

## **Various Legal Challenges facing in set up of Multinational Corporations in India**

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### **Abstract**

India remains one of the fastest growing large economies globally, offering substantial market opportunities, a large consumer base, rising incomes, and government incentives for foreign direct investment (FDI). However, setting up Multinational Corporations (MNCs) in India involves navigating a complex legal and regulatory environment. This paper examines the legal challenges that foreign companies face in their entry, establishment, taxation, licensing, intellectual property, corporate governance, dispute resolution, and regulatory compliance. It draws on recent case studies (e.g. Volkswagen, Paytm, Myntra, Vodafone, Cairn Energy) to illustrate specific difficulties. The analysis underscores how overlapping laws, retrospective changes, ambiguous regulations, and enforcement delays increase risk for MNCs. Finally, the paper offers policy recommendations aimed at clarifying laws, reducing uncertainty, improving dispute resolution mechanisms, and balancing regulation with investor confidence.

### **Introduction**

India has, over the past few decades, opened substantially to foreign investment. Policymakers often highlight the importance of MNCs in bringing capital, technology, management expertise, and access to global supply chains. Initiatives like Make in India, Digital India, and various state-level investment incentives are intended to attract foreign players.

Yet, the legal environment—comprising statutes, regulations, administrative policy, and judicial / quasi-judicial enforcement—often poses challenges. These include: delays, regulatory overlap, changing rules (sometimes retrospective), uncertain interpretation, heavy compliance burdens, and disputes over taxation, customs/import duties, and foreign exchange control.

This paper explores the major legal hurdles faced by MNCs in India, using recent developments and case studies, analyses their implications, and proposes reforms to make India more attractive for sustainable multinational operations.

## **Regulatory & Entry-Level Challenges**

### **Foreign Direct Investment (FDI) Policy and Sectoral Caps**

India's FDI regime is governed largely through the Foreign Exchange Management Act, 1999 (FEMA), rules made under it, and the Consolidated FDI Policy as notified periodically by the Department for Promotion of Industry and Internal Trade (DPIIT). In many sectors, FDI is permitted under an automatic route; in others, approval of the government is required. Sectoral caps, ownership restrictions, and security-clearance requirements apply in sensitive sectors (defence, telecom, media, financial services etc.).<sup>1</sup>

Recent policy ambiguity arises with overlapping jurisdiction among regulators (e.g. RBI, SEBI, DPIIT), leading to uncertainty. Fintech / digital finance firms often face dual regulation. Also, beneficial ownership definitions, press notes (e.g. Press Note 3 of 2020) restricting investment from specified nations or via shell / intermediary companies have added layers of approval and scrutiny. These raise questions of due process, timelines, and clarity.<sup>2</sup>

### **Incorporation & Company Law**

Under the Companies Act, 2013, an MNC setting up a subsidiary (or branch, liaison office) must comply with registration requirements, appoint directors (often at least two), maintain certain key managerial personnel (CEO, CFO, company secretary), hold board meetings, file financial statements, audit requirements, etc.

Non-compliance with such appointments or other corporate formalities can lead to penalties. For example, an MNC was penalised about INR 24 lakh for failure to appoint a Chief Financial Officer timely; another for failure to appoint a company secretary on time under Section 203 of the Companies Act.<sup>3</sup>

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<sup>1</sup> <https://www.linkedin.com/pulse/fdi-india-legal-framework-compliance-key-investment-fcemc/> FDI in India: Legal Framework, Compliance & Key Investment Sectors"

<sup>2</sup> Government of India, Foreign Exchange Management Act, 1999 (FEMA)

<sup>3</sup> Companies Act, 2013

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## **Foreign Exchange, Beneficial Ownership, and Reporting Obligations**

FEMA rules require that foreign investments be reported, that pricing guidelines in case of inbound investment are adhered to, and that foreign investments via certain routes be cleared. Companies must disclose beneficial ownership, especially when investment comes from jurisdictions or via entities that obscure the identity of the ultimate owner.

Violations of reporting obligations, or failure to comply with government/RBI issued pricing guidelines, can lead to large notices and enforcement action. The Paytm case is a recent example: India's Enforcement Directorate alleged violations of FEMA in foreign investments and delayed reporting.

## **Taxation, Customs, and Import-Duty Disputes**

### **Tax Residency, Permanent Establishment, and Source vs. Residence**

Determining the tax liability of foreign entities depends on whether they are considered tax residents or have a permanent establishment (PE) in India under Indian Income Tax law as well as relevant Double Taxation Avoidance Agreements (DTAAs).

