SANNAM S4
MARKET ENTRY SIMPLIFIED

The Indian Education Sector—Navigating the Tax and Legal Framework

WHITE PAPER

FINANCE

INDIA | BRAZIL | CHINA

OVERVIEW

India is an extremely attractive market for international organisations looking to invest in the education sector. Low literacy rates, huge demand-supply gaps in higher education infrastructure, a low employable population, a growing per capita income, and an increased concentration of population in urban areas—has created a huge untapped market for the foreign players in the regulated and non-regulated segments.

This huge demand-supply gap can be filled by international institutions either by offering courses in India or through study opportunities abroad. Foreign investors are also looking at collaborating with Indian institutions for research projects, twinning/dual degree programmes, faculty/student exchange programs, distance education/e-learning platforms and joint research programs.

INVESTING IN INDIA: KEY CHALLENGES

The current regulatory framework for the education sector provides for 100% Foreign Direct Investment [FDI] to organisations looking to invest in higher education. However, other related regulatory issues still control the actual flow of FDI. The major concerns surround education being regarded as a not-for-profit activity in India. Only registered societies/trusts, and not-for-profit companies registered under section 8 of the Indian Companies Act, 2013 are allowed to establish formal educational institutions. Another continuing problem is the absolute lack of clarity regarding the existing regulations across the board. An example is the differing sets of regulations which exist for research and executive education vis-à-vis college education.

Regulatory Challenges:

- The *All India Council for Technical Education (AICTE)*[1], permits section 8 companies to act as sponsoring bodies to technical institutes with a clause that no foreign investment (directly or indirectly) is allowed in the education sector. At first glance, this clause would appear to block foreign investment in all AICTE regulated technical institutes.
- AICTE has also set regulations for international universities that intend to start collaborative/joint courses with Indian educational institutions in technical education. Some of the key features are:
    - The fee structure and number of seats will be recommended by AICTE.
    - The degree/institution must be recognized by the home country.
    - It is mandatory for degree granting institutions to be affiliated to or tied-up with an Indian university with a legal setup.
- The *University Grants Commission (UGC)*[2], under "Promotion and Maintenance of Standards of Academic Collaboration between Indian and Foreign Educational Institutions Regulations" 2012, granted approval to twinning (collaborative/joint courses) arrangements. This regulation insists that:
    - To collaborate with Indian institutions, the foreign university must be noted among the top 500 in either the Times Higher Education World University Ranking or Shanghai Jiaotong ranking lists.
    - An Indian institution must have a high accreditation grade from National Assessment and Accreditation Council (NAAC) or National Board of Accreditation (NBA) to be eligible for collaboration with an international university.

WHAT FOREIGN EDUCATIONAL INVESTORS NEED TO KNOW

- Education continues to be seen as a 'not-for-profit' business.
- The Foreign Education Providers Bill may make a comeback and open doors for foreign institutions to participate in Indian Higher Education.
- The new government has initiated a separate ministry to manage skill development. A new education and skills development policy is set to be announced by May 2015.
- The government plans large-scale investments in the areas of e-learning/ Massive Open Online Course (MOOCs).
- 'Make in India', 'Digital India' and the '100 Smart Cities' projects will leave their mark on most new initiatives in the next five years. These will include indigenous programmes and products such as SWAYAM (a MOOC platform), GIAN (Global Initiative of Academic Networks), and establishing IIMs/IITs in every state.
- The National Skills Development Corporation (NSDC) is keen to work with international institutions and academic bodies to set up local community colleges.
- Government reform plans include the scrapping of four year undergraduate programmes (FYUP), restructuring the planning commission and overhauling the university grants commission (UGC).

[1] A national level Apex Advisory Body that manages technical education and promotes development in the country.

- An agreement between the Indian and foreign institution requires UGC approval for initiation of the collaboration.
- A franchise agreement is not permitted.

■ FDI regulations have no specific guidelines that describe in-depth the rules and regulations that a foreign investor must follow in order to set up a not-for-profit/trust/society in India.
- The pre-conditions prescribed in the AICTE/UGC guidelines make it difficult to plan a market entry strategy and require careful assessment.
- For profit making entities, 100% FDI under the automatic route is currently allowed. However, for setting up a limited partnership, liaison/branch/project office, prior approvals by the India central bank (RBI) is required.

■ The foreign investment in a 'not-for-profit entity' requires approval by the Union Government under the Foreign Contribution Regulation Act 2010 (FCRA). As per FCRA, the foreign funds should be utilized for the welfare purpose or activities in line with the objectives. Thus, no profits can be distributed to the shareholders in any form whatsoever.

■ The Foreign Educational Institutions (Regulation of Entry and Operations) Bill, introduced in 2010 to regulate the entry and operation of foreign educational institutions is still pending before the Indian Parliament.

