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Global Capability Centres: Navigating Indian Tax Implications

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As Global Capability Centres grow in India, navigating through the right setup strategy (direct ownership or Built Operate Transfer) and understanding Indian tax implications is crucial for an MNE's business structuring and predictability, say Khaitan & Co. practitioners.

India is fast becoming a prime destination for Multinational Enterprises (MNEs) to set up their Global Capability Centres (GCCs), thanks to its rich human capital, scalability, and cost efficiency. Increasingly, business functions such as finance, human resource functions, information technology (including complex and nascent fields of data research), artificial intelligence, machine learning, software product development service, etc. are being outsourced to India's GCCs. With this growth, it is crucial to examine tax considerations and potential strategies for GCCs in India. This article delves into the critical Indian income-tax considerations pertinent to India's GCCs.

The government's *Economic Survey* underpins the growing prominence of GCCs in India, with GCCs currently employing about 3.2 million people in the country. By 2028, India is expected to host 2,100 GCCs, generating an estimated revenue of USD 121 billion by 2030 and contributing about 3.5% to India's GDP. A significant portion of this revenue, USD 102 billion, is expected to come from exports of services (Government of India, Ministry of Finance Department of Economic Affairs, Economic Division, [Economic Survey 2023-24](#) (July 2024)).

Setting Up a GCC in India

Evaluating an MNE's strategy for setting up a GCC in India is vital. For direct ownership structures, MNEs typically establish a company, usually a limited liability company (LLC) (a limited liability partnership (LLP) or a branch model are seldom chosen), as a liaison office or a project office. Engaging with third-party service providers, including the Built Operate Transfer (BOT) model, is also a commonly preferred approach.

Direct Ownership Structure.

LLP vs LLC: Choosing between an LLP and an LLC involves careful analysis of each option's pros and cons, especially regarding the efficient repatriation of surplus profits. An LLC (either as subsidiary or as a joint venture) could potentially face double taxation in India, first taxed at a rate of around 25.17% at the LLC

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level and then at 20% at the shareholder level upon profit repatriation, subject to any lower tax rate under applicable tax treaties. Conversely, an LLP provides a single layer of taxation in India, with profits taxed at 30% and further distribution to partners being tax-exempt. Exits from an LLP or LLC via secondary buyouts are tax-neutral under domestic law, with gains taxed at 12.5% (subject to any tax treaty benefits) if the LLP interest or LLC shares have been held for over 24 months. There are nuances with LLPs as India taxes LLP income on an opaque basis, which may cause difficulties in claiming tax credits if the home country taxes income from LLP on a transparent basis (i.e., at the partner level). An LLC model may also offer advantages over an LLP structure in terms of the corporatization of the structure, ease of raising funds, (debt or equity), complying with regulations, and managing exchange risk, etc.

Branch Office, Liaison Office, Project Office of MNE: From a tax perspective, a branch and a project office are considered a permanent establishment (PE) of an MNE in India, and their income is taxed as a non-resident at a rate of 35% on net income. A liaison office is typically not considered a PE due to its limited role. From a GCC perspective, branches, liaison offices, and project offices are generally not the preferred options. Branches, despite their ability to generate revenue, face certain restrictions. Liaison offices cannot generate revenue, and project offices are typically established for specific projects in India.

Location of GCC: From an Indian tax incentive perspective, the location of a GCC, whether in cities like Bangalore, Mumbai, Chennai, Hyderabad, etc., generally does not impact tax benefits. However, setting up GCCs in the GIFT City, Gujarat may offer tax incentives to GCCs in the financial service sector[1]. Some key tax incentives include a 100% tax exemption for 10 out of 15 years (although 9% tax based on adjusted book profits may apply for certain companies), applicability of concessional withholding tax at 10% as against 20% on dividends distributed by GCC to its non-resident shareholders and the non-applicability of the Goods and Services Tax (GST) on services received by such GCCs.

Note that the International Financial Services Centres Authority (IFSCA) [notified](#) the Global In-House Centres (GIC) Regulations, 2020 to provide a framework for the operation of GICs. Interestingly, the guidelines use the term "GIC" instead of the commonly used term "GCC." Regulation 2(1)(e) of IFSCA (Global In-House Centres) Regulations, 2020 define GICs as "*a unit set up in the International Financial Services Centre for providing support services, directly or indirectly, to entities within its financial services group, including but not limited to banks and non-banking financial companies, financial intermediaries, investment banks, insurance companies, re-insurance companies, actuaries, brokerage firms, funds, stock exchanges, clearing houses, depositories, and custodians, for carrying out a financial service in respect of a financial product.*"

Using Service Provider to Assist the MNE in the Setup (BOT Model).

A prevalent approach for MNEs to set up their GCCs is through third-party service providers under a BOT model. This strategy minimizes initial investment and offers local market insights before a formal GCC presence is established in India. Initially, the GCC is integrated within the service provider's structure, which ensures adequate resources and provides the MNE with market understanding. Eventually, the GCC's ownership and control may be transferred to the MNE. Therefore, in third-party service arrangements, it's crucial to anticipate any costs/tax costs during the arrangement's continuity, including any potential tax/ costs at the time of transfer to the MNE. Some common methods for separating the GCC from third-party service providers to an MNE are (i) cherry picking assets and employee transfers; (ii) contractual business transfers; and (iii) share sales. The foreign buyer/MNE would require an Indian presence to house the employees'/assets/business but they can acquire the

shares directly from outside India. While all three modes are generally taxable (except for treaty benefits available to non-resident shareholders in share sales or court approved business transfers like mergers/demergers), the manner of taxation differs. Certain successor risk may flow to the buyer of the business, and GST provisions generally apply in case of pure asset/employee transfer but do not apply in case of business or share transfer. Pricing considerations, reporting/filing compliances, withholding tax can also apply. Notably, foreign sellers can still be taxed in India upon exiting an offshore entity which derives at least 50% of its value from Indian assets. Contractual protections including indemnity/insurance against withholding tax risk (especially in case of treaty benefits), successor risk, target risk, title protection against transfers being treated as void due to outstanding taxes of the sellers are usually watched for and negotiated.

