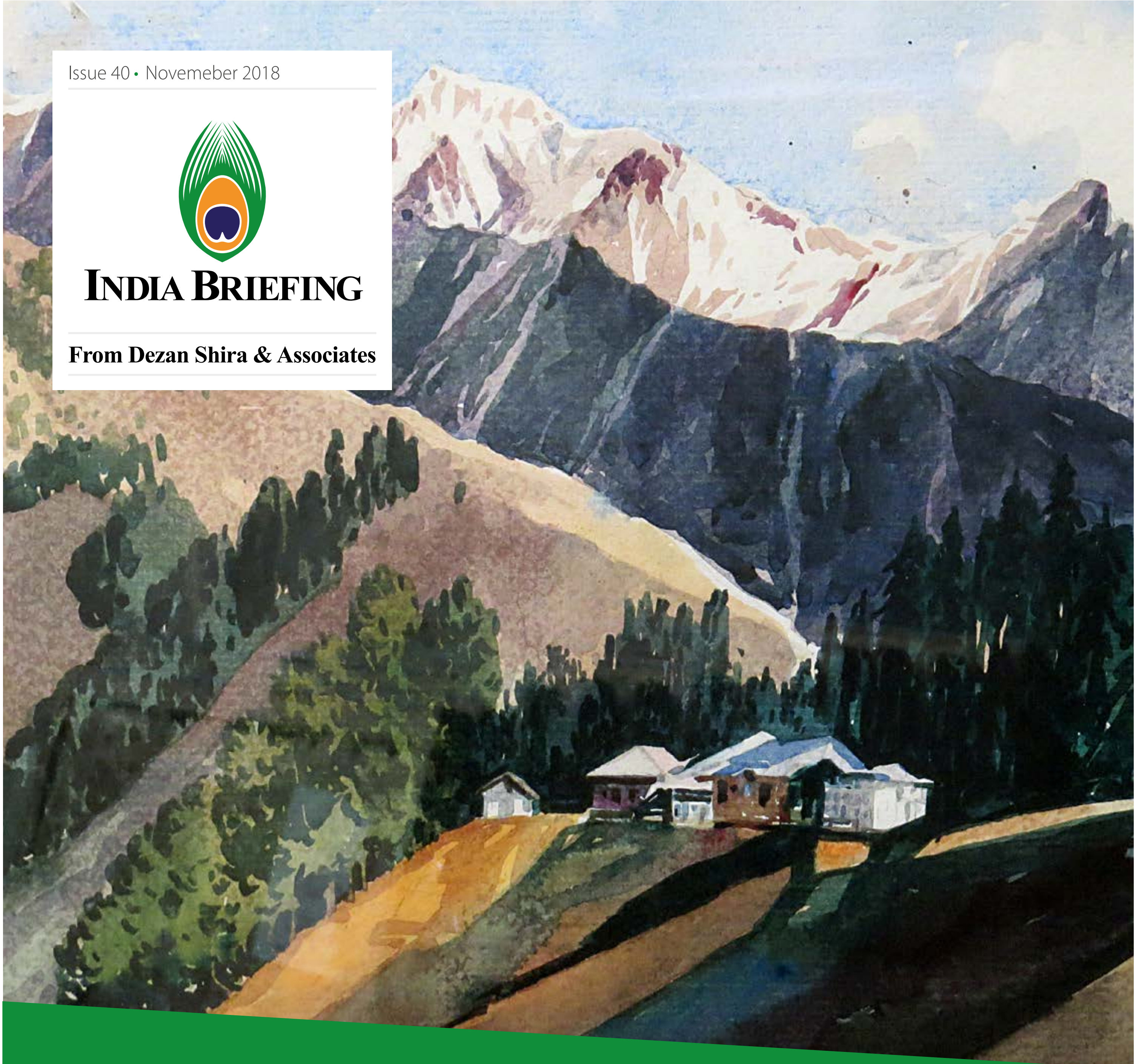
From Dezan Shira & Associates



Manufacturing and Trading in India

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Introduction

ADAM LIVERMORE
Partner

China is re-positioning itself in the global value chain – moving away from an export-driven economy to a consumption driven one. Adding to this are the continuously rising wages and comparatively high social welfare costs that are pushing away foreign-owned manufacturing companies. Many companies are considering their options – whether to relocate their China-based production units or supplement existing operations with cheaper inputs sourced from lower-cost markets in Asia – a strategy widely known as 'China plus one'.