Tax concerns:

■ In India, 'taxability' is determined by whether the foreign university has a 'taxable presence' (based on the duration of stay of faculty/staff, and access to premises/space at disposal). If the university has a 'taxable presence', then the tax rate could be as high as 40%. Further, different tax systems and rates apply depending on the type of entity setup.

■ Tax benefits for educational institutions are helpful, but have many restrictive covenants attached.

■ Services rendered by international educational institutions may be liable to service tax (12.36%), which is otherwise exempted.

■ Non-compliance to withholding tax obligations will lead to tax, multiple interest and penalty exposures, many of which are time-based.

OVERCOMING THE CHALLENGES:

Careful assessment, planning and implementation is needed. For foreign institutions an organisational structure conducive to doing business in India from a tax and regulatory perspective can be created by:

■ **In-depth Knowledge of the legal, financial, tax and regulatory framework. Seek advice. An experienced service provider should:**
- Help prepare a suitable structure for the India business, keeping in mind tax and regulatory concerns.
- Help mitigate global tax implications through appropriate planning.
- Support in setting up a legal presence and obtain necessary registrations and approvals.
- Assist with day-to-day payroll, HR and expense management.
- Provide expert advice on financial, regulatory, accounting and tax issues, and support with day-to-day compliances requirements.
- Draft and review agreements from a tax and regulatory perspective.

WHAT YOU NEED TO KNOW ABOUT TAXATION IN INDIA

Educational institutions must consider their eligibility for claims on Tax Treaty benefits and taxability of incomes earned from India, when planning any arrangements with Indian parties.

■ **Direct Taxes:** Tax rates range from 30-43%, depending on the type of entity structure.

■ **Transfer Pricing:** India contributes to over 70% of the transfer pricing disputes worldwide, so be very careful while structuring inter-company transactions to avoid litigation and adverse tax implications.

■ **Withholding Taxes:** Foreign players need to understand implications of domestic and international withholdings, and be mindful of the compliance requirements that come along with such tax costs.

■ **Indirect Taxes:** A multitude of indirect taxes with varying state laws exist across India. It is essential to understand their rates, credit mechanism and the compliance requirements involved. Also, do note that the Modi government has proposed a comprehensive Goods and Services Tax bill which will change the structure of indirect taxes in India.

■ **Double Tax Avoidance Treaties:** It is imperative that foreign universities also take into account the implications under tax treaties between India and its home country to avail reduced tax rates, and to avoid the cascading effect of taxes. Specific attention should also be given to definitions for permanent establishments (PE).

■ **Taxability on Individuals:** Tax on individuals (non-residents) depends on residential status which is determined by the number of days of stay in the country. Benefits may be available to be examined on case-to-case basis.

■ **Tax Benefits:** Various tax exemptions are also available for not-for-profit institutions in India. However, obtaining approvals and observing annual compliances/ conditions sometimes becomes an arduous task, especially for multinational institutions.

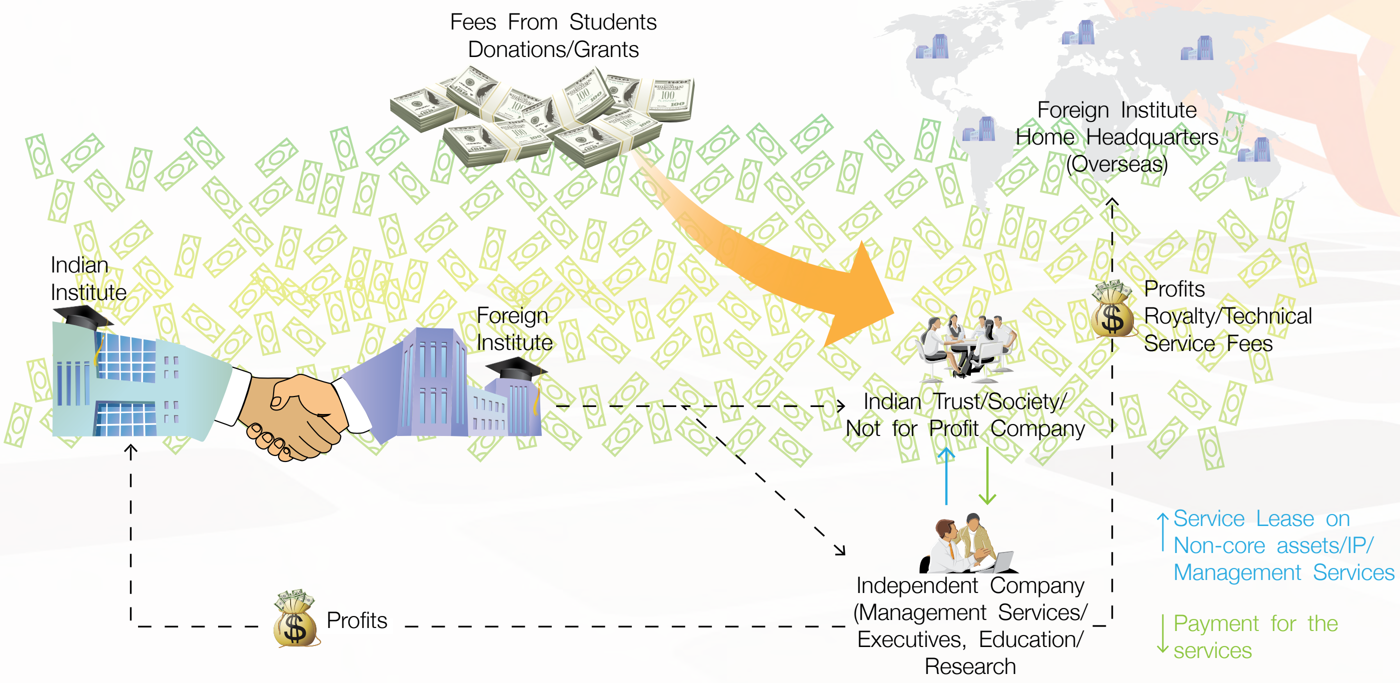
[2] A statutory organisation set up by the Union Government for coordinating, determining and maintaining the standard of university education in India.