Other Tax Considerations

Taxable Presence of the Foreign Entity.

Under both models (direct ownership or BOT), the mere presence of an Indian entity (such as a subsidiary, JV, or third-party service provider) per se does not create a taxable presence for foreign MNE group entities in India. In case the foreign entity is said to have a PE in India, then income of the PE would be taxed at 35% (excluding surcharge and cess) on a net basis and would also be required to undertake tax compliances in India. Attribution of profit to a permanent establishment is a vexed issue and tax officers generally tend to take aggressive position around attribution of profits to the PE in India. In a recent ruling of the Full Bench of the Delhi High Court[4], the Court ruled that MNEs having loss at a global level would still be required to pay taxes on income attributable to the operations of the PE India, thereby making attribution of profits a keenly debated issue even for foreign entities having global losses. Thus, it is important to plan the GCC operations well to mitigate any taxable presence in the form of business connection/permanent establishment of the foreign MNE in India. Some of the safeguards typically include:

- **Robust service agreements:** Be it BOT or direct ownership, the service agreements should be on a non-binding basis and at arm's length (usually cost plus models). The India GCC should have the wherewithal to provide such services on a principal-to-principal basis.
- **Nature of services:** It is crucial to assess the nature of services performed by the India GCC. Services should be carefully defined; support / ancillary functions are acceptable if they are rendered independently by the India GCC (*Hyatt Int'l Southwest Asia Ltd. v. ACIT (Intl Tax'n)-2(1)(1) (New Delhi 2024) [ITA 215/2023]*). However, services involving decision-making, securing, concluding contracts, or participating in negotiations on behalf of foreign MNEs by the GCCs are not advisable.
- **Employees of GCC:** The employees' employment letters, terms, reporting, supervision, hiring, firing, and remuneration are policies to be decided by the India GCC. Similarly, social media, communications, visiting cards to also demonstrate that employees of India GCC (*[2014] GE Energy Parts Inc. 150 ITD 107 (Delhi - Trib.)*). A foreign MNE can set the overall scope of work and expectations for the India GCC employees/consultants and should not directly exercise supervision or control over them or the manner of their working – quality control and inspection rights in the capacity of a service recipient should be fine to exercise. Similar considerations will also be relevant where employees are seconded to the India GCC, the secondment arrangements must be structured carefully and ensured that seconded employees are indeed employees of India GCC, not the foreign MNE (*Yum! Restaurants (Asia) Pte. Ltd. [2020] 81 ITR(T)*)

440 (Delhi – Trib). Otherwise, the foreign MNE could be exposed to a taxable presence in India and potential GST leakage.

- Infrastructure: The India GCC is to bear the cost of the infrastructure, computers, laptops, and enter such lease/ownership arrangements —though recovery of such cost as part of a service fee is acceptable.

Transfer Pricing.

GCCs generally operate as captive centres to their foreign group affiliates and being so, transfer pricing is a relevant issue in pricing the services of the Indian GCC and ensuring that an appropriate arm's length margin is charged by the GCC from its foreign affiliates. India GCCs (be it a third-party model or direct ownership) usually are remunerated on cost plus models. With evolving transfer pricing concepts such as DEMPE (*Development, Enhancement, Maintenance, Protection and Exploitation*) –based remuneration, allocation of arm's length pricing has become dynamic. Note that *DEMPE functions are tested in the context of transfer pricing analysis for intangible assets.*

Thus, it is critical that the GCC adopts a robust and comprehensive transfer pricing mechanism. To achieve tax certainty and avoid prolonged disputes with the Indian tax authorities, taxpayers may consider alternate dispute resolution mechanics such as entering into bilateral or unilateral Advanced Pricing Agreements (APAs) with the Indian government to ensure an agreed arm's length margin is being charged by the Indian GCC. Lately, we have been seeing a lot of GCCs opt for APAs as an effective measure to achieve predictability around the margins to be charged.

Conclusion

As GCCs grow in India, choosing the right setup strategy - direct ownership versus BOT model is crucial for MNEs' business structuring and predictability. The BOT model offers benefits like lower capital needs, lower setup costs, lead time to familiarize with the market, specialized skills, and cost savings, but also brings challenges like third- party reliance, operational conflicts, cultural differences, scalability issues, and transition costs. Additionally, it is simpler for GCC employees to participate in the global incentives of a foreign MNE under a direct ownership structure compared to the BOT model. Direct ownership provides more control, improved planning, but demands significant capital and could entail time/costs if operations are prematurely closed. The optimal strategy, not one-size-fits-all, should be customized considering factors like commercial goals, long-term plans, specific needs, capabilities, risk appetite, etc. Aligning tax considerations into the operations of the GCC would also help mitigate an unintended tax consequence.

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