Embassy of India
Berlin, Germany

MAKE IN INDIA MITTELSTAND!

Rödl & Partner

NEWSLETTER

Investment Support for German Mittelstand Enterprises

IN THIS ISSUE:

Contract Manufacturing in India

Introduction

Contract manufacturing, also known as outsourcing or third-party manufacturing, involves companies engaging a specialised manufacturing firms to produce goods on their behalf. It's a business agreement where one company pays another to provide the necessary components to assemble finished goods, or even manufacture the product in its entirety.

Suitability of contract manufacturing

In these competitive times, investors are demanding continued high financial and operational performance, under all circumstances. Thus, contract manufacturing should be opted for companies who often don't have the resources, budget, or staff to manufacture products on their own, especially during expansion into a new geographical territory. Companies could improve their bottom lines, by conversion of their fixed costs into variable costs. They accomplish this by eliminating in-house production capabilities and replacing them with contract manufacturers.

Contract manufacturing may not suit complex or unique products, sensitive Intellectual Property, or strict quality standards. It is unsuitable for products with unpredictable demand cycles, prototyping, and when long-term cost efficiency or strategic control is needed. In-house manufacturing is favoured for greater brand control, effective communication, or due to regulatory compliances.

Benefits of contract manufacturing

Contract manufacturing presents a cost-efficient avenue for businesses, minimising production expenses through economies of scale and access to affordable labour. Leveraging the expertise of specialised manufacturers allows companies to focus on their core competencies, such as marketing and innovation, while benefiting from advanced manufacturing technologies. The flexibility and scalability of contract manufacturing enable quick adjustments to market demands, reducing excess inventory and optimizing resources. Additionally, it mitigates operational risks and accelerates time-to-market, aiding in global market expansion. Overall, contract manufacturing offers an efficient and strategic approach to production, driving competitiveness and ensuring high-quality products for businesses.

Contract manufacturing in India

There are many market participants in India's contract manufacturing sector, and they provide full manufacturing services for a range of industries. The market for contract manufacturing in India stands at USD 19.63 billion in 2023, and it is estimated to be worth USD 38.92 billion by 2028[1]

Summary of the advantages of contract manufacturing in India:

- *Cost-Effectiveness: Lower production costs due to affordable labour and operational expenses.*
- *Favourable demographic profile: Maximum population in the working age group*
- *Skilled Workforce: Abundance of skilled workers across various industries.*
- *Diverse Industry Expertise: Specialised manufacturing across a range of industries.*
- *Government Incentives: The Indian government provides various incentives for the manufacturing sector, providing stable growth for the manufacturing sector.*
- *Market Access: Ease of access to India's growing domestic market as well as the Asian and Western markets.*

Legal framework in India

The term contract manufacturing has not been defined under laws in India, even though you might find references of contract manufacturing in certain laws. In simple words, contract manufacturing means outsourcing your manufacturing function to a third party through a legally tenable contract. Certain Indian laws which shall affect contract manufacturing activity in India are:

- Indian Contract Act, 1872: Governs basic contract principles.
- Income Tax Act, 1961: Regulates income taxation and transfer pricing.
- Goods and Services Tax (GST) Act: Governs in-direct taxation and compli -ance for goods and services.

1 According to Mordor Intelligence Research & Advisory on Contract Manufacturing in India Market Size & Share Analysis - Growth Trends & Forecasts (2023 - 2028). **See here.**

- Intellectual Property Laws such as the Patents Act of 1970, the Copyright Act of 1957, the Trademarks Act of 1999, and Designs Act of 2000 protect intellectual property rights of the owner.
- Customs Act, 1962: Regulates import and export of goods.
- Foreign Exchange Management Act (FEMA), 1999: Governs foreign exchange transactions.
- Environmental Laws such as the Environmental Protection Act of 1986, Water Act of 1974 and Air Act of 1981 shall govern the environmental impact of manufacturing, if any.

Crucial considerations

It is essential for companies looking to engage contract manufacturers to strategically protect their intellectual property and proprietary information which contract manufacturers become privy to. This mitigates the risk of infringement and allows principal companies to retain their competitive edge. Poorly managed intellectual property can lead to serious competition, in some cases from the contract manufacturer itself who may become a competitor, resulting in a diminished market and serious losses for the principal company.

Another critical point is control over the quality. It may be challenging to replicate the in-house quality of your products when you contract manufacture. Hence, it is very important to do the due diligence of the capabilities and capacities of the contract manufacturer before entering into a definitive agreement.