India, with its large consumer market and economic policies – promoting the development of manufacturing capabilities, looks strikingly similar to how China looked 20 years back. India's rapid infrastructure growth, improving business climate, along with a rich vein of product availability for global sourcing businesses – makes it an increasingly viable choice for manufacturing companies looking for their 'China plus one' in Asia.

In this issue of *India Briefing* magazine, we discuss what are the benefits of choosing India as a business location – its market size, labor force, and tariff rates. Subsequently, we highlight relevant information for companies looking to relocate or diversify their production in India's special economic zones (SEZs) – the permitted activities in India's SEZs, incentives available, key locations, and sourcing and procurement considerations for raw material and equipment. Further, we discuss the steps and procedures for establishing an import-export business in India.

With our specialized business intelligence, tax and compliance, and market entry knowledge within India, Dezan Shira & Associates is well positioned to assist companies in their efforts to survey and establish their India operations, and take advantage of Asia's second fastest growing economy.

With kind regards,

Adam Livermore

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This Issue's Topic

Manufacturing and Trading in India

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What India Offers Businesses in China

By Dezan Shira & Associates
Editor: Vasundhara Rastogi

As the Chinese market matures and moves up the value chain, it is gradually losing some of its cost advantage and competitiveness in comparison to other Asian countries. Many companies with China operations are looking to diversify their production to other low-cost countries in Asia – a strategy known as 'China plus one'.

Besides holding down operating costs, this approach enables firms to diversify their workforces and supply chain, as well as access new markets. It also helps companies hedge against the political and economic risks that comes from reliance on one country. As a result, businesses are less vulnerable to shocks like supply chain disruption, currency fluctuations or tariff risks, and can quickly scale up one country if market conditions deteriorate in the other.

With steady market growth and increasing economies of scale, India offers a great alternative to China for those seeking to expand their production base to South Asia. India has both the benefit of an inexpensive, huge and growing labor pool, as well as an improving infrastructure. Besides, the present Indian government's business-friendly policies complement many market conditions that foreign businesses first discovered in China.

Push factors

Increased operating costs

Most manufacturing units established in China are located on its eastern coastal regions, around Shanghai and the Pearl River Delta. In the last few years, costs in these locations have increased sharply – at a rate more than 10 percent per year on average; office rents are high, the industrial land is in short supply, and utility costs have increased. Most significant of all are the wage increases. All across China, the minimum wages have increased due to the increased cost of living. In 2018, the minimum monthly wages in Shanghai and Shenzhen, for example, increased to RMB 2,420 (US$348.5) and RMB 2,200 (US$316.8), respectively. In 2017, 14 provinces in China increased their minimum wages, while nine provinces had raised their minimum wages in 2016 and 19 provinces had raised their minimum wages in 2015.

Less preferential policies

Up until 2007, foreign investments received preferential treatment under China's general tax regulations. For example, manufacturing companies that received foreign investment were subject to 15 percent corporate income tax (CIT) rate, while domestic companies paid 33 percent. However, over the last decade, China has stepped up its efforts to narrow the gap between foreign and domestic companies as it transitions from an export-led economy to a services-oriented economy. In 2008, it unified the rate for both domestic and foreign firms at 25 percent.

Higher Regulatory Standards

China is known as the 'world's factory', but these factories have brought severe pollution to much of the country. This has prompted the Chinese government to take aim at polluters with new environmental standards, pollution control systems, and environmental taxes.

