



Article

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MODELS OF GLOBAL CAPABILITY CENTERS

There are several models that can be used to establish and operate a Global Capability Centre in India, varying in cost structure, capability diversification, outsourcing, tax implications and level of control. While each model has its own challenges and benefits, the end objectives, operations of the group and size of the centre would play a crucial role in determining which model would work best. The three basic models that are most popularly understood are (a) the managed services model, where an entity is set up and run by a third party with services being provided to the group (b) the Captive Centre Model, where the group itself sets up and manages the centre and (c) the Build-Operate-Transfer Model, where the centre is set up and operations commenced by a third party which are then eventually shifted to the group. There are some lesser known models as well, which include (a) the Hybrid Model, where the entity is set up and run by the group itself and some non-core services are provided by a service provider (b) the Centre of Excellence Model in which the group sets up an entity for development of scientific and technical knowledge and (c) the Shared Services Model, in which a company centralises internal support functions to serve multiple business units.

The table below sets out a comparative overview of these models which endeavours to provide a snapshot of the benefits and challenges of each mode. The term “**GCC**” in this table refers to the operational centre carrying out the relevant activities in India, irrespective of the legal form adopted for its establishment. The “**Multinational Group**” denotes the foreign multinational for whose benefit the GCC operates. The “**Service Provider**” refers to an Indian independent entity engaged to establish, operate or support the GCC under the relevant model.

Depending on the model adopted, a service agreement would be required to govern the relationship between the Multinational Group Company and the Service Provider, particularly in the Managed Services, Build-Operate-Transfer, Hybrid and Shared Services Models (“**Service Agreement**”).

Parameter	Managed Services Model	Captive Centre Model	Build-Operate-Transfer Model			Hybrid Model [#]	Centre of Excellence Model	Shared Services Model
			Undertaking	Legal Entity	Services			
Role of Service Provider	The Multinational Group contracts an external Service Provider to manage the GCC functions from end-to-end.	No role.	Establishes and operates the GCC in the form of a business undertaking. The GCC is transferred to the Indian entity of the Multinational Group.	Establishes and operates the GCC in the form of a private limited company/limited liability partnership. *	<u>Provides ancillary and specialised operations.</u>	<u>Provides non-core services such as information technology services or acts as employer on record</u> outside of the Indian entity set up by the Multinational Company.	No role.	No role.
Role in of the Multinational Group GCC	No role.	Establishes and operates the Indian entity which acts as the GCC.	Sets up the Indian entity at a later date to which the GCC is transferred.	Takes over Indian entity holding GCC established by the Service Provider.	Sets up the Indian entity to internalise serviced functions.	Sets up the Indian entity which acts as the GCC for core functions.	Establishes and operates the Indian entity, which acts as the GCC.	
Control of Multinational Group over employees	Indirect control by the Multinational Group	Direct control over employees by the GCC.	Direct control over employees by the Indian entity of the Multinational Group <u>after transfer</u> of the GCC/GCC functions.			Direct control over employees by the GCC in	Direct control over employees by the GCC.	

	through Service Provider.			relation to non-core services.		
Day-to-Day Operational Decisions	Made by the Service Provider.	Made by the GCC under the supervision of Multinational Group.	Initially made by the Service Provider. Thereafter, by the GCC being the Indian entity under the supervision of Multinational Group.	Made by the Service Provider for the non-core functions.	Made by the GCC under the supervision of Multinational Group.	
Scalability and Expansion of GCC	Heavily dependent upon capacity of the Service Provider.	No dependence on the capacity of the Service Provider.	Initially, dependent upon capacity of the Service Provider. Thereafter, dependent upon the capacity of the Multinational Group.	Dependent upon the capacity of the Service Provider for non-core activities.	Need for scalability and expansion is limited due to nature of function. No third-party dependence.	No third-party dependence.
Risk to Owned IP (i.e. IP initially owned by the Multinational Group Company)	High third-party exposure risk. Owned IP may need to be licensed to the Service Provider. Safeguards required in Service Agreement.	IP of the Multinational Group may need to be licensed to the GCC. Low third-party exposure risk.	High third-party exposure risk. Owned IP may need to be initially licensed to the Service Provider. Safeguards required in Service Agreement. After transfer, may need to be licensed to the GCC.	Limited third-party exposure.	Moderate third-party exposure risk. Critical IP may need to be licensed to the GCC.	Low third-party exposure risk.
Ownership and use of created IP	Must be factored into the Service Agreement.	To be documented between GCC and Multinational Group.	Must be factored into the Service Agreement.	Can be factored into the Service Agreement.	To be documented between GCC and Multinational Group.	If needed, can be documented between GCC and Group.