Conclusion

Contract manufacturing in India offers an attractive proposition for businesses seeking to optimize production processes and leverage cost advantages. Understanding the legal framework, intellectual property considerations, compliance with regulations, and taxation aspects is crucial for a successful contract manufacturing relationship. With careful planning and adherence to legal guidelines, contract manufacturing can be a mutually beneficial arrangement for both parties involved.

- ***Akash Valappil, Senior Associate, Roedl & Partner***
- ***Shraddha Bhosale, Senior Associate, Roedl & Partner***
- ***Sayan Mitra, Senior Consultant, Roedl & Partner***

India: New Facility introduced for non-residents to register on Indian Income Tax Website without tax registration (‘PAN’)

In an unexpected, but much-needed move favoring non-residents and foreign companies, the Indian tax department introduced a facility to enable non-residents and foreign companies to register on the Income Tax portal without obtaining a Tax Registration in India (“Permanent Account Number” or “PAN”). This move is expected to benefit foreign companies who have non-taxable transactions with Indian customers and are still exploring the Indian market and who have been facing challenges in receiving moneys abroad due to not having a PAN in India.

Until last week, foreign companies who did not have a PAN had been facing a challenge in dealing with their Indian customers due to the requirement of filing of Form 10F electronically for claiming treaty benefits. On the one hand, relaxations existed in the Indian Income tax law from furnishing PAN to Indian tax deductors/payors of income to such foreign companies on the basis of valid Tax Residency Certificate. Whereas, on the other hand, foreign companies who were desirous of availing beneficial rates as per the respective tax treaty of country of residence were required to file the Form 10F electronically by virtue of Notification No. 03/2022 dated 16 July 2022. These foreign companies were therefore mandatorily required to obtain a PAN because, procedurally, a PAN was required to create an account on the Income Tax Portal and in turn file a Form 10F.

Thus, for undertaking the Electronic Filing of Form 10F, non-residents were required to register on the Indian Income Tax website, for which a Permanent Account Number (‘PAN’) was inevitable.

In a welcome move, the Income tax department has introduced a facility to enable non-residents to register on the Income Tax portal without obtaining the PAN.

The Indian Income Tax Act provides an option to non-residents to discharge their tax liability either in accordance with the provisions of Income Tax Act or Double Taxation Avoidance Agreements (‘DTAA’) whichever is more beneficial.

However, in order to avail the benefit available under the DTAA, non-residents are required to fulfil certain conditions such as furnishing of Tax Residency Certificate ('TRC') issued by the local tax authorities. In case the TRC does not contain all the required details (like tax identification number, period, address, etc.) as mandated, non-residents are also required to furnish Form 10F. The CBDT mandated furnishing of Form 10F electronically last year.

For filing the Form 10F electronically, non-residents were required to register themselves on the Income Tax Portal with their PAN. Which meant, a PAN was necessarily required to be obtained by non-residents.

The Income Tax department has provided a functionality on the portal to allow non-residents without a PAN to register themselves.

In this connection, the following details are required to be furnished on the Income Tax Portal:

Basic Details such as Name of the taxpayer, Date of Incorporation, Tax Identification number and country of residence.

Key Person Details such as Full Name of the Key person, Date of Birth, Tax Identification number and designation of such key person

Contact Details such as Primary mobile number and Email ID, secondary mobile number and E-mail ID and Postal Address of non-resident. The primary mobile number and e-mail ID will be verified by way of an OTP.

Attachments The non-resident must upload
- ID Proof,
- Address Proof
- a copy of TRC on Income Tax Portal.

In respect of ID Proof and Address Proof, a non-resident is required to upload a document which is considered as valid document in his country of residency.

Basis the above and verification of OTP, the non-resident will receive a user ID on the registered email ID, through which login on the Income Tax Portal should be possible.

Once this is complete, it shall be possible to upload the Form 10F electronically upon submission of TRC and verification by way of OTPs sent on mobile and e-mail.