Apart from these new regulations, difficult legal hurdles, and a maturing social security system have forced foreign investors to rethink their strategies and move some of their production to other countries as the costs of compliance increase.

Risk diversification

The escalating US-China Trade War has huge implications for heavily integrated and globalized supply chains. So far, the US has levied tariffs on US$250bn of Chinese products. While China has attempted to soften the blow for exporters, the increased tariffs have disrupted supply and distribution chains.

Narrowing margins and the prospect of further tariff increase is prompting companies to reshuffle their production network and move their factories from China to lower-cost countries in Asia. Spreading production across several markets leaves producers less vulnerable to supply chain disruption, currency fluctuations, and tariff risks in any individual market.

Pull factors

Massive market

India has a GDP (PPP) of US$7.78 trillion. Its nominal year-over-year expenditure growth of 12 percent is more than double the anticipated global rate of 5 percent and is likely make India the third-largest consumer market by 2025. Rising affluence is the biggest driver of this growth, followed by the change in the consumer behavior and spending patterns, especially in lower-tier cities.

Growth in digital connectivity, infrastructure development coupled with rising household income, and an increase in India's consumer spending represent the massive opportunities that lie in the Indian market.

Large labor force

In addition to a population of 1.35 billion people, India has a large, young population. More than half of India's total population are under the age of 25 – two-third are less than 35. By 2027, India is likely to have the world's largest workforce, with a billion people aged between 15 and 64. Analysts expect this large, young workforce to make a significant contribution to India's growing consumer base.

Low labor costs

China is committed to developing high-end, value-added manufacturing to fuel the next stage of its economic development. India, on the other hand, just wants to develop a manufacturing base.

Companies that want to manufacture cheap goods in Asia need to understand how lower labor costs in India can help them achieve their goals. India has some of the lowest labor costs in Asia: an hourly labor cost in India is roughly one-third the cost of the same hour in China.

Incentives

The Indian government has introduced a wide spectrum of programs and incentives across sectors to encourage manufacturing in the country. The country's 'Make in India' campaign is designed to transform India into a global manufacturing hub by facilitating investment, fostering innovation, and building best-in-class manufacturing infrastructure.

Government initiatives to create smart cities, trade corridors, and industrial clusters also have the potential to create more business-friendly environments. Beyond this, India's encouragement of 'competitive federalism' has helped localize economic reforms and business incentives, adding a healthy dose of realism to the federal government's expansive vision.

India, China slash tariffs for APTA members

Recently, India slashed import duties on 3,142 items imported from its Asian neighbors under the Asia Pacific Trade Agreement (APTA) – a preferential trade agreement between Bangladesh, China, India, Laos, South Korea, and Sri Lanka.

China, on its part, initiated a reduction or removal of duties on 8,500 items for APTA partners – on agricultural produce, pharmaceuticals, and other goods that have suffered a tariff hike in the US. The tariff relaxations are an important step forward for Asia-Pacific trade, which has been stuck in limbo since India signed onto APTA in 1975.

Global trade patterns are shifting, and India needs to secure market access for key products while also protecting its industry from trade-related stress.

