

Higher Education

Opportunities for Foreign
Education Institutes
in the Indian Market

May 2015

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The higher education sector in India has witnessed a paradigm shift in recent times. Until few years back, the sector was primarily focused on certain home grown institutions like the Indian Institutes of Technology (IITs) and the Indian Institutes of Management (IIMs). However, in the past few years, there has been an upsurge in participation of domestic and global players in this sector. Specific factors that have opened up such opportunities *inter alia* include lesser number of institutes of higher learning in the country, dated curriculum and lack of good infrastructure facilities. This has led to an increasing demand for pursuing education programs offered by global institutions, which tend to offer a curriculum which reflects latest trends, and imparts new age learning, use latest teaching methods and technology in imparting education and generally aim at making the students employable.

In fact, the education sector received foreign direct investments (FDI) of a total of US\$ 1,071.5 million from April 2000 to January 2015, according to data released by Department of Industrial Policy and Promotion (DIPP).¹ Particularly, investment in the higher education space is considered to have a great potential. India's Gross Enrollment Ratio (GER) in higher education currently is 15%, which is much lower than the world average of 23% and the target of the government is to increase it to 30% by 2020.² Thus, the Indian education sector offers good opportunities for a foreign player.

In order to encourage foreign participation, several initiatives have been / are being taken by the Indian government as well. Foreign Direct Investment up to 100% is allowed under the automatic route in the education sector in India. In addition to this, even amongst the private players, efforts are being taken to encourage development of strong collaborations between well-established foreign universities and Indian universities in order to facilitate greater academic exchange among students. Such progressive developments have attracted the eye of foreign institutes, who have been showing interest in this unique and emerging business opportunity in the country.

In this paper, we have discussed some of the options available to foreign educational institutes ("FEI") to do business in the education sector in India along with the key regulatory and tax concerns.

1. Fact Sheet on Foreign Direct Investment (FDI) – From April 2000 to September 2014, available at: <http://www.ibef.org/industry/education-sector-india.aspx> (last visited on April 15, 2015).

2. M.R. Madhavan & Kaushiki Sanyal, "Regulation in the Education Sector", available at: http://www.idfc.com/pdf/report/2012/Chapter_1.pdf (last visited on April 15, 2015).

1. Broad overview of regulatory framework governing the education sector in India

The higher education segment in India is typically categorized as:



I. Regulated Sector

This sector typically includes:

- diploma courses
- bachelor’s/undergraduate degree courses
- master’s/post-graduate degrees courses
- pre-doctoral/ doctoral programs

As per the University Grants Commission (“UGC”) Act, 1956, the right of conferring or granting degrees can be exercised only by a university or an institution deemed to be a university.³ The UGC Act stipulates the criteria for qualifying as universities, deemed universities and has provisions relating to the pre-requisites / eligibility for grants of degrees. Thus, degree / diploma courses are offered through universities, colleges affiliated to universities, deemed universities and autonomous colleges.⁴

The regulated sector can be further sub-categorized broadly into technical and non-technical education.

A. Technical courses

‘Technical Education’ has been defined in the All India Council for Technical Education (“AICTE”) Act, 1987 to mean “*programs of education, research and training in engineering technology, architecture, town planning, management, pharmacy and applied*

arts and crafts and such other programme or areas as the Central Government may, in consultation with the AICTE, by notification in the Official Gazette, declare”.⁵ The AICTE oversees technical education and the functioning of technical institutions within the country. ‘Technical Institution’, under the AICTE Act, refers to the institutions, other than universities, conducting the courses or programs in the field of Technical Education.

B. Non-technical courses

Non-technical education refers to courses other than technical courses. To the extent they lead to the award of a degree, diploma, etc., they are regulated by the UGC.

In addition, some statutory professional councils regulate certain professional courses. They are responsible *inter alia* for recognition of courses, promotion of professional institutions and providing grants for programmes. The Medical Council of India, for instance, is empowered to prescribe minimum standards for medical education required for grant of recognized medical qualifications by universities or medical institutions in India. It is also responsible to give its recommendations to the Government for establishing new medical colleges. Similarly, Bar Council of India, Dental Council of India, Indian Nursing Council, etc., are some of the notable councils. These councils have been empowered to

3. Section 22, UGC Act.

4. Autonomous colleges refer to colleges which have been granted such status by the university with which they are affiliated. Such status is conferred with the concurrence of the state government and the UGC. UGC Guidelines for Autonomous Colleges during the Eleventh Plan Period (2007-12), available at: <http://www.ugc.ac.in/oldpdf/xiplanpdf/revisedau8tonomous240709.pdf>.