Return filing compliance:

It shall however be noted that, despite the above relaxation, where the tax treaty provisions are availed by non-residents, there is still an obligation on their part to file tax returns in India. The tax rate for income earned in the nature of Royalty, Fees for Technical Services ('FTS'), Interest and Dividends is 20 per cent under the Indian Domestic Tax law (increased for royalty and FTS to 20 per cent from 10 per cent*) from the Indian Financial Year 2023-24, whereas in most treaties, it is either 10 per cent or 15 per cent. **A general relaxation is provided from filing returns where the taxes are withheld as per rates provided for in the Income Tax Act provisions. In case the non-resident prefers to be governed by the beneficial treaty rates, it shall be obligated to file tax returns in India.**

In case of Fiscally Transparent Entities, the situation is tricky as very often the TRC is not granted and in the absence of TRC, the Form 10F cannot be filed. Such entities may be compelled to accept the higher withholding rate of 20 per cent if their customers do not accept their claim to the treaty provisions.

Thus, the new relaxation of permitting non-residents to register without obtaining a PAN and filing the Form 10F online seems to benefit those non-residents who do not wish to avail the beneficial treaty provisions. Therefore, depending upon quantum involved, non-residents could evaluate between foregoing the treaty rates vis-a-vis undertaking all compliances under the Income Tax Act, including that of obtaining PAN, and filing tax returns in India.

* please refer to our earlier News Flash on this topic: **India: Increase in tax rate for income earned in the nature of Royalty and Fees for Technical Services under the Indian Domestic Tax law | Rödl & Partner (roedl.com)**

- Chetan Kakariya, Partner, Roedl & Partner

- Priyanka Limaye, Associate Partner, Roedl & Partner

Mittelstand In Focus
Unlocking value through TReDS

Make in India Mittelstand, a pivotal initiative by the Indian government integrates a wide range of support services that German mid-sized companies can avail for entering the Indian market. Since its launch, collaborative efforts between the Government of India and the Reserve Bank of India (RBI) have resulted in several such initiatives focused on the ease of doing business in India for global entities. Through our Mittelstand in focus series, we will explore various initiatives that make India an attractive market. We start off with the Trade Receivables Discounting System (TReDS).

TReDS: An Overview

The growth engine of any economy, the Micro, Small, and Medium Enterprises (MSMEs)* sector is often constrained by inadequate access to working capital and financing. The RBI, in a responsive move, has introduced a pantheon of schemes and policies to augment financial inclusion for the MSME sector, with TReDS emerging as a notable initiative.

Rolled out in 2017, the RBI established TReDS platforms through comprehensive guidelines, designed to ease the accessibility of bank financing at competitive rates for the MSME sector and timely payments from large corporates.

With digital and automated workflow, TReDS emerges as a formidable enabler for corporates to support their MSME suppliers, by activating a stable and efficient working capital financing mechanism. The TReDS platform seamlessly connects buyers, suppliers, and financiers in one place, fostering a collaborative and efficient transactional workflow in a regulatorily controlled environment, giving an opportunity to suppliers/buyers to choose their bid among the financiers, thus also helping them reduce their overall cost on the financing availed.

TReDS offers non-recourse financing to MSMEs backed by unconditional payment undertaking from buyers, thus embedding a culture of timely payments to buyers and financial stability to suppliers. The RBI further strengthened this by including TReDS exposure under the Priority Sector Lending (PSL)** policy as an exception, thereby incentivizing banks to offer competitive rates and encourage higher engagement on the platform.

Currently, under the governance of the Payments and Settlement System (PSS) Act 2007 of the RBI, five entities have been licensed to operate TReDS platforms, of which three are already live.

The parties on the TReDS platform and their roles

Party	Eligibility	Role
Buyer	All corporates and public sector undertakings are eligible to onboard on TReDS platform. However, as per a Gazette notification, all the corporates having turnover of more than INR 5 billion (~EUR 56 million) must mandatorily get registered on at least one exchange.	Buyers would provide their acceptance on the invoices submitted by their supplier.
Supplier	Only MSME sellers as per the Micro, Small and Medium Enterprises Development Act, 2006 are allowed to be on-boarded	Suppliers will upload their invoices on the platform to avail early payment.
Financier	All banks and non-banking financial companies (NBFCs)	Financing of invoices through bidding

Workflow and Documentation

The TReDS platforms revolutionize the financial landscape for MSME suppliers, offering a streamlined platform to list their receivables from prominent corporates, ensuring timely and efficient financing from banks or NBFCs. Following the submission of invoices by suppliers and acceptance by buyers, financers extend their bids to purchase these receivables in the open market, where the supplier/buyer is free to select the bid/financer of their preference. The financing over TReDS is enabled under the Factoring Act, 2011, ensuring legally enforceable seamless financing to suppliers on a without-recourse basis.