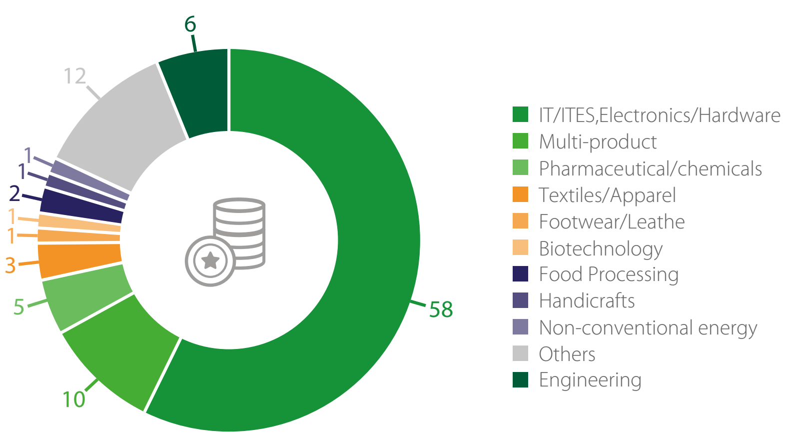
Where to Locate: Special Economic Zones

By Dezan Shira & Associates
Editor: Vasundhara Rastogi

In the last five years, the Indian government has acted aggressively to promote exports and make investing in India easier. The government has taken several initiatives to make India a more attractive manufacturing destination, largely to make doing business in the country easier. These include easing processes for finance acquisition, property registration, and paying taxes, as well as improving minority investor rights, contract enforcement, insolvency conditions.

Currently, India houses over a million registered exporting companies. It is a large manufacturing hub for products that include, but are not limited to, textiles, apparel, food processing, agriculture, gems and jewelry, chemicals, pharmaceuticals, machinery, and electronic items.

Sector-wise distribution of SEZs in India (%)



The country encourages manufacturing and sourcing of products at competitive costs, primarily through special economic zones (SEZs), which feature lower CIT rates and limited duration tax exemption.

An introduction to SEZs

SEZs are specialized industrial areas deemed 'foreign territory' for tax purposes by the Indian government in order to attract both domestic and foreign investment. The Indian government implemented their SEZ policy in 2000, and formalized it with the Special Economic Zones Act, 2005, which helped upgrade former export-processing zones (EPZs) into SEZs. The 2005 Act laid out the following purpose and goals for SEZs:

- Generation of additional economic activity;
- Promotion of exports of goods and services;
- Promotion of investment from foreign and domestic sources;
- Creation of employment opportunities; and
- Development of infrastructure.

As of September 2017, India had 221 SEZs in operation. In January 2018, a massive 423 more received formal approval for operation. Notable SEZs in the country include Santa Cruz (Maharashtra state), Cochin (Kerala state), Kandla and Surat (Gujarat state), Chennai (Tamil Nadu state), Visakhapatnam (Andhra Pradesh state), Falta (West Bengal state), Noida (Uttar Pradesh state), and Indore (Madhya Pradesh state).

Permitted activities in SEZs

Broadly speaking, investors are permitted to engage in all activities commonly associated with manufacturing, as well as an array of services. The scope of economic activity permitted in SEZs is wider than many other Asian economies and covers the following:

Manufacturing – make, produce, fabricate, assemble, process or bring into existence a new product having a distinctive name, character or use, including processes such as refrigeration, cutting, polishing, blending, repair, remaking, and re-engineering.

Services – trading, warehousing, research and development services, computer software services, call centers, data processing, database management, insurance claim processing, medical transcription, back-office support centers, offshore banking, professional services (excluding law/ tax), rental or leasing services, business services, courier, audio-visual, construction, distribution, educational, financial, hospital, travel and tourism, cultural, transportation, entertainment, recreational, and auxiliary services, free trade, and warehousing.

SEZ app for importers, exporters

In 2017, the Ministry of Commerce and Industry (MOCI) launched a mobile app called SEZ India under the government's e-governance initiative. The app features four main sections: SEZ information, SEZ online transaction, trade information, and contact details.

SEZ information provides detailed information about approved SEZs, the SEZ Act, associated regulations, and MOCI circulars.

SEZ online transactions allow users to track the bill of entry and shipping bill processing status in the Electronic Data Interchange (EDI) system of the Indian Customs and Central Excise Electronic Commerce/ Electronic Data interchange Gateway (ICEGATE).

Trade information provides details of the foreign trade policy, import and export schemes, excise and customs circulars, and Merchandise Exports from India Scheme (MEIS) rates.

Contact details includes contact information for authorities involved in regulatory and trade approvals, such as the Reserve Bank of India (RBI), Commerce Ministry, Directorate General of Foreign Trade (DGFT), and the SEZ Development Commissioners Office.