							Multinational Group.
Exit of the Service Provider	Termination of Service Agreement.	Not applicable.	By transfer of business to Indian entity.	By transfer of the shares to the Indian entity/Multinational Group.	Termination of the services as functions are internalised.	Termination of Service Agreement.	Not applicable.
Transition of Employees	Not required.	Not required.	Employees transfer to Indian entity as part of undertaking. Issues such as continuity of service, terms of service need to be looked into.	No transfer. However, employment policies etc. should be aligned beforehand.	If needed, to be carefully structured at the time of transfer.	Not required.	Not applicable.
Dissolution of GCC – issues such as winding up, termination of employees etc.	Primary responsibility of Service Provider.	Responsibility of Multinational Group.	Initially, responsibility of Service Provider. After transfer, responsibility of Multinational Group. Must be factored into in the Service Agreement.			Responsibility of Service Provider.	Responsibility of Multinational Group.
Income Tax to Indian entity	Not applicable.	Service fees received by Indian entity, taxable as business income.	After transfer, service fees received by Indian entity taxable as business income.			Service fees for core services received by the Indian entity taxable as business income.	Service fees received by the Indian entity taxable as business income.

Transfer Pricing Concerns	None.	Service fees paid by the Multinational Group Company to the GCC must be at arm's length. **	Initially, none. After transfer, service fees paid by the Multinational Group to the GCC must be at arm's length.	Service fees for core services paid by the Multinational Group Company to the GCC must be at arm's length. **	Service fees paid by the Multinational Group Company to the GCC must be at arm's length. **
Data Protection and Confidentiality	High third-party exposure.	Internal exposure only.	High third-party exposure.	High third-party exposure.	Internal exposure only.

#Only has details pertaining to the non-core functions serviced by the Service Provider, except in relation to the Income Tax to Indian entity/Multinational Group Company. For the GCC servicing core functions please refer to the Captive Centre column.

* It must be noted that foreign participation in a partnership firm is restricted under exchange control regulations subject to approval by the Reserve Bank of India. Consequently, participation is typically structured through a company or limited liability partnership rather than a partnership firm.

** Appropriate transfer pricing study to be done and documentation would have to be maintained for future issues.

Where a service provider is used, we have assumed that this is a third-party service provider. Further, the services provided by the GCC would, in our view, amount to an export of services. With reference to the Integrated Goods and Service Tax Act, 2017, export of services, being a zero-rated supply, is eligible for refund on goods and service tax which has already been paid.

The income tax implications for the Multinational Group depend on whether a permanent establishment (“PE”) is seen to be constituted in India, which would require to be analysed based on facts and circumstances in each case. On a broad overview, depending on the tax treaty of the foreign country where the Multinational Group is located, PE analysis would have to be done for fixed place PE, service PE, agency PE, etc. The overall risk may be deemed to be low where transactions are between the Multinational Group, and the Indian entity are done on an arm's length basis.

CONCLUSION

According to the model selected, the Service Agreement must be structured to address indemnities, confidentiality, non-solicitation arrangements, limitation of liability, representations and warranties, and intellectual property ownership and protection considerations. Further, each model may give rise to distinct taxation implications, including considerations relating to transfer pricing, permanent establishment exposure, indirect taxes, and capital gains in the event of business transfer or restructuring.

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