Cross-border taxation| Direct & Indirect transfers

- CA Saurabh Dhadphale

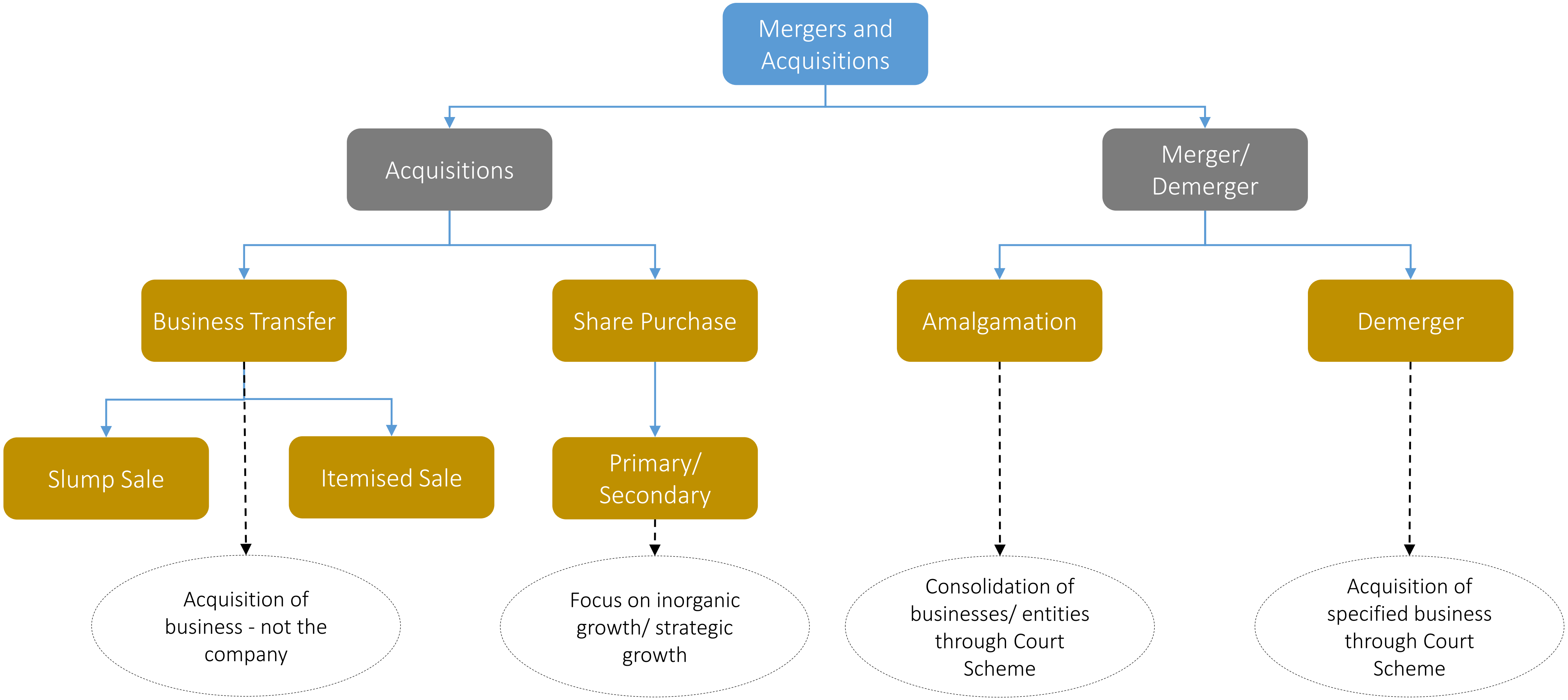
15 December 2018

Table of content

Section 01

Back to basics

Modes of restructuring



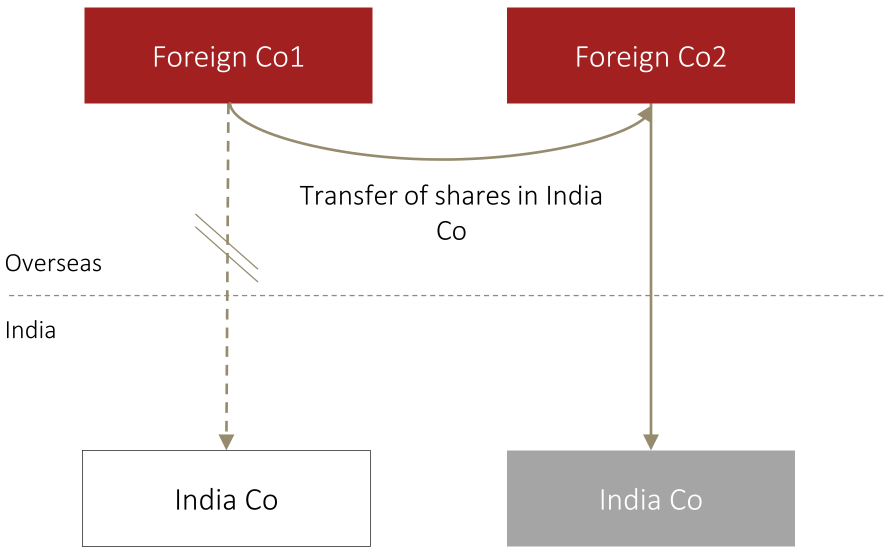
Regulations to be considered

Regulations

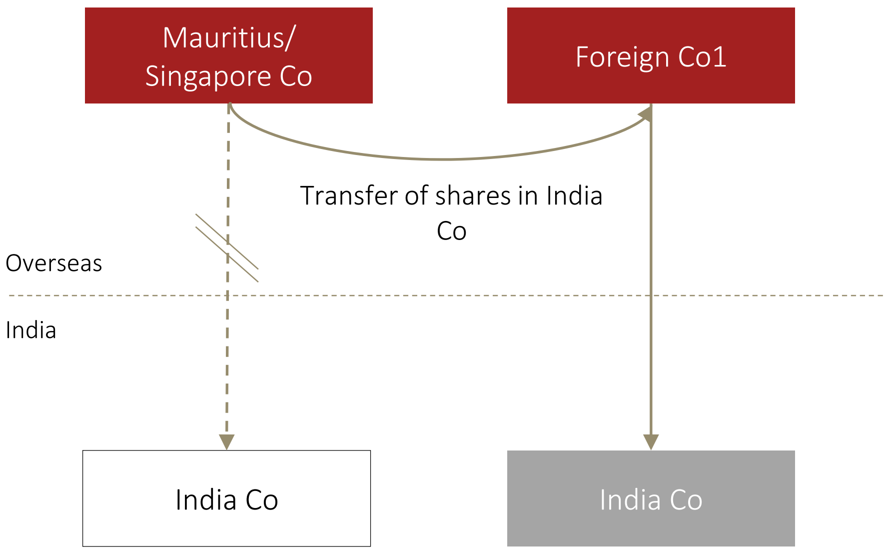
- *Income Tax Act, 1961*
- *Companies Act. 2013 (to the extent notified)*
- *Foreign exchange managemen 1999*
- *NBFC Regulations*
- *Securities and Exchange Board of India Act, 19 and regulations thereunder*
- *Competition Law*
- *Stamp Duty Laws*
- *Goods and Service Tax ("GST")*
- *Accounting Implications*
- *Sectoral policies*