The App benefits for businesses

The app helps business people find information about approved SEZs and associated trade policies, which is often difficult for first-time India investors. Businesses can also use the app to track their transactions on the SEZ online system, The system helps SEZ developers and units to conduct transactions to pay their registration charges, procurement reports, bill of entry, and shipping bill charges, as well as to make electronic filings.

Importers and exporters can also use the SEZ online transaction section to track their bill of entry and shipping bill status as well as conduct the verification process through QR code scanner provided by the app.

The government has produced similar tools for merchants, traders, and citizens that allow government services to be conducted through electronic mediums. Some of the apps developed under the initiative include Bharat Interface for Money (BHIM) for cashless payments, DigiLockerfor storing and electronic signing of government-issued documents, eTaal for access to e-Transactions taking place under e-Governance applications as well as Aadhaar Payment for merchants.

Incentives available for setting up an SEZ in India

Some advantages of setting up a sourcing or manufacturing platform within an Indian SEZ include:

- Duty-free import and domestic procurement of goods for the development, operation, and maintenance of the company;
- 100 percent income tax exemption on export income for the first five years, 50 percent for five years thereafter, and 50 percent of the export

profit reinvested in the business for the next five years (these incentives will be withdrawn from April 1, 2020 under the Sunset Clause, pending an extension, which is currently under discussion);

- Exemption from the Goods and Services Tax (GST) and levies imposed by the state government (supplies to SEZs are zero-rated under the IGST Act, 2017, meaning they are not taxed);
- External commercial borrowing (ECB) is allowed up to US$500 million a year without restriction (For developers of an SEZ, the ECB channel may be availed after receiving government approval, and only for providing infrastructure facilities in the zone. However, ECB will not be permissible for development of integrated township and commercial real estate within the SEZ);
- Permission to manufacture products directly, as long as the goods produced fall within a sector that allows 100 percent FDI.

The benefits of India's SEZ policy have been substantial and have already served to increase the number of foreign firms operating in India. Since 2005, exports from the country have almost continually been increasing, largely due to the rise in sourcing and manufacturing platforms there.

How to choose an SEZ

Companies directly sourcing from or manufacturing in India must weigh the geographic benefits and special features of each SEZ against the needs of their business. They must ensure that their sourcing platform is well placed to acquire the raw materials needed for production, and is positioned in an area suitable for export, that is, near or on the coast. While previously it was a difficult balance to strike, the new government's emphasis on infrastructural development has made procuring materials from other parts of India a lot easier for manufacturers.

Sourcing and procurement considerations

The raw materials and equipment that a sourcing company in India uses affects not only the quality of its goods, but also the total expenditure of its operations. These further informs a company's decision on where to locate.

Materials

In India, domestic procurement is the most common means of acquiring the necessary materials for production. The country has a diverse economy that encompasses traditional farming, modern agriculture, and a multitude of contemporary industries. Locating the desired materials domestically therefore is not much of a problem. While operating around an SEZ, a company can procure materials domestically and quickly export them. In some cases, when the material cannot be procured locally, manufacturers can import them from abroad following the rules and regulations listed under the Foreign Trade (Development and Regulation) Act.

Equipment

To ensure that the produced products are of high quality, the equipment used for production must be up to date. If the equipment is found to be inoperative, the business or its partner may contact the National Small Industries Corporation Limited (NSIC) and acquire equipment on a long repayment basis. That is, without immediately having to pay the heavy price. Alternatively, the company may import it from its parent firm as per the regulations under the Foreign Trade (Development and Regulation) Act.

How to Establish an Import and Export Company

By Dezan Shira & Associates
Editor: Vasundhara Rastogi

Starting an import-export business with the right approach can render a business very profitable. However, the long-term success and profitability of a firm depend greatly on the importer's knowledge and understanding of international procedures, in addition to a keen analysis of the foreign and procedure-centric market in India.

