At first glance, in contrast to other Asian countries India appears to be remarkably “easy to access”. Many Indian business people have many years of experience of western countries. English is the generally recognised and used language in business life. The surprise is even greater when it becomes clear that apparently “clear” details and statements in reality have no meaning or a completely different meaning. After some time it is evident that the completely different cultural background of the Indian contact person poses a great obstacle and a risk for western companies.

Indian negotiating partners are extraordinarily experienced in representing and asserting their positions. From a western point of view the negotiating culture is often perceived to be demoralising and frequently a western contact person interested in a “constructive” and “quick result” will make wide-ranging concessions which later are very difficult to correct.

In Indian law, a “common law” system, fundamentally different principles are valid in many areas such as in contract law or in corporate law. The most important decision-making body of an Indian GmbH, the board of directors, works strictly according to majority rule. Only the majority on the board will also secure control of the own subsidiary. The structure of the court system is also significantly different to that prevailing in continental Europe. The Indian judiciary is also incredibly overloaded. The duration of legal proceedings in the first instance in India is commonly ten years.

The structure of Indian tax law is very complex and the execution by the financial authorities can result in a high burden for the taxpayer. For example, there are four different types of sales taxes. An extensive system of withholding tax requirements on a national level and often also with cross-border payments also extends tax liability to the contract partner. The financial authorities are focused on tax transfer prices. Starting with the first rupee, there are extensive obligations to disclose and justify pricing.

Due to the various types of tax and notification requirements, the obligations relating to financial accounting for Indian companies require highly qualified support which is usually not given by “all-round” employees.

Rödl & Partner is active throughout India and has own offices with German and Indian advisors in Delhi, Mumbai and Pune. On the same premises, Indian auditors and lawyers for legal proceedings provide comprehensive support for strategy planning, daily operations and crisis situations.
Practical examples

Auditing

Background facts:

When an Indian subsidiary was established the German parent company relied completely on the Indian managing director who had already proven himself in the area of sales. An auditor was proposed to audit the annual financial statement for an “amazingly” low fee. In a local meeting, the representatives of the parent company were very impressed with the personal presentation of the performance profile and personal experience of the proposed auditor. The financial accounting was also managed for a low cost through an “all-round” employee selected by the managing director. In the following years an unqualified audit opinion was always given.

When the local company repeatedly reported losses and there was a recurrent need for fresh capital, the German parent company decided to commission the Rödl & Partner audit team to carry out the audit of the financial statement. Already when the first draft of the annual financial statement was received it was apparent that in the local company the basic principles of balance sheet management and valuation were not known. The audit of the annual financial statements turned out to be a formality which was simply rubber stamped. Inventories had not been properly recorded. There were numerous errors in the area of withholding tax and in the area of inventory discrepancies amounting to a seven-digit euro amount.
What can be done now?

Rödl & Partner was commissioned to reconstruct the processes of the last years and also to clear up inventory discrepancies. A control system in the area of incoming and outgoing goods was defined and checked during the year. The employee in the area of finance was replaced by an employee with considerably higher qualifications, whereby Rödl & Partner assisted with the selection of the successful candidate.

Rödl & Partner also took on the processing and correction of incorrect notifications in the area of withholding tax and various other areas.

What should one have done differently from the beginning?

Highly qualified employees in the area of finance are usually incorrectly labelled as being an unnecessary cost factor and high quality auditors are seen as a burden because they ask questions about structures and procedures and do not accept the “final word” of the “managing director”.

Due to the remote premises it is particularly important and also supportive for the local managing director when an auditor with structured working principles is selected as a sparring partner to audit the annual financial statement who will name critical areas right from the beginning. These can then be systematically checked and secured.

An internal or external financial accounting department with well qualified personnel initially leads to higher costs, but will also maintain order in complex circumstances and allow the management to concentrate on developing the business.
Taxes

Background facts:

The German company “Anlagen-AG” is negotiating an extensive contract (for an eight-digit euro amount) with an Indian customer for the supply and commissioning of a production line. There is a global business relationship between the two companies. Therefore the contractual documentation is incomplete and has not been audited from a tax point of view either by the ordering party or by Anlagen-AG. After two years of activity the project is nearly finished. When the final payment is due the Indian customer declares that his own tax consultants had interpreted the contract such that Anlagen-AG had established a tax presence in India. Therefore 43% of the total remuneration had to be retained for the withholding tax. Instead of the final payment, a claim would now be made for a repayment. The tax liability for the project for Anlagen-AG and its Indian subsidiary including penalties for delay and fines amounts to 100% of the order volume.

What can be done now?