Case Example:

- A US university wanted to ensure maximum coverage for its leading schools across the Indian sub-continent. Sannam S4 not only helped them set up a liaison office, but also provided on-going business support relating to the accounting, tax, financial, compliance and regulatory challenges.
- A top US Institute of Technology wanted to effectively manage their existing Indian trust. They needed advice/support on various tax and regulatory matters. Sannam S4 delivered a unique 'on-call advisory' model with the institute to cater to the complex fiscal, compliance, HR, tax and accounting demands of doing business in India.

For many universities, planning through tax friendly jurisdictions like Singapore and Mauritius is a beneficial way to mitigate global taxes

- **Ensure quarterly review and assessment of Permanent Establishment (PE) situation:** Foreign Professors/staff visiting India for prolonged periods (say, six months to a year) can introduce PE implications, with adverse tax repercussions at a global level. This amounts to a 40% (+surcharge and cess) on the "apportioned" income to the institute. The tax office will allocate a calculated figure of the global income and render it taxable in India, as it is attributed to income sourced from Indian operations. The time defined for the tax treaty with USA, UK, Australia and Canada is 90 days in any 12 month period. Due care must be taken to ensure that such a breach is not triggered, and there is an appropriate mechanism in place to assess and review a PE situation.
- **Setting up the correct business structure**
  A typical business structure for a 'not-for-profit' organisation is:



- **On-the-ground representation:** This is vital to create partnerships/research collaboration ties with educational institutions; manage and support the existing agent network; and engage with Indian universities to facilitate student exchange programs.

Case Example:

- A UK university needed to enhance its presence and provide effective on-the-ground support to students and agents. Sannam S4 recruited two sector experts to deliver a strong representation and support for the university in India as well as in neighboring countries, Sri Lanka and Indonesia. This resulted in wider access to students and agents. The client was able to extend more support to its direct applicants. In a difficult market, the client continued to grow. They have forged relationships with multiple Indian institutions and are starting to deliver programmes in India. Sannam S4 also provided clear advice on financial, tax and regulatory compliances which were related to this project.
- An American university was looking to establish a private school in India. Sannam S4 developed the financial modeling under different scenarios—preliminary cash flow model and a projected breakdown of ideal inflows and outflows over 10 years. The client was advised on how to best fund the additional cash requirements from external /internal sources.

CONCLUSION

By 2020, India will be the third largest economy in the world. Driven by economic and demographic growth, the Indian higher education system will see an extraordinary transformation in the coming decade.

For foreign institutes, the market continues to be highly attractive. However, it is vital to fully understand the regulatory framework and the tax issues surrounding not-for-profit organisations in India and how to repatriate funds whilst remaining compliant with the set regulations. Selecting a local partner, experienced in managing tax and regulatory compliance in this sector should be a priority.

KAPIL DUA

CFO and Director, Financial Consulting

E: kapil.dua@sannams4.com

ABHINAV SOOD

Deputy Manager - Tax

E: abhivav.sood@sannams4.com

SANNAM S4
MARKET ENTRY SIMPLIFIED

ABOUT SANNAM S4

Sannam S4 helps international educational institutions enter, establish and prosper in India.

Our business model is unique in that from the outset we proactively seek new revenue opportunities in the market for our clients and then we help them implement and manage these opportunities longer term.

Our teams comprise of dedicated local and international specialists delivering market research, company structuring, compliance, finance, tax, accounting, inward investment, partner/distributor due diligence, business development.

In India, Sannam S4 has offices in New Delhi, Mumbai, Chennai, Pune, and Bangalore.

Sannam S4 also operates in Brazil and China.

LONDON
Tel: +44 (0) 203 3030025

LOS ANGELES
Tel: +1 (888) 860 2195

NEW DELHI
Tel: +91 (0) 11 4212 4100

www.sannams4.com

E. consult@sannams4.com