Setting Up an Import-Export Business in India

1. Establish your company following guidelines provided in the Companies Act
2. Apply for an Importer Exporter Code (IEC) from the relevant regional office of the Director General of Foreign Trade (DGFT)
3. Obtain an Import License
4. Register with the regional office of the Export Promotion Council and relevant tax authorities, including the Sales Tax Office and Export Credit Guarantee Corporation
5. Obtain an Export License and Certificate of Origin for export purposes from the Chamber of Commerce
6. **Begin trading**

Further, prospective investors looking to start an import-export business in India need to obtain the necessary information regarding foreign trade agreements and trade policies, which may require a lot of preparation time.

In order to register any kind of company in India, the proposed director(s) of the company must first apply for a Director Identification Number (DIN), which can be obtained by submitting an application to India's Ministry of Corporate Affairs (MCA).

The MCA recently introduced the SPICe Form INC-32, which stands for Simplified Proforma for Incorporating Company Electronically. Noted below are the new changes for company incorporation in India:

- Form INC-32 replaces INC-29 and is similar except for a few minor changes relating to reporting requirements;
- The subscribers and witnesses of the concerned establishment need to apply for their Digital Signature Certificate (DSC) for use in the SPICe MOA and SPICe AOA;
- SPICe also allows for the provision to apply for company incorporation with a pre-approved company name;
- Filings of the MOA in e-Form INC-33 and AOA in e-Form INC-34 will be linked with SPICe (Form INC-32), except for not-for-profit associations formed under Section 8 of the Companies Act, 2013;

- Upon approval, the Registrar of Companies (RoC) assigns a company with a 21 digit Corporate Identity Number (CIN).

Once the company is registered and incorporated as an Indian company, it can begin proceedings for import and export-related matters. The entire registration procedure, including the processes mentioned below, takes about two months to complete.

Registering with the Director General of Foreign Trade

Operating as an arm of the Ministry of Commerce and Industry's Department of Commerce, the DGFT is the agency responsible for virtually all matters related to India's import and export policies.

The Indian law requires all first-time exporters or importers to register with the DGFT – the agency the Ministry of Commerce and Industry's Department of Commerce that is responsible for all matters related to India's import and export policies. The DGFT, in turn, provides the applicant business with a unique Import-Export Code (IEC).

The IEC Code is a ten-digit code required for both exports and imports and is checked by Indian Customs during every single import/export transaction. To apply for an IEC number, companies must submit the "Aayaat Niryaat Form" (ANF2A) to the nearest regional authority of the DGFT, via post, online, or in person. Below is the list of documents required to get the code:

- Two passport-size photographs of the legally responsible person;
- Permanent account number (PAN);
- The valid mobile number and email ID;
- Current bank account number; and,
- Banker's certificate.

For almost all import businesses, an IEC number is necessary; however, certain exceptions do exist. These include individuals or companies importing items from Nepal, Myanmar (through the border), China or a small number of selected ports and locations around India, if the value of individual consignments does not exceed US$382.20 (Rs 25,000). Business must note that exemptions from obtaining the IEC number are not applicable for export of specific items listed by the DGFT.

Obtaining an import license

India's import-export laws are not considered highly restrictive by any standard, and the vast majority of goods making their way in and out of India are license-free, making them easy to administer, and profitable. That said, Indian customs laws do prohibit the import of certain items, by way of placing import conditions on them.

To deal with any such restrictive regulation, the importer must apply for an import license, which is issued by the relevant government authorities. Without the necessary documents, imports run the risk of being declared unauthorized – which may subject them to confiscation or refusal of entry into the country.

Import licenses, which are renewable, are typically valid for 24 months for capital goods and 18 months for raw materials components, consumables, and spares. There are two copies of import license that are issued – one, to certify compensation for the foreign seller of the goods, and the second, to present to the relevant customs authority for import clearance purposes.