A notable recent ruling: the Delhi High Court held that multi-national companies, even if loss-making globally, but having a permanent establishment in India (subsidiary, liaison office, etc.), must pay taxes on income attributable to their Indian operations.

Disagreement often arises over what constitutes a PE, how much of value addition or activity is “fixed” in India, etc. Ambiguity here raises risk of unexpected tax liabilities.

### **Transfer Pricing and Mutual Agreement Procedure (MAP)**

MNCs have to price intra-company transactions (goods, services, intangibles) at “arm’s length” under the transfer pricing rules. Disagreements over transfer pricing often result in litigation.

India has made efforts to resolve cross-border tax disputes via MAP under tax treaties. For instance, between April 2014 and December 2018, ~600 tax disputes were resolved under MAP. The government amended rules (e.g. Rule 44G) to encourage resolution within 24 months.

### **Retrospective Taxation & Regulatory Changes**

Historically, India had controversial retrospective tax amendments (notably in 2012) which allowed taxing transactions undertaken before the amendment date. Cases such as Vodafone and

Cairn Energy exemplify how retrospective tax laws undermine predictability. Although retrospective taxation has largely been abolished, legacy cases still hang over investor confidence.<sup>4</sup>

### **Customs & Import Duty Disputes**

Import duties and customs classification can pose major cost risks. Misclassification of imported goods (e.g., whether a set of parts constitutes a Completely Knocked Down (CKD) kit versus individual component imports) can make a big difference in duty rates (which could be between ~5-15% vs 30-35%). Foreign automakers Kia, BYD, Volkswagen are involved in disputes over import-duty classification.

The Volkswagen tax demand of approx USD 1.4 billion is a high profile example: authorities alleged misclassification of imports to lower duties. Volkswagen has challenged in Mumbai High Court that the demand is inconsistent with import tax rules.

### **Regulatory Uncertainty, Overlapping Regimes, and Compliance Burdens**

#### **i) Ambiguity & Overlapping Legal/Regulatory Frameworks**

An MNC may be subject to multiple overlapping jurisdictions/regulators (e.g. DPIIT, RBI, SEBI, Ministry of Corporate Affairs, state governments). Rules under FEMA, FDI policy, company law, tax law often intersect, sometimes conflicting or being silent, causing uncertainty.

For example, fintech / payments / digital service companies may need to satisfy both SEBI and RBI regulation, which can have diverging standards. Data protection and data localisation requirements (e.g., under the Digital Personal Data Protection Act, 2023) add additional legal obligations for tech MNCs.

#### **ii) Approval Delays, Bureaucratic Procedures, and Licensing**

Even where law provides clear entitlement or route (automatic FDI), in practice many approvals, registrations, licenses, and clearances take time. The need for state government clearances, land acquisition, infrastructure, environmental clearances, and municipal / zoning permissions adds layers of delay.

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<sup>4</sup><https://timesofindia.indiatimes.com/govt-amends-i-t-rules-for-faster-resolution-of-multinational-corporations-tax-disputes-under-map/articleshow/75604944.cms?> "Govt amends I-T rules for faster resolution of multinational corporations' tax disputes under MAP - Times of India"

Procedural requirements (e.g. KYC, outward remittance under LRS, foreign exchange approvals) can also be burdensome. Enforcement agencies increasingly ask for compliance with rules and rectification of past lapses before allowing new permissions (as in Overseas Direct Investment etc.).<sup>5</sup>

### **iii) Compliance Costs, Penalties & Retroactive or Ex Post Interpretation**

Penalties for non-compliance with even technical regulations (e.g. appointment of key managerial personnel) can be steep. MNCs often incur expense in legal, accounting, regulatory advisory. There is also risk that regulatory authorities retrospectively interpret existing law or policy to allege breach, as in import classification, valuation, or FDI route compliance.

FDI violations (or alleged violations) can attract not just financial penalties but also reputational risk and regulatory investigations (often by agencies like ED – Enforcement Directorate), Customs, Income Tax, etc. The Myntra case (alleged FDI violation of about 1,654 crore) under the ED is illustrative.

### **iv) Intellectual Property, Data Laws & Localisation**

For many MNCs, IP rights and protection are key. India has strengthened its IP regime, and is a member of major international treaties. However, there are practical issues: delays in registration, enforcement times in courts, piracy/counterfeiting, and variability of enforcement across states.

Data protection, data localisation, cross-border data transfer rules have come into greater focus, particularly for tech MNCs. The requirement to store certain categories of data locally can impose costs, affect cloud strategies, infrastructure planning, and raise concerns about privacy and security.