5. Section 2(g), AICTE Act.

prescribe standards and formulate regulations with respect to their field of involvement.

In addition to the in-person education offered through colleges and universities, the distance education sector also forms part of the formal education system in India. It was initially governed by the Distance Education Council (“DEC”) which was set up under the Indira Gandhi National Open University Act, 1985. Thus, if a private university set up under a State Act wanted to offer programs and courses via distance education mode, it had to take approval from the UGC and the DEC and act in accordance with the various guidelines and regulations of both the UGC and the DEC. However, in May 2013, the DEC was dissolved. Subsequently, the Government, in May 2013, issued a notification transferring DEC’s responsibilities to the UGC. Thereafter, vide notification dated June 17, 2013, the UGC has adopted the Guidelines of the DEC on Minimum Requirements for recognition of Open and Distance Learning (“ODL”) institutions, till such time the UGC frames regulation for ODL institutions.⁶ Thus, institutes proposing to offer distance education need to comply with the Guidelines of the DEC on Minimum Requirements for recognition of ODL institutions.

II. Unregulated Sector

The unregulated sector primarily comprises of:

- Certification courses not leading to the award of a degree or diploma
- vocational training
- tutoring services / coaching classes
- online education programmes

In the recent past, the certification courses, vocational training and tutoring programmes have attracted a great amount of interest among education

service providers. This is because a significant portion of students graduating from colleges are not readily employable in industries because of lack of skills. This results in students enrolling in coaching classes/ vocational training classes and seeking certification courses to increase their scope of employability.

Another new space of growth is the online education sector, which is witnessing a lot of investments and entry of new players through acquisitions, new initiatives or partnerships. Government policies to encourage e-learning, various Massive Open Online Course (“MOOC”) initiatives by universities and the digitization of books are facilitating the importance of e-learning in the country. Some prominent examples of investments and initiatives in 2014 are:⁷

- In the context of MOOCs, Birla Institute of Technology and Sciences (BITS) Pilani, IIT Bombay and IIM Bangalore have partnered with the MIT & Harvard’s massive open online course (MOOC) platform edX to offer MOOCs to their on-campus and off-campus students.
- In the context of digitization of books, in April 2014, Encyclopedia Britannica tied up with Indian publisher Katha to take Indian stories to children across India and worldwide.
- As a government initiative, the Union Human Resource Development (HRD) Ministry had initiated its MOOC platform called SWAYAM, where professors of centrally funded institutions will offer online courses free of cost. The union cabinet also approved the signing of a declaration of intent with the U.S. Department of State for US universities to offer post-graduate academic programs with certification on the SWAYAM platform.

6. Available at: http://www.ugc.ac.in/pdfnews/0450821_ODLSystem.PDF (last visited on April 15, 2015).

7. Trends in the online education sector in 2014, available at <http://www.medianama.com/2015/01/223-trends-in-the-online-education-sector-in-2014/> (last visited on April 15, 2015).

2. Operation of FEIs in the regulated sector

Currently, FEIs are not permitted to establish an independent campus in India. As a step towards liberalization of the heavily regulated higher education sector, the government on September 10, 2013 had issued a press release⁸ informing various stake-holders about its proposal to allow foreign universities to set up campuses in India as not-for-profit companies (without having to collaborate with domestic educational institutions). As per the said press release, the Ministry of Human Resource development (“MHRD”) is in the process of finalizing the UGC (Established and Operation of Campuses of Foreign Educational Institutions) Rules by virtue of which foreign universities can set up campus in India and issue foreign degrees. These rules are to be finalized in consultation with other government departments. However, currently, the only way foreign educational institutes can enter the regulated sector is by way of collaboration with Indian institutes.

Both the AICTE and the UGC have their own set of regulations to govern the operation of FEIs.