Conventional acquisitions

Non favorable tax treaty jurisdiction



Favorable tax treaty jurisdiction



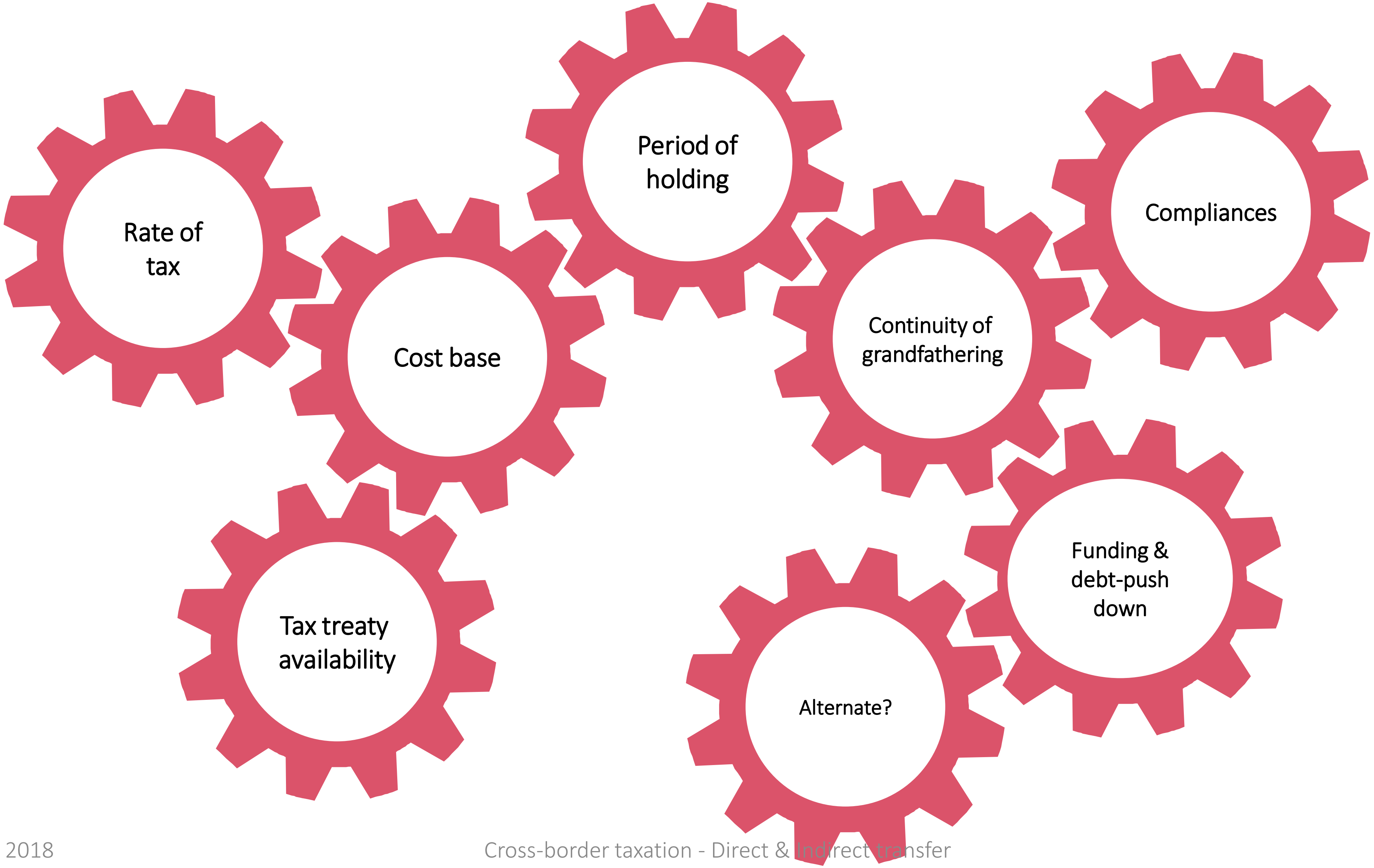
Facts: Transfer of shares in India Co by Foreign Co1 to Foreign Co2

Issues: Rate of tax?

Facts: Transfer of shares in India Co by Mauritius/ Singapore Co to Foreign Co1

Issues: Whether the treaty protection under specific tax treaties would be available?

Lets think?


Rate of tax
Cost base
Period of holding
Continuity of grandfathering
Compliances
Tax treaty availability
Alternate?
Funding & debt-push down

Section 02

Recent regulatory update

Cross border merger – India evolution

V: 20 March 2018

The RBI issued the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 [FEMA 389/2018-RB].

IV: 26 April 2017

The RBI issued draft regulations for cross-border mergers to the public for comments.

III: 13 April 2017

Notified section 234 of the Companies Act, 2013, allowing outbound mergers

II: Companies Act, 2013

Introduced section 234, allowing cross-border mergers

I: Companies Act, 1956

A foreign company can be merged with an Indian company

Allowed		Not allowed
Ireland [1]	Luxembourg [1]	UAE
Netherlands [1]	United Kingdom [1]	South Africa
Mauritius [2]	Cyprus [3]	Japan
France [4]	Sweden [4]	Australia
		Canada
		Singapore

Notes:

1. *As per EU merger directives, EU member states can engage into cross-border mergers (both inbound and outbound) with other EU member states only.*
2. *Mauritian tax and regulatory provisions allowed cross-border mergers with other countries. However, in light of the recent budget amendments in Mauritius, cross-border provisions may also undergo changes.*
3. *Countries where inbound mergers are allowed.*
4. *Inbound and outbound mergers are both allowed, subject to certain conditions.*

Key aspects

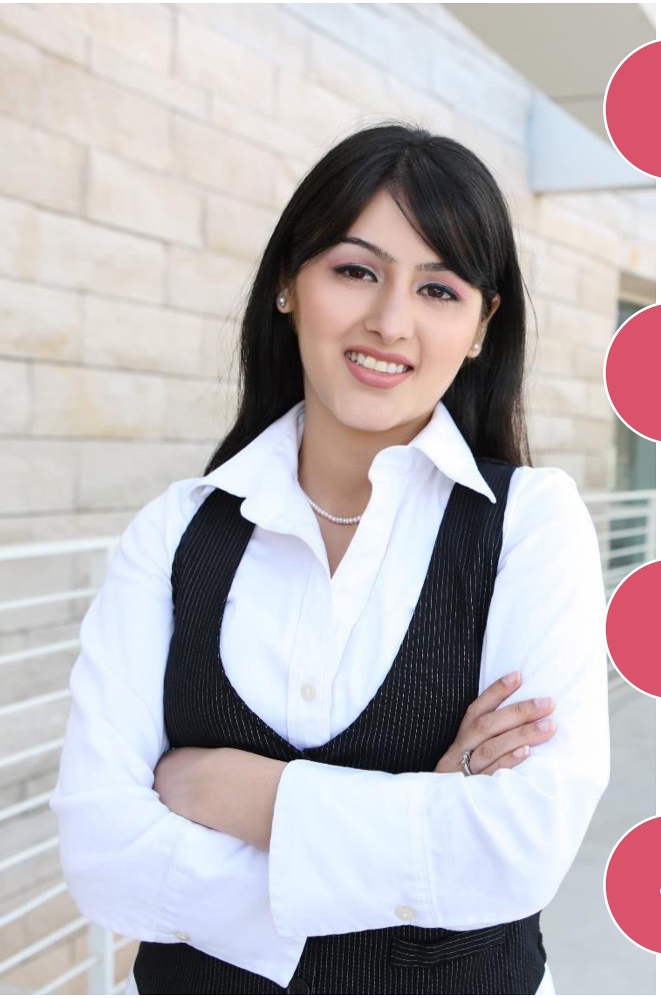
Tax:

- Capital gains tax
- Corporate tax rate vs foreign branch tax rate
- Foreign tax credit and transfer of other credits (direct/ indirect)
- Minimum alternate tax (MAT)
- Interest deductibility
- Special economic zones (SEZs)
- Carry forward of losses

Regulatory:

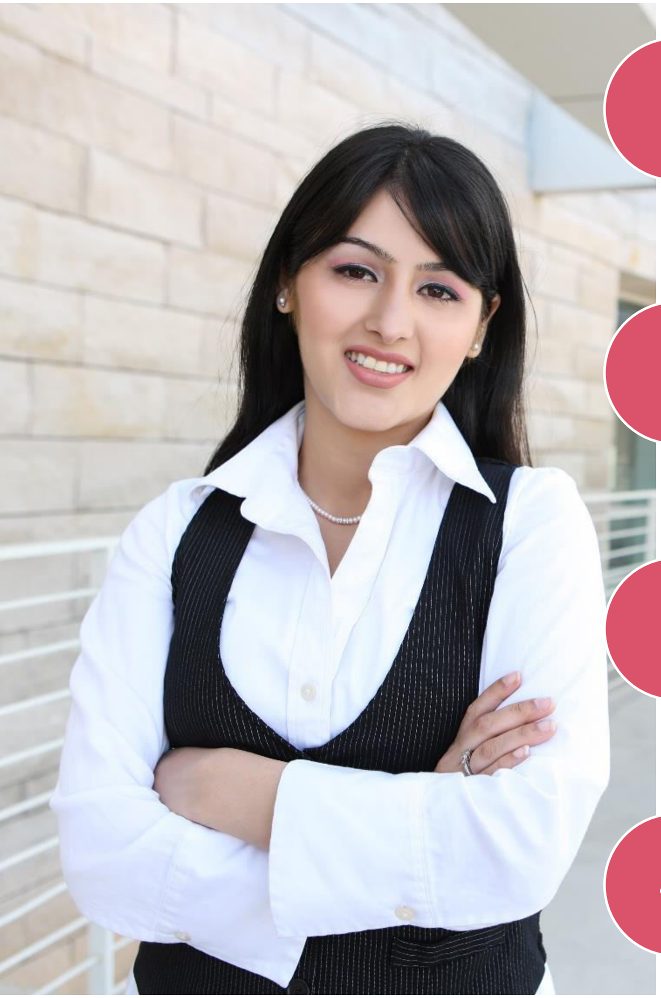
- Eligibility
- Exchange control framework (migration/new structure)
- Treatment of borrowings and guarantees
- Procedural aspects (resolutions, court approval, approval of any other regulatory body)
- Valuation report
- SEZs
- Reporting obligations
- Assignment/transfer of licences/contracts/ intellectual property

Inbound merger - Triggers



1. *Consolidation of overseas entities (parent/ subsidiaries)*
2. *Debt/interest servicing*
3. *Place of effective management (PoEM)*
4. ***Capital repayment and exit to joint venture (JV) partners***

Outbound merger - Triggers

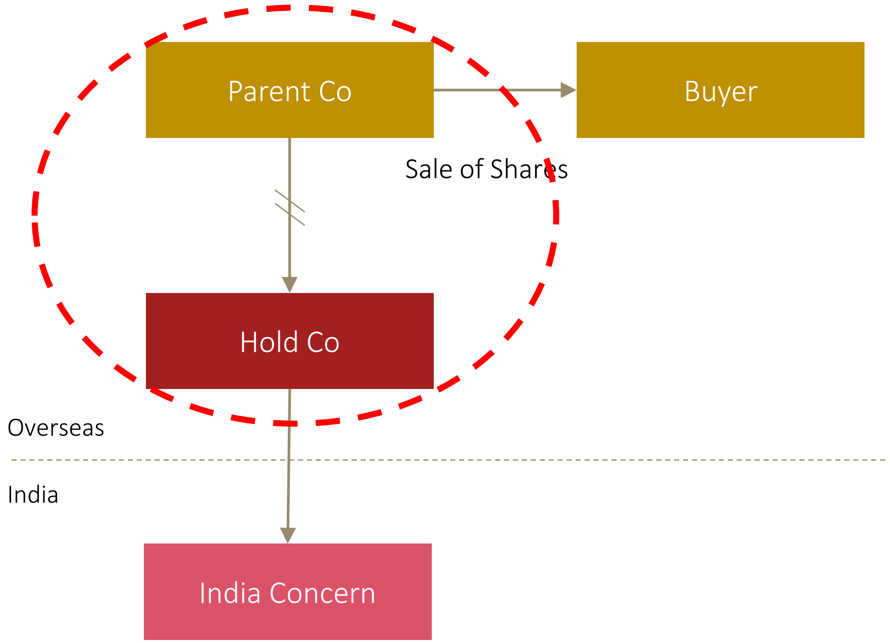


1. *Consolidation of entities (parent/ subsidiaries)*
2. *Debt/interest servicing*
3. *Externalisation and strategic partnerships*
4. ***Capital repayment and exit of JV partners***

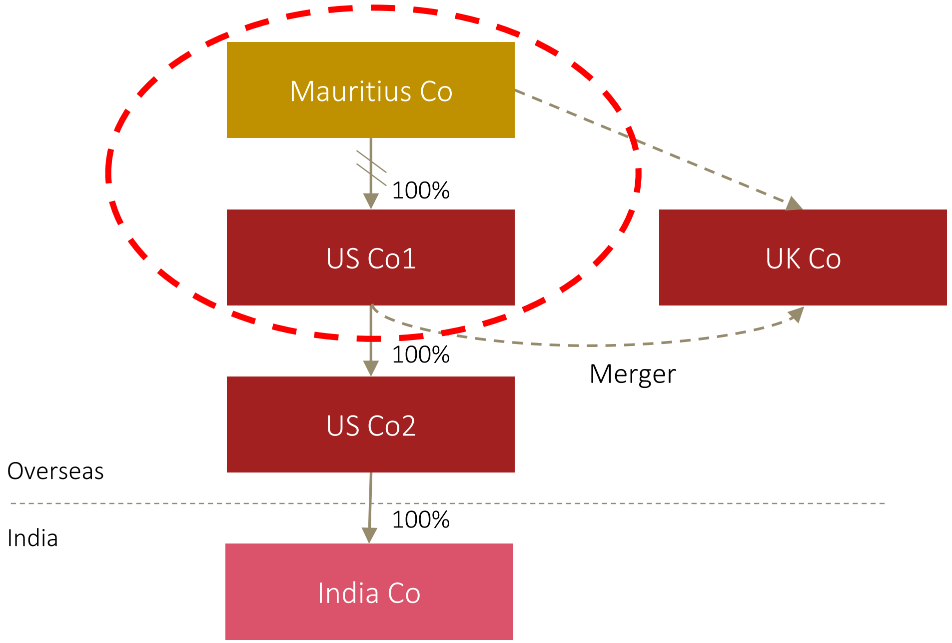
Section 03
Indirect transfer

Indirect transfer – Lets evaluate

On transfer of shares



On extinguishment of shares



Summary of Indirect transfer tax

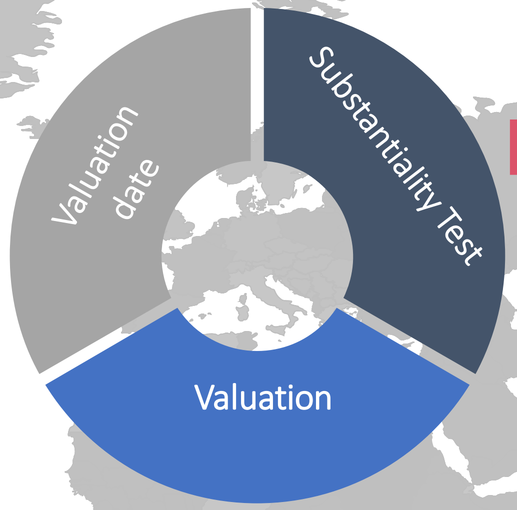
Specified date

The last day of the accounting period of the entity preceding the transfer; or

Date of transfer, if the book value of assets has increased by 15% or more from the above date

Exemptions:

- Foreign amalgamation / demerger – conditions apply
- No transfer of right of management / control in target entity (Foreign or Indian; and
- Voting power/share capital / interest held by non residents (along-with AEs) < 5% in:
  - Indian entity or assets; or
  - Foreign entity holding Indian entity / assets



Derivation of substantial value from India: If the value of Indian assets is

Exceeding INR 10 Cr; and

Representing atleast 50% of value of all assets owned by the Foreign entity

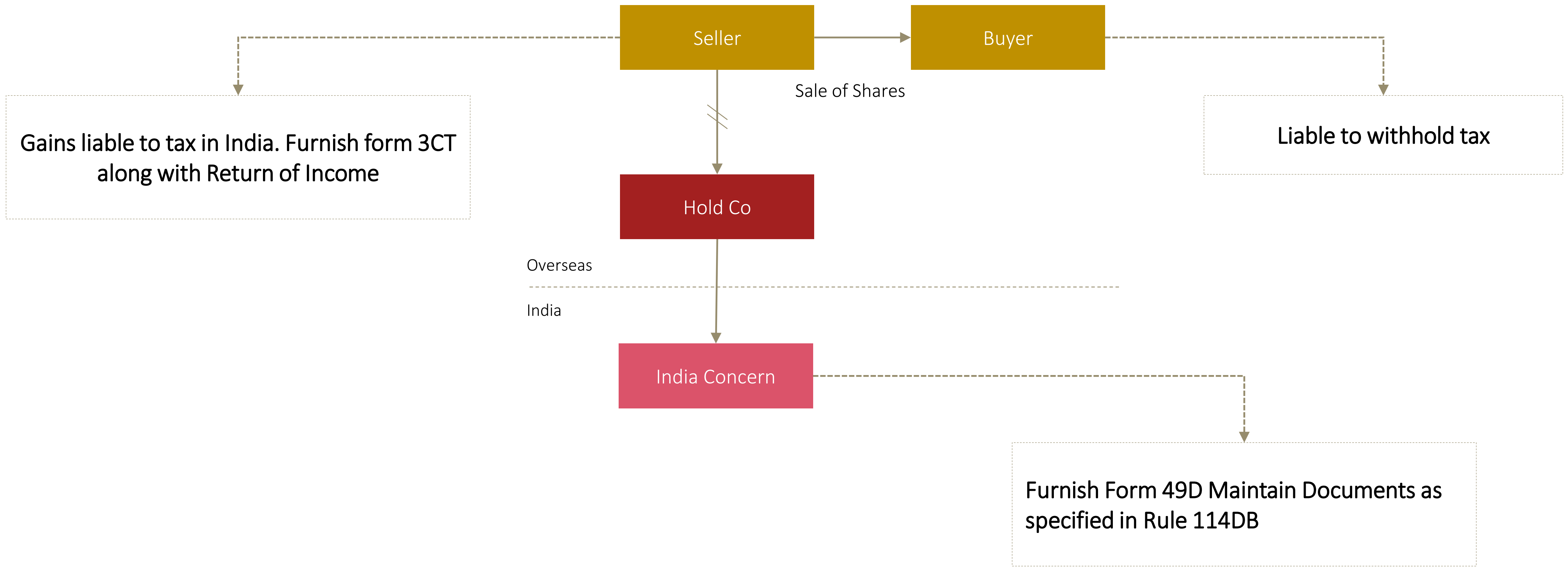
- Transferor to file ROI and CA report (for correct computation)
- Indian entity to file Form 49D reporting Indirect Transfer
  - Penalty on Indian entity depending upon default:
  - 2% of the fair value of overseas transfer; or
  - INR0.5 million

Enterprise value approach

Valuation to be determined by Merchant Banker or a Chartered Accountant

Gain in proportion to stake holding with Non residents to be taxed in India

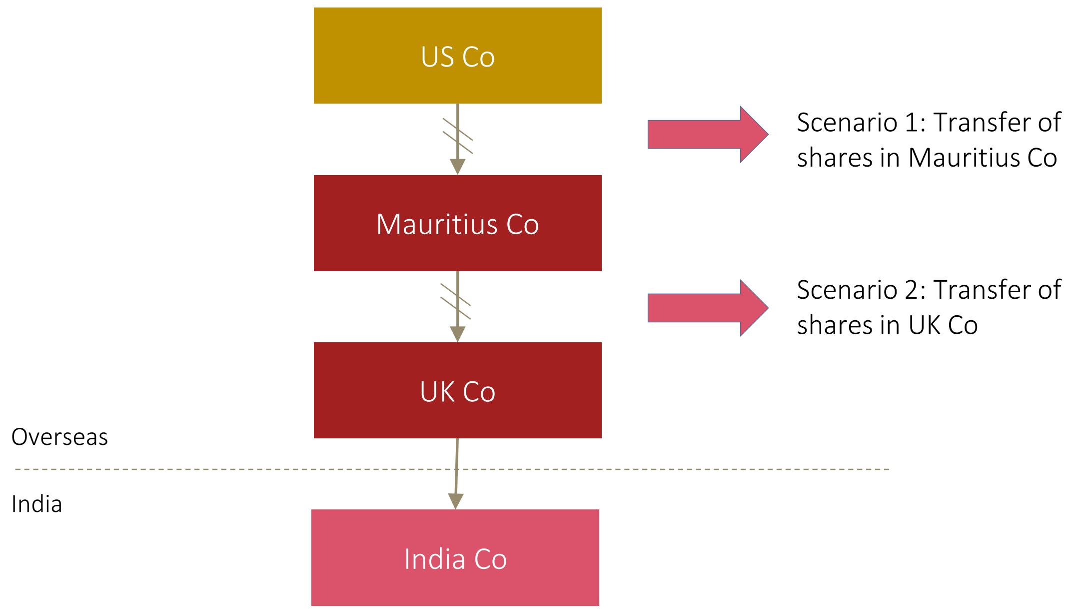
Indirect transfer – Lets evaluate



Section 04

Case studies

Case study 1: Indirect transfer – treaty provisions



Facts and issues:

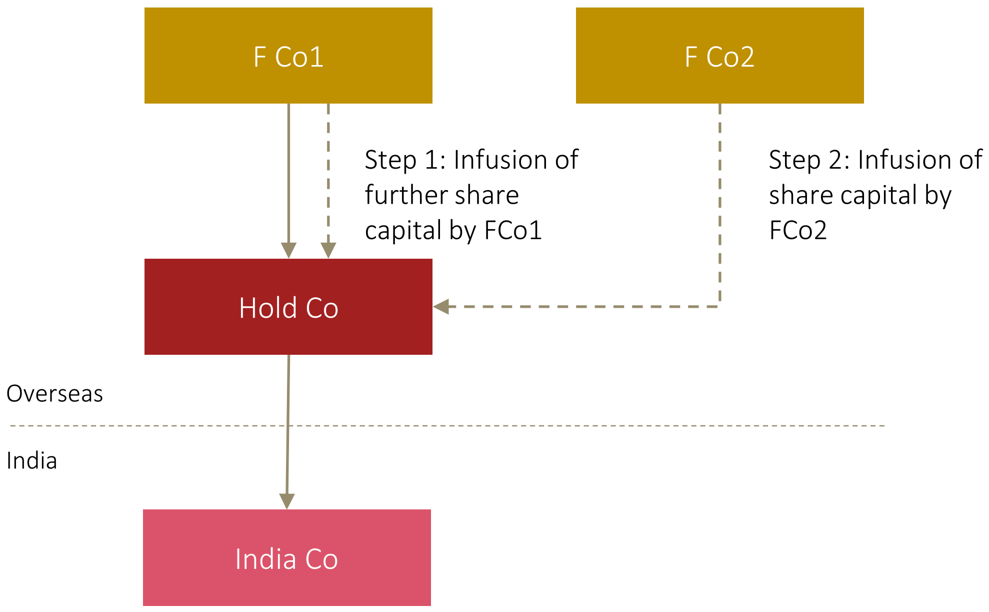
Facts:

- Mauritius Co and UK Co derive its value directly or indirectly substantially from India
  - Scenario I: US Co to transfer shares in Mauritius Co
  - Scenario II: Mauritius Co to transfer shares in UK Co

Issues:

- Which treaty to refer under Scenario 1 & 2?
- Whether treaty benefit available, if any?

Case study 2: Indirect transfer on dilution of shareholding



Facts and issues:

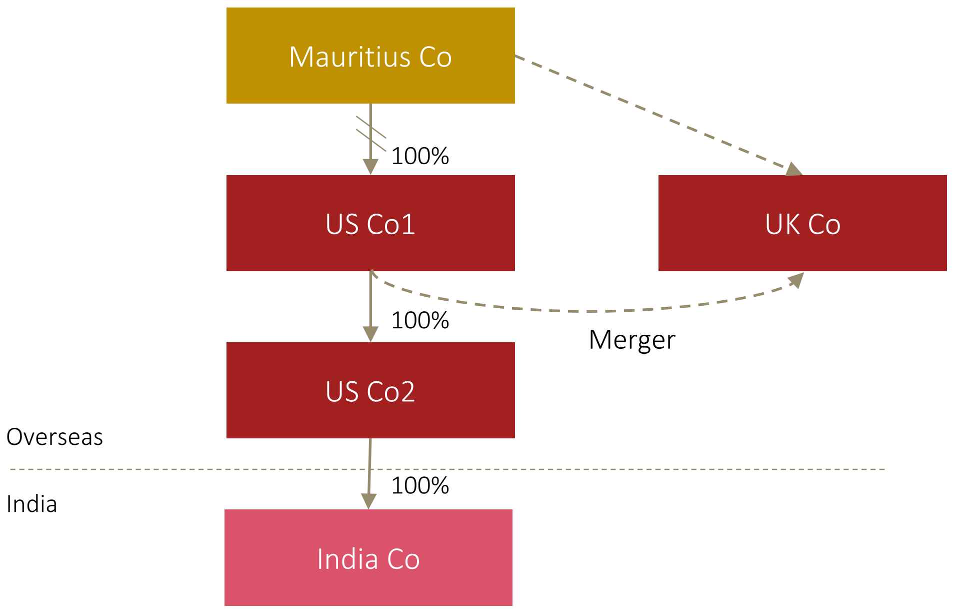
Facts:

- F Co1 holds 100% shares in Hold Co and
- Hold Co holds 100% shares in India Co
- F Co1 derives substantial value from assets located in India
- F Co1 initially infuses further share capital in Hold Co
- F Co2 subsequently infuses share capital in Hold Co resulting in change in control and management in Hold Co and dilution of voting power of FCo1

Issues:

- Whether indirect transfer provisions will apply on step1 and step2?

Case study 3: Amalgamation of Foreign Companies



Facts and issues:

Facts:

- Mauritius Co holds 100% of US Co1
- US Co 1 holds 100% in US Co2
- US Co 2 holds 100 in India Co
- Mauritius Co, US Co1 and US Co2 derives directly or indirectly its value substantially from assets located in India
- Merger of US Co1 with UK Co contemplated

Issues:

- Whether indirect transfer provisions trigger for US Co2, US Co1, Mauritius Co ?
- Tax treaty analysis?

Thank You !

Legislation history of Indirect transfer tax

Finance Act	Section	Amendments	With effect from
2012	Capital Asset Section 2(14)	Deemed to include any rights in or in relation to an Indian Company, including rights of management or control or any rights whatsoever	1.04.1962
	Transfer Section 2(47)	"Transfer" deemed to include disposing of or parting with an asset / interest or creating any interest in any manner, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India;	1.04.1962
	Situs of Shares / interest in certain foreign companies Section 9(1)(i)	deemed to be situated in India, if the share /interest derives, directly or indirectly, its value substantially from the assets located in India	1.04.1962
2015	Explanation 6 to Section 9(1)(i)	Word "substantially" has been defined to say that value of assets located in India should exceed Rs. 10 Cr and represent at least 50% of the value of all the assets (FMV) owned by the company as on the specified date	1.04.2016
	Explanation 7 (a) to Section 9(1)(i)	Exemption provided to small shareholders holding less than 5% of voting power or share capital or interest of shares of a company or entity which directly owns assets situated in India as per conditions specified	1.04.2016
	Explanation 7 (b) to Section 9(1)(i)	In a case where indirect transfer of provisions are triggered for a foreign company, only income attributable to assets located in India shall be taken into consideration for the purpose of computation of capital gains in a prescribed manner	1.04.2016

Legislation history of Indirect transfer tax

Finance Act	Section	Amendments	With effect from
2015	Section 47(viab) and Section 49	Any transfer, pursuant to a scheme of amalgamation or demerger, subject to fulfilment of prescribed conditions, shall not fall under the purview of Section 9(1)(i) Cost of Acquisition of capital assets in the hands of amalgamated company shall be the cost to its previous owner	1.04.2016
	Section 285A	Reporting obligations in connection with indirect transfer	1.04.2016
	Section 271GA	Penal consequences in the event of non compliances as prescribed u/s 285A	1.04.2016
2017	Explanation 5A to Section 9(1)(i)	Exemptions for specified types of FIIs/FPIs from indirect transfer provisions	1.04.2012

Reporting requirement

Form 3CT

Income attributable to assets located in India u/s. 9 of the Income-tax Act, 1961

- To be filed by the Transferor along with the Return of Income
- Duly signed and verified by an accountant
- Providing basis of apportionment according to the formula, and
- Certifying income attributable to assets located in India has been correctly computed

Form 49D

Information and documents to be furnished by an Indian concern u/s. 285A

- To be filed by the Indian Concern within
  - 90 days from end of FY in which transfer takes place; or
  - 90 days of the transaction where transaction has the effect of directly / indirectly transferring right of management or control in relation to Indian concern
- Form to be filed electronically
- The information may be furnished by one designated Indian concern, if there are more than one Indian concerns that are constituent entities