Although recent acts (such as Digital Personal Data Protection Act, 2023) are intended to provide clarity, there remain grey areas in defining “sensitive personal data”, exceptions, compliance obligations, as well as enforcement mechanisms.

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<sup>5</sup> <https://evmagazine.com/news/foreign-automakers-kia-vw-byd-face-tax-disputes-in-india/> "Foreign Automakers Kia, VW & BYD Face Tax Disputes in India | EV Magazine"

### **v) Dispute Resolution, Judicial & Arbitration Risks**

India has improved availability of arbitration and commercial courts, but delays in litigation remain common. Enforcing contracts, obtaining judicial remedies, or challenging regulatory decisions may involve long proceedings.

There is risk connected with investor-state arbitration (especially legacy cases involving retrospective laws), treaty protections (e.g. Bilateral Investment Treaties (BITs)), and the interaction between domestic courts and international arbitration.

Courts sometimes take broad interpretations (e.g. Delhi High Court's ruling about loss-making MNCs paying tax on Indian operations even before global profits) that may surprise businesses. Such unpredictability increases risk premiums for foreign investors.<sup>6</sup>

Mutual Agreement Procedure (MAP) under tax treaties is one mechanism for resolving cross-border tax disputes. But although there has been policy reform to bound timelines (e.g. 24 months objective), actual time and outcomes may still vary.<sup>7</sup>

### **Case Studies**

#### **Volkswagen vs India – Import Duty / Classification Dispute**

Volkswagen (Skoda Auto Volkswagen India) was served a tax / customs demand of ~US\$1.4 billion, alleging misclassification of imported parts: company claimed that many components were imported separately and did not form CKD kits, thus eligible for lower duties; authorities challenged that view. The dispute raises issues of clarity in classification, retrospective or long-standing obligations, interpretation of customs law, and investor risk.<sup>8</sup>

#### **Paytm & FEMA / Foreign Exchange Violations**

India's ED alleged that Paytm and its subsidiaries violated the Foreign Exchange Management Act by not properly reporting foreign investment, not adhering to pricing guidelines, and delays in

<sup>6</sup> <https://economictimes.indiatimes.com/tech/startups/ed-files-fema-case-against-myntra-for-rs-1654-crore-fdi-violation/articleshow/122855101.cms?> "ED files Fema case against Myntra for Rs 1,654 crore FDI violation"

<sup>7</sup> <https://www.reuters.com/business/autos-transportation/Volkswagen-sues-India-to-quash-enormous-1.4-billion-tax-demand-legal-filing-shows>

<sup>8</sup> [https://www.business-standard.com/companies/news/here-re-the-foreign-companies-embroiled-in-tax-disputes-with-govt-125020501398\\_1.html?](https://www.business-standard.com/companies/news/here-re-the-foreign-companies-embroiled-in-tax-disputes-with-govt-125020501398_1.html?) "Here're the foreign companies embroiled in tax disputes with govt | Company News - Business Standard"

compliance. This shows how fintech / payments businesses with complex investment structures are vulnerable to foreign exchange regulatory oversight.

### **Myntra & FDI Violations Case**

The Enforcement Directorate filed a case against Myntra for alleged breaches of FDI regulations, involving a large sum (1,654.35 crore). It illustrates how e-commerce platforms, ownership structures, inter-company investments, and reporting obligations are under rigorous scrutiny.

### **Vodafone and Cairn Energy – Retrospective & Treaty Disputes**

Vodafone: had a long dispute over whether the transfer of shares in a foreign country (acquiring an Indian company) is taxable in India. Initially Supreme Court sided with Vodafone (2012) but then retrospective tax changes prompted renewed claims and investor concern. Eventually, via international arbitration Vodafone won. ([Business Standard][9])

Cairn Energy: similar issues with retrospective taxation, treaty protection, and delays. Ultimately, a settlement was reached after international arbitration. ([Wikipedia][10])

### **Implications for MNCs & Investor Confidence**

**Risk Premiums & Cost of Capital:** Uncertainty in tax, regulatory stability, or classification leads investors to demand higher returns or include risk mitigation clauses (higher transfer pricing, large provisions for litigation, etc.).

**Strategic Planning Difficulties:** Difficulty in forecasting costs (tax, duties, compliance) complicates investment, pricing, supply chain, and manufacturing decisions.

**Reputation & Compliance Burden:** Investigations (e.g. under FEMA, ED, Customs) can harm reputation. Costs of compliance (legal, accounting, regulatory advisors) are high. Non-compliance may lead to heavy fines.

**Delays & Opportunity Costs:** Time delays in approvals, clearances, litigation or MAP processes can lead to missed market windows, cost overruns, or discouraged investment.

**Perceived Unfairness & Policy Volatility:** Retrospective laws, sharp changes in interpretation, or regulatory actions create perception of risk, reducing attractiveness compared to other jurisdictions with more stable frameworks.<sup>9</sup>

### **Legislative, Judicial & Policy Reforms: Recommendations**

Based on the foregoing, the following recommendations may help improve the legal environment for MNCs in India, increasing predictability, reducing friction, and enhancing investment inflows.

| Area                             | Proposed Reform/initiative                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|----------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Clarity & Predictability in Laws | <ul style="list-style-type: none"><li>• Define critical concepts clearly (beneficial ownership, permanent establishment, import classification) via statute or authoritative rules.</li><li>• Avoid retrospective changes; ensure that legacy cases are addressed transparently. &lt;br&gt;</li><li>• Harmonise overlapping regulation (e.g. reconcile differences between FEMA, income tax law, customs, company law, and sector-specific laws).</li></ul> |
| Streamlined Regulatory Processes | <ul style="list-style-type: none"><li>• Establish fixed timelines for approvals under government route, clear policies on documentation and processing.<ul style="list-style-type: none"><li>• Enhance use of single-window clearance systems at central and state levels.</li><li>• Reduce procedural burdens for compliance across multiple regulators; better coordination among ministries/regulators.</li></ul></li></ul>                              |
| Tax and Customs Reform           | <ul style="list-style-type: none"><li>• Strengthen tax treaty network and ensure MAP / advance pricing agreement (APA) mechanisms function efficiently with bound timelines.</li><li>• Enhance capacity of customs authorities to provide advance rulings on classification and valuation.</li></ul>                                                                                                                                                        |

<sup>9</sup>[https://en.wikipedia.org/wiki/Cairn\\_Energy\\_and\\_Government\\_of\\_India\\_dispute?](https://en.wikipedia.org/wiki/Cairn_Energy_and_Government_of_India_dispute?) "Cairn Energy and Government of India dispute"

|                                           |                                                                                                                                                                                                                                                                                                                                                                                |
|-------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                           | <ul style="list-style-type: none"><li>• Ensure policies on import duties are clear, stable, well-published, and predictable</li></ul>                                                                                                                                                                                                                                          |
| Enforcement & Dispute Resolution          | <ul style="list-style-type: none"><li>• Establish or strengthen specialized commercial / investment courts for faster resolution.</li><li>• Promote arbitration / mediation, ensure investor-state treaty protections are credible.</li><li>• Provide transparent administrative appeal mechanisms; ensure decisions are reasoned.</li></ul>                                   |
| Corporate Governance & Compliance Culture | <ul style="list-style-type: none"><li>• Emphasise timely appointment of key managerial personnel, maintenance of company records, annual filings etc., so that technical non-compliance does not escalate into major legal risk.</li><li>• Encourage internal compliance frameworks for foreign companies to monitor trade, foreign exchange, reporting obligations.</li></ul> |
| Data Protection, IP & Digital Economy     | <ul style="list-style-type: none"><li>• Clarify data localisation / cross-border data transfer rules, ensure costs and operational constraints are understood in advance.</li><li>• Speed up grants of IP registrations; enforce rights more uniformly.</li></ul>                                                                                                              |

## Conclusion

While India is an attractive destination for multinational business due to its market size, improving infrastructure, skilled labour, and strategic location in Asia, legal challenges remain a significant deterrent. These challenges stem from complex overlapping regulatory regimes, ambiguous laws, retrospective tax or duty demands, enforcement uncertainties, and delays in approvals and litigation.

Recent high-profile cases—Volkswagen, Paytm, Myntra, Vodafone, Cairn Energy—highlight that even large multinational players are not immune. For India to fully realise the benefits of foreign investment, it must ensure legal predictability, clarity, fairness, and speed in its laws and



administrative processes. Reforms in regulatory clarity, streamlined approvals, reliable dispute resolution, and stable taxation and customs regimes can help in this direction.

The balance is delicate: regulation is necessary for protecting public interest, security, fair competition, and national policy goals. But over-regulation, ambiguity, or unexpected legal changes undermine investment confidence. With thoughtful reform, India can reduce legal friction, attract higher quality investment, and foster more robust multinational operations contributing to economic growth.