I. AICTE Regulations⁹

These regulations facilitate the entry of FEIs in India by way of collaboration with Indian universities/institutions for imparting technical education leading to the award of diplomas, degrees, etc. This is subject to satisfaction of prescribed conditions and obtaining registration from the AICTE. The registration is granted for a period specified at the time of registration. Key conditions under the regulations include the following:

- the foreign institution has to be approved and accredited with higher grades in its home country;
- the Indian institution has to be an AICTE approved institution and registered as a not-for-profit entity;
- the degree / diploma granted to students has to be recognized in the foreign institution’s home country;
- the fee, quantum of student intake, admissions, entry-qualifications and conduct of courses should be as prescribed by AICTE form time to time;

- the foreign institute has to submit a detailed project giving details regarding infrastructure facilities, facilities available for instruction, faculty, admission procedure, prescribed fee, courses, curricula, availability of requisite funds for operation for a minimum period of three years and other terms and conditions of collaboration, if any;
- the foreign institution is responsible for obtaining accreditation from the National Board of Accreditation after two batches have passed out;
- a performance guarantee fee is required to be paid at the time of seeking registration;
- franchise arrangements are not permitted.

II. UGC Regulations¹⁰

These regulations allow foreign educational institutions to collaborate with Indian institutes (other than technical institutions) upon obtaining approval from the UGC. Approval is granted for a period of five years. These regulations also cover twinning programmes whereby students may complete their course by part study in India and part study in the main campus of the foreign institution. The key conditions under the regulations include the following:

- the foreign institute has to be accredited in its home country with the highest grade;
- the Indian institute has to be accredited with minimum grade B accreditation from the National Assessment and Accreditation Council;
- the draft memorandum of understanding to be entered into between the foreign and Indian institute has to be approved by the UGC;
- the foreign institution has to submit details about the infrastructure facilities, facilities available for instruction, faculty, specified fee, courses, curricula, availability of requisite funds for operation for a minimum period of three years and other terms and conditions of collaboration, if any;
- franchise arrangements are not permitted.

8. See <http://pib.nic.in/newsite/PrintRelease.aspx?relid=99225> (last visited on February 11, 2014).

9. AICTE Regulation for Entry and Operation of Foreign Universities/Institutions Imparting Technical Education in India, 2005.

10. The UGC (Promotion and Maintenance of Standards of Academic Collaboration between Indian and Foreign Educational Institutions) Regulations, 2012, read along with the UGC (Mandatory Assessment and Accreditation of Higher Education Institutions) Regulation 2012.

3. Structures commonly adopted by FEIs operating in the unregulated sector

In light of the various regulatory restrictions, FEIs seem to be focusing on the unregulated segments of the higher education sector to avoid regulatory hassles. Some of the business models commonly adopted are:

I. License Arrangement

As foreign universities are not allowed to conduct regulated educational programs independently in India, they enter into license arrangement with Indian educational institutions, wherein they license brand name, curriculum, know-how etc. to the Indian party. Such an arrangement is a win-win situation for all as (i) the foreign institutes benefits from the license fee and goodwill generated because of its name being recognized in the Indian market; (ii) the Indian institute benefits from the license of curriculum and brand name from the foreign institutes, which enable them to attract students to their institute; and (iii) the students get access to the curriculum and teaching methods of foreign institutes in India itself, thus saving on costs. It is important to note that such an arrangement should be a pure license arrangement and the foreign institute should not be awarding any degree or diploma to students in India, else the programme may fall under the purview of the regulated sector.

II. Services Arrangement

FEIs also engage in services arrangement with the Indian institutes where they provide services such as advising on standards for evaluation of students, qualification and recruitment of teachers, training teachers, advertising, inputs on infrastructure facilities etc. At times, FEIs also send their teacher and staff to the Indian institutes for teacher/ student training programmes. The FEIs benefits from such an arrangement as it is able to establish its presence in the Indian market and earn from the services fee and the Indian institute benefits from the expertise and

experience of the FEIs.

III. Setting up of Knowledge / Research Centers

There has been an increasing interest for setting up research centers in India, particularly, by tie-ups with corporates operating in the specific industry in which the foreign university has expertise, for example, with hospitals.

IV. Online Programmes

India does not have any specific regulation governing offering of educational courses / programmes through online medium as of date. This offers a lucrative opportunity to foreign institutes looking at India as a market. However, depending on the nature of the course / programme offered, certain sector specific regulations may apply.

4. Important Considerations for setting up an entity in India

FIEs looking to explore the Indian market (for instance by providing training, certificate or corporate executive programs, or similar programs etc.) may consider the following options for setting up presence in India:

I. Setting up a Liaison Office (“LO”)

An LO is an extension of a foreign company and is not a separate legal entity. A foreign company can set up an LO only after meeting certain eligibility criteria and obtaining an approval from the Reserve Bank of India (“RBI”). Further, there are limitations on the extent of activities that can be undertaken by LOs. It can only undertake activities which are in the nature of business development, liaising, public relations, etc. – i.e., activities which do not involve actual income-generating activities, but are merely preparatory and auxiliary in nature.