Registering with an Export Promotion Council

After completing the initial registration, the next step is to register with an Export Promotion Council (EPC) to obtain a Registration Cum Membership Certificate (RCMC). The RCMC is mandatory for any firm applying for an authorization to import or export or to avail trade benefits and concessions under the federal Foreign Trade Policy (FTP).

Presently, there are fourteen export promotion councils under the administrative control of the department of commerce. They have branches all over the country and offers procedures based on state laws. They are:

- Engineering Export Promotion Council of India (EEPC);
- Project Exports Promotion Council of India (PEPC);
- Basic Chemicals, Cosmetics, and Dyes Export Promotion Council (Chemexcil);
- Chemicals and Allied Products Export Promotion Council (CAPEXIL);
- Council for Leather Exports (CLE);
- Sports Goods Export Promotion Council (SGEPC);
- Gem and Jewellery Export Promotion Council (GJEPC);
- Shellac and Forest Products Export Promotion Council (SHEFEXIL);
- Cashew Export Promotion Council of India (CEPCI);
- The Plastics Export Promotion Council (PLEXCONCIL);
- Pharmaceutical Export Promotion Council (PHARMEXCIL);
- Indian Oil Seeds And Produce Export Promotion Council (IOPEPC);
- Services Export Promotion Council (SEPC); and,
- Export Promotion Council for EOUs & SEZs (EPCES).

EPCs are registered as non-profit organizations under the Companies Act or the Societies Registration Act and work to promote various goods exported from India in international markets. The councils also work closely with the Ministry of Industry and Commerce, acting as a platform for interaction between the exporting community and India's federal government.

Given its function, exporters should regard the need to obtain a registration and membership certificate from the respective council as paramount. In order to apply for registration, a certified copy of the already-provided IEC number is required. Further, those wishing to register with the respective EPC are required to submit a membership fee that varies as per the location.

Registering with tax and regulatory authorities

A company must register itself with the local tax authorities such as the regional goods and services tax department and the export-import credit guarantee corporation to enjoy the tax exemptions available on Indian manufactured goods.

Besides, the Indian Chamber of Commerce issues the non-preferential certificates of origin to India manufactured goods. The exporter can use this certificate to claim benefits available to Indian origin goods in the country of exports.

Applying for an export license

To determine whether a license is needed to export a particular commercial product or service, an exporter must first classify the item by identifying its Indian Trading Clarification (ITC) based on a Harmonized System (HS) classification.

ITC (HS) is India's chief method of classifying items for trade and import-export operations. The code, issued by the DGFT, is an 8-digit alphanumeric code representing a certain class or category of goods, which allows the importer or exporter to follow regulations concerned with those goods.

If a license is necessary for the product in question, the exporter must file an application for the relevant license to the DGFT. The export licensing committee under the chair of the export commissioner is responsible for the consideration of such applications.

Additionally, the DGFT occasionally releases public announcements, timed to coincide with the implementation of new laws, noting that certain specified goods that are not included in the ITC (HS) classifications of export and import items may be exported without a license.

These announcements also detail conditions for the export of these items, which may include a minimum export price registration with the relevant specified authorities, quantitative ceilings, and compliance with other relevant laws, rules, or regulations.

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Beijing Office

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Introduction

Dezan Shira & Associates is a multi-disciplinary professional services firm operating throughout the Asia-Pacific (APAC) region. We provide our clients with legal, audit, accounting, and advisory services.

Our network of 28 offices and 620 partners across 100 countries give us a unique advantage to help our Chinese clients invest in international ventures. Additionally, our multilingual Outbound Investments team allows our clients to utilize our services as a one-stop solution for multi-jurisdictional ventures.

Our Outbound Direct Investment Services

Dezan Shira & Associates' outbound investment team is committed to providing a comprehensive and specialized range of advisory services to Chinese companies interested in an overseas expansion.

Our aim is to help businesses expand outside their domestic markets and leverage international business opportunities.

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