The fundamental functionalities of TReDS are:

Agreement Execution: TReDS ensures the execution of comprehensive agreements with suppliers, buyers, and financiers; ensuring seamless financing of invoices by financiers with settlement of monies through National Automated Clearing House (NACH).

Invoice Upload: Suppliers or buyers can conveniently upload invoices, with adequate acceptance from the buyer to make payment on the due date.

Bidding: TReDS fosters a competitive bidding environment, where financers actively bid to finance invoices, and suppliers or buyers can select the most favourable bids from their preferred financier.

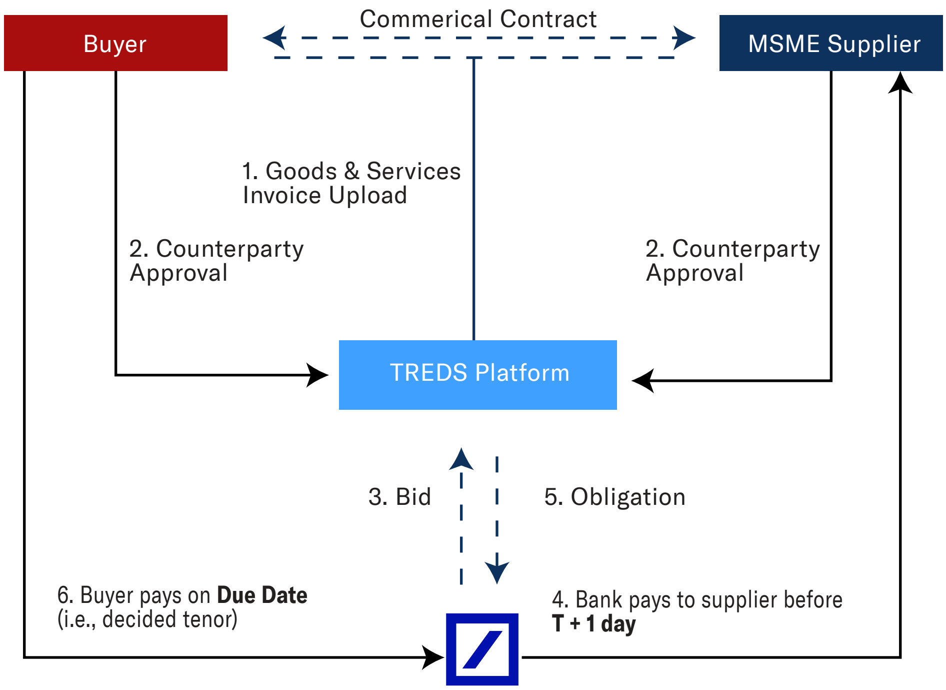
Settlement: On the maturity date, TReDS ensures efficient settlements, transferring funds from the buyer's account to the financer, ensuring financial fluidity and reliability.

KYC and Documentation: TReDS takes the helm in managing all necessary Know You Customer (KYC) documentation, ensuring compliance and ease of transaction for all parties involved. RBI has allowed financers to leverage on the KYC performed by TReDS to enable one-time documentation and operational efficiency.

Transaction Flow on TReDS

TReDS optimises transaction flow, leveraging the NACH system to mitigate settlement risks, ensuring seamless and risk-free transactions for all parties involved.

Here is a brief overview of the process:



Advantages for Suppliers

- **Enhanced Access to Financing:** Suppliers can enjoy improved access to low-cost unsecured without-recourse financing, with banks offering rates based on the buyer's credit standings.

- **Competitive Pricing:** As financing over TReDS is eligible for Priority Sector Lending classification as per RBI regulations, sellers receive financing at competitive pricing.

- **Digitalised Workflow:** Suppliers can experience a digitalised workflow solution with seamless settlements and automated reconciliation, leading to optimised operations.

- **Streamlined KYC Process:** A one-time KYC documentation is required on the TReDS platforms, avoiding the need for repeating this process when choosing a different financer or buyer.

Advantages for Buyers

- **Extended Payment Terms:** TReDS enables an extension in payment terms up to 180 days, offering flexibility and financial ease.

- **Automated Payment Process:** TReDS digitise and automate the payment process on due date for buyers, ensuring compliance with payment terms.

- **Regulated Operations:** All TReDS platforms operate under the meticulous guidelines issued by the RBI, ensuring reliability and compliance.