It is generally tax efficient (so long as the LO’s activities are limited to activities permissible under the exchange control framework- eg: general business promotion and not core business / revenue earning activities).

II. Setting up a Branch Office (“BO”)

Like an LO, a BO is also an extension of a foreign company and is not a separate legal entity and needs to meet certain eligibility criteria and obtain approval from RBI for set-up. A BO can undertake a wider range of activities including business / actual income-generating activities as compared to a LO, though there are certain limitations.

A BO is, prima facie, considered a permanent establishment (“PE”) of the foreign company in India. Therefore, the net income of the foreign company, to the extent attributable to the PE, could be taxable in India at the rate of 40%.

III. Incorporating a Private Limited Company

A company is a separate legal entity and is not an extension of its parent entity. Therefore, it ring-fences potential liabilities (including business-related liabilities). There are no general limitations on the activities that can be undertaken by a company. Unlike a BO or LO, incorporation of a subsidiary (including a wholly owned subsidiary) is permitted under the automatic route and does not require approval from an exchange control perspective.

A subsidiary usually does not constitute a PE and hence reduces tax risks for the foreign company and is usually preferred if activities in India are to be scaled up. However, it is to be noted that repatriation of income and capital of the subsidiary (especially, dividend payments and buyback of shares) involves significant tax implications. This becomes particularly important as investment in debt instruments (and consequently repatriation of income by way of interest) is restricted under exchange control regulations and as services availed by the subsidiary from offshore group entities would be subject to transfer pricing compliances (and consequently, the consideration paid for such services cannot exceed the arms’ length price).

5. Important considerations from legal and commercial perspective

While doing business in India, FEIs should insist on robust documentation to capture the commercial understanding of the parties. Some key contractual clauses are:

I. Intellectual Property Rights

When IP is licensed by FEIs, terms of the license should be documented. At times, FEIs share their brand usage guidelines with the Indian institutes to specify the manner in which the brand name and trade mark can be used by the Indian entity. Further, it should also be specified that all goodwill emanating from the use of the mark in India will accrue to the benefit of the FEI. As far as licensing of copyrighted work is concerned, there are certain nuances under the Indian copyright Act (for example, term of the license / assignment is deemed to be 5 years and territory is deemed to only be India unless parties agree otherwise). These nuances should be borne in mind specifically if any license or assignment of copyrighted work is to be taken by an FEI from an Indian entity.

II. Exclusivity

If FEIs desires that the Indian contracting entity should not engage in a business arrangement for similar courses with another foreign institute, then obligations on exclusivity should be documented in the agreement.

III. Protection from Potential Claims from Regulatory and Tax Authorities

Contractual provisions outlining whether consideration payable under contract is gross / net of taxes, safeguards in case of any claims raised by regulatory or tax authorities, etc., are important and should be negotiated and documented appropriately.

IV. Dispute Resolution

Parties are usually free to decide upon the governing law and dispute resolution mechanism to be adopted in a contract. However, one important aspect to note here is that as per a judgment of the Apex court in India¹¹, in case of foreign seated arbitrations, the parties are not entitled to approach the Indian courts for interim reliefs. This becomes critical in a cross border scenario where the foreign party may prefer arbitration to be seated outside India. Hence, in a situation where an FEI may need to take immediate and urgent reliefs against the Indian contracting party in cases of infringement / breach of confidentiality, it may make more sense to agree to arbitration in India. Secondly, judgments of foreign courts and awards of foreign seated arbitrators are enforceable in India only if such country is notified as a reciprocating country in India. Hence, it becomes important to check for reciprocity between India and the foreign country before deciding on the dispute resolution mechanism.

11. *Bharat Aluminum Co. Vs. Kaiser Aluminium Technical Service Inc.*, (2012) 9 SCC 552.

6. Important considerations from an Indian tax perspective ¹²

I. License of Trademark, Curriculum, Software, know-how, etc

In case of a licensing arrangement (as explained above), the consideration payable under the license agreement may be taxable as royalty at 25% on a gross basis. This rate is proposed to be reduced to 10% as per the recent budget proposals.¹³ It may be noted that payments which are normally not considered 'royalty' may be treated as 'royalty' for the purposes of the Indian income tax law, which defines the term in very wide terms. For example, the definition includes consideration paid for limited license of off-the-shelf computer software, even if the licensee is not given any right to commercially exploit the underlying IP. However, it may be possible to avail relief from such taxation under an applicable tax treaty.

II. Providing Services

The consideration paid to FEIs by Indian institutions for services rendered by the FEIs may be taxable as fees for technical services ("FTS") at 25% on a gross basis. This rate is proposed to be reduced to 10% as per the recent budget proposals. However, under several Indian tax treaties (including the treaty with the US), consideration for services qualifies as FTS only where the services enable the service recipient to apply the underlying technology independently. Therefore, if payment for services do not constitute FTS, they would not be taxable in India unless the entity has a PE in India. Further, under treaties with some countries (for e.g., US and Singapore), consideration paid for teaching in or by an educational institution is also excluded from the purview of FTS.

III. 'Business Connection' in India

If a foreign educational institution is considered to have a 'business connection' in India, its net income, to the extent attributable to such 'business connection' may be taxable in India at 40%. 'Business connection' is the corresponding domestic law concept of a permanent establishment ("PE"). Its ambit is generally wider than the ambit of PE as defined under tax treaties.

Further, even if a FEI enjoys tax-exempt status under its domestic laws, generally it may not be able to claim any tax exemption/ charitable status under Indian domestic tax laws except if it obtains approval / registration from the prescribed authorities and fulfils prescribed conditions. Therefore, it may be key to avail relief under tax treaties. In the context of educational institutions, FEIs may find it difficult to claim tax treaty relief if they are set up as a fiscally transparent entity (like a partnership, trust, or LLCs), etc. However, tax-exempt entities (for example, 501(c)(3) exempt entities in the US) should normally be entitled to relief if they are taxable in the absence of such exemption / upon not satisfying the conditions applicable to such exemption.

Some other important consideration from a tax perspective include applicability of service tax liability at 12.36% on consideration paid by Indian entities for services rendered by FEIs (the rate is proposed to be increased to 14% as per the budget proposals)¹⁴, personal taxation of faculty or other employee visiting India, risk of collaboration arrangements constituting an 'association of persons' ("AOP") between the foreign and Indian institutes. An AOP is a separate taxable entity and is considered to be resident in India even if a part of its control and management is situated in India. For example, in case of collaborations between an FEI and an Indian institution where the FEI provides course content, faculty training, etc. and the Indian institution is responsible with respect to infrastructure and other

12. All income tax rates mentioned in this paper are exclusive of surcharge and cess; in case of non-resident companies, surcharge of 5%/ 2% is applicable on the income-tax if their total taxable income is in excess of INR 100 million (about USD 1.67 million) / in excess of INR 10 million (about USD 0.17 million) but less than INR 100 million (about USD 1.67 million) respectively; education and higher education cess of 3% (cumulative) is applicable on the total of the income-tax and surcharge.

13. The budget proposals are yet to be passed into law.

14. The budget proposals are yet to be passed into law.

on-ground activities, there is a risk that both entities may jointly be treated as an AOP (depending on the nature of relationship between the entities). As the Indian institution is resident in India, such an AOP would also be treated as a resident of India. AOP classification could give to significant exposure for foreign educational institution as AOPs resident in India are taxable on its worldwide income in India.

7. Conclusion

Although, Indian education sector has certain regulatory hurdles and challenges, it offers great opportunity for foreign institutes and investors. With foresight and strategic planning taking into account legal, regulatory and tax considerations in dealing with these issues, FEIs interested in investing in education can overcome these challenges and generate favorable returns. The push by the government to allow FEIs to set up base independently in India (without the need to partner with Indian institutes),¹⁵ certainly seems like a step towards facilitating foreign participation in India's education sector.

15. If Smriti Irani has her way, Foreign Universities could be in India, Economic Times (June 23, 2014), available at: http://articles.economictimes.indiatimes.com/2014-06-23/news/50798353_1_india-campuses-foreign-universities-foreign-educational-institutions; Govt may soon liberalize legal services, Mint (April 6, 2015), available at: <http://www.livemint.com/Politics/PwlaQ7gOvELjM6TFprSuDO/Govt-may-soon-liberalize-legal-services.html>

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Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines"*. These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our *ThinkTank* discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports. Please feel free to contact us at research@nishithdesai.com

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