Clarification has to be made as to whether a branch office has actually been established or whether a different argumentation can be pursued with a chance of success. The facts of the present case clearly indicated that only certain services can be assigned to a branch office subject to the payment of tax to considerably reduce the financial risk. As there was a risk of expiry by limitation, the required tax returns had to be prepared and submitted at short notice. The personal tax liability of the engaged employees also had to be checked and explanations had to be submitted. Legal appeals were made against the tax assessments and these were ultimately successful. The Indian ordering customer then had legal certainty and was able to pay the outstanding amount.

What should one have done differently from the beginning?

Due to the Indian system with its withholding taxes, the question of the tax classification of a process is already relevant before the tax office is involved at all. The Indian payee has to check whether and to which extent withholding tax must be retained. In the early stages of a cross-border project it is therefore necessary to consider the possible tax consequences and how the development of a branch office subject to the payment of tax can be avoided. In the case in question, had an Indian subsidiary been available, given clear contractual arrangements, it would have been able to process important parts of the projects. A transparent structure would have drastically reduced the tax risk for all involved parties.
Law

Background facts:

The German “Maschinen GmbH” has had an authorised dealer in India since 1990 with an exclusive contract. The contract is subject to German law. For a long time the Indian market was just a “minor area” of operations for Maschinen GmbH. The long-serving Indian partner is clearly unable to keep up with the requirements of the now thankfully expanding Indian market. Two meetings in India take place without a result. In order not to damage its brand, Maschinen GmbH decides to cancel the contract with an extraordinary notice of termination. At the same time Maschinen GmbH appoints a new distributor in India. Maschinen GmbH then receives a letter by DHL courier in which the lawyer of the Indian dealer advises that the dealer has filed suit against the dismissal in Mumbai and that a hearing on interim protective measures will take place two days later. The Maschinen GmbH company does not view the court in Mumbai as competent and is of the opinion that the summons has not been correctly or formally handed over. Some days later Maschinen GmbH receives, also via DHL, notice of the court ruling which provisionally bans Maschinen GmbH from commissioning a different authorised dealer or to be itself active in India. The new distribution partner of Maschinen GmbH is also sued in the same action.

What can be done now?

A defence in court has to be organised. An attempt has to be made to remove the provisional court order. In addition, own legal proceedings against the authorised dealer have to be prepared. In parallel, an attempt has to be made through negotiation to achieve a withdrawal of the legal action. This will require numerous personal meetings with the advisors and the parties. As a result, the authorised dealer seeks a face-saving solution and accepts payment of compensation.

What should one have done differently from the beginning?

In particular, when dealing with long-serving Indian contract partners it is urgently necessary to have a conflict strategy. Before notice of termination is given the risk of litigation should be exactly assessed. Temporary legal protection in India also threatens contracts which foresee a different legal venue. An intensively negotiated end of the contract with payment of a settlement and a loose further co-operation is frequently more economic than a confrontational approach. If a confrontation is unavoidable, the lodging of a pre-emptive brief and close monitoring of the court calendar will at least minimise surprises. A well prepared legal team can often effectively block attacks and strengthen the negotiating position.
Company Administration

Background facts:

The financial accounting processes in the Indian subsidiary were left over a number of years in the hands of the manager of financial accounting and his employee. Both had a good relationship to the auditor of the annual financial statement of the company. The audit of the financial statements always lasted a very long time, but ended with a successful result. From one week to the next the manager of the financial accounting now announces that he will leave the company because he has received a “better offer“. Immediately afterwards the second employee in the financial accounting department also hands in his notice and so a transfer does not take place.

It turns out that the documents of the financial accounting department are in an awful state. Representatives from the authorities appear, in particular from the tax authorities and trade control department, and announce demands based on formal obligations which due to insufficient data and a lack of understanding of the background are hard to comprehend or fulfil. There is a danger that a large supplementary payment must be made together with fines and even the closing of the business.

What can be done now?

The status of compliance of the tax and other obligations must be clarified as quickly as possible from the available data and as far as necessary from the inspection of records at the authorities. An analysis must be made of how the threats of the representatives of the authorities to close the business can be objectively countered. In practice the authorities accept the removal of shortcomings if the processes are professionally managed by a consultant to the company. Periods of notice can be extended through discussion with the authorities provided qualified consultants are at hand.

What should one have done differently from the beginning?

In India personal relationships quickly lead to a change of loyalty and therefore from a western point of view lead to “irresponsible“ behaviour (change of job, the taking of data). The introduction of a transparent system and a regular critical assessment in the area of the audit of the annual financial statement are necessary in order to secure business processes.

Rödl & Partner manages the financial accounting for many companies as an external service provider. This establishes a defined system of processing and the company is not affected by the change or incapacity of an individual employee.