- **Streamlined KYC Process:** Just as suppliers, buyers too, only need to complete the KYC process once, avoiding the need for it when changing a supplier or financier.

Deutsche Bank's Support to Clients

Deutsche Bank remains a steady ally to clients navigating the TReDS landscape. It is one of the leading multinational banks that is integrated with all three exchanges on TReDS and has established limits with various clients, reflecting a growing interest and engagement in this domain.

The bank offers informative assistance to corporates in relation to the TReDS platforms, aiding in the registration process for corporates and their suppliers, and providing necessary support for seamless interactions with the TReDS platforms.

More information about TReDS is available on the **RBI website.**

**MSME entities are defined by their capital and turnover. As per MSME Act, 2006, entities with capital up to INR 1 crore of investment and turnover up to INR 5 crore are defined Micro entities, entities with capital up to INR 10 crore of investment and turnover up to INR 50 crore are defined Small entities, and entities with capital up to INR 20 crore of investment and turnover up to INR 100 crore are defined Medium entities.*

*** Priority sector lending (PSL) is a lending requirement administered by the RBI, requiring banks to give a minimum proportion of their loans to sectors of development importance or the sectors that don't have access to bank loans.*

Upcoming Events

Make in India for the World: Visit of Invest India Delegation to Germany

Berlin | 14.11.23

11:00 – 12:30 CET
Register here for the event.

India-Germany Digital Partnership: German Mittelstand Meets Indian IT Industry (NASSCOM)

Berlin | 23.11.23

15:30 – 17:30 CET
Register here for the event.

“Make in India Mittelstand!” Meets Thüringen: Business Opportunities in India

Erfurt | 28.11.23

16:00 – 18:30 CET
Register here for the event.

Stay tuned for many more events!

About MIIM

MIIM' is a market-entry support programme for German Mittelstand and family-owned enterprises launched by Embassy of India Berlin, Germany in 2015; driven by Government of India's national programme, 'MAKE IN INDIA'.

The objective of MIIM programme is to facilitate investments by German Mittelstand and family-owned companies in India and to provide market entry related services.

The MIIM program has enrolled more than 177 companies which represent a cumulative declared investment of 1.63 bn EUR to India.

As a part of MIIM program members are exposed to a wide range of business support services under a single platform. The program is being implemented with the support of its Knowledge Partner – Rödl & Partner, Facilitation Partners including Central and State Government Ministries in India and also key industry partners who can support the companies in various aspects of market entry into India. Offered services includes Strategy consulting, M&A, operational market entry support, tax & legal support, financial services and other services

MAKE IN INDIA MITTELSTAND!

Rödl & Partner - Exclusive Knowledge Partner

Investment support for German Mittelstand Enterprises

MIIM Team

MRS. RACHITA BHANDARI
Head MIIM Project Team
Deputy Chief of Mission
Embassy of India, Berlin

MR. SAKETA MUSINIPALLY
Deputy Head - MIIM Project Team
First Secretary
Embassy of India, Berlin

MR. MARTIN WOERLEIN
MIIM Project Team
Head of India Practice
Rödl & Partner

MIIM Hotline:

Email: miim@indianembassy.de | Phone: +49 30-25795514 | Fax: +49-30-25795520

MIIM Team

www.makeinindiamittelstand.de

www.facebook.com/IndiaInGermany

www.twitter.com/eoiberlin

www.linkedin.com/in/miim-make-in-india-mittelstand

Herausgeber/Editors:
Embassy of India

Embassy of India
Tiergartenstraße 17
10785 Berlin
Deutschland/Germany
https://indianembassyberlin.gov.in/
miim@indanembassy.de

Verantwortlich für Inhalt, Layout, Satz /
Responsible for content and layout :

Embassy of India
Tiergartenstraße 17
10785 Berlin
Deutschland/Germany
https://indianembassyberlin.gov.in/
miim@indanembassy.de

EMBASSY OF INDIA
BERLIN

INVEST INDIA
NATIONAL INVESTMENT PROMOTION
& FACILITATION AGENCY

MAKE IN INDIA MITTELSTAND!

Rödl & Partner

Driving Growth:

Sector Overview and Opportunities in India's Automotive Industry

Our report on India's Auto Sector has just been published! Download the report here for some exclusive and comprehensive insights on the sector and relevant tax and regulatory aspects!

MAKE IN INDIA