Key India tax developments and global perspectives
India Tax Workshop 2011
Discussion
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1. Cross border transactions
   - Hutch - Vodafone transaction
   - AT&T – Idea transaction

2. Anti Tax avoidance measures

3. International tax related developments
   - Transfer Pricing updates
   - POEM
   - CFC
01. Cross border transactions
Hutch - Vodafone transaction
Hutch – Vodafone transaction – Background

Shareholders
Listed in Hong Kong and New York
British Virgin Islands
Cayman Islands
Mauritius

India

Outside India

HTIL (Cayman Islands)

HTI (BVI) Holdings Ltd

CGP

8 Entities

Vodafone plc

UK

Vodafone NL

Netherlands

Sale Purchase Agreement

Transfer of CGP share to Vodafone NL

India Tax Workshop 2011
HC decision

► Price paid for the acquisition of the shares in Cayman Island entity factored in, as part of the consideration, diverse rights and entitlements

► Transactional documents recognized independently, rights and entitlements to the Indian business which were transferred to Vodafone NL

► Divestment of Cayman Island entity’s interests comprised in itself various facets or components (including India business) and hence, ITA have jurisdiction to tax the transaction

► In view of the multiplicity of arrangements involved, there should be an apportionment of the income between the part which has nexus with India and that which does not

► Income having nexus to India should be taxable in India

► Tax authorities raised a demand of approx USD 2.2 billion treating entire transaction as taxable in India

The arguments in this case have recently concluded in the Supreme Court
AT&T – Idea transaction
AT&T Idea transaction – Background

- Sale of shares of ICL by AT&T Mauritius to AB Nuvo – Mauritius Treaty tested
- Sale of entire shares of AT&T Mauritius by NCWS to TIL - Indirect Transfer controversy tested
HC decision – transfer of shares of ICL

- Circumstances in which the JVC was formed and the shares were allotted to AT&T Mauritius:
  - The obligation to subscribe and own shares of ICL was on NCWS
  - All rights in respect of the shares vested with NCWS
  - Payments made by AT&T Mauritius were on behalf of NCWS
  - On facts, AT&T Mauritius cannot be treated as legal/beneficial owner
    - AT&T Mauritius bound by JVA and could not independently exercise any of the rights
    - Sale of shares of ICL could be done by AT&T Mauritius only with consent of NCWS
    - The fact that the shares of the JVC stood in the name of AT&T Mauritius did not make AT&T Mauritius the legal owner
  - SC ruling in Azadi Bachao and CBDT Circulars not relevant to present facts
  - No lifting of corporate veil - income of NCWS sought to be taxed on account of its investment in India and not as a shareholder of AT&T Mauritius
HC decision – transfer of shares of AT&T Mauritius

► Entire transaction appears to be ‘colorable device’
  ► AT&T Mauritius not holding any other asset except ICL shares
  ► TIL purchased shares of AT&T Mauritius at the same price at which it had earlier agreed to purchase ICL’s shares
  ► TIL cannot contend that it was unaware that AT&T Mauritius was not the owner of the shares of ICL

► Transaction under the SPA merely for transferring the right, title and interest in ICL
Key considerations

► Challenges arising from indirect transfer
  ► Computation of cost of acquisition
  ► Subsequent direct transfer of shares in Indian company

► Taxability of indirect transfers under various scenarios
  ► Overseas operating cum holding companies
  ► Overseas regional holding companies
  ► Overseas companies not having controlling interest in Indian company
  ► Transfer of part shareholding
  ► Internal restructuring

► Indirect transfer of capital asset provisions as proposed in DTC 2010 could create complexities
  ► Nominal shareholding in foreign companies holding shares directly or indirectly in Indian company
  ► No exclusion even if shares of foreign company are listed and publicly traded
Key considerations

► In what circumstances can the tax authorities pierce the corporate veil

► Importance of documentation in determining taxability of cross border transactions

► Post DTC, countries like China, Indonesia, Peru have also introduced provisions relating to taxability of indirect transfer of shares

► Shares of overseas company being transferred is merely a vehicle for transfer of business, rights, entitlements, etc

► Reconciling: *Azadi Bachao* (Treaty Shopping is not illegal) & AB Nuvo (Mauritius Co is not the legal/beneficial owner of the shares of Indian Co)

► Impact of AB Nuvo’s case on Mauritius Treaty/Azadi Bachao/Circular 789

► Is the approach one of: Substance over Form; Determining the true Legal Form; Disregarding Legal Form
02.

Anti Tax avoidance measures
GAAR – Indian perspective

► Sophisticated forms of tax avoidance adopted by taxpayer stated to be the trigger for proposed introduction of GAAR

► GAAR to be invoked on identification of an Impermissible Avoidance Arrangement (‘IAA’)

► Provision has the effect of invalidating an arrangement entered into by the taxpayer for the purposes of obtaining a tax benefit

► Tax treaty provisions to not apply once GAAR applies

► Powers to invoke GAAR bestowed upon the Commissioner

► Burden to prove that transaction is not an IAA wholly on the taxpayer
GAAR – Global Scenario

► GAAR introduction under debate in UK – though, in past dropped after debate
  ► However, detailed reporting requirements
► ‘Purpose test’ at the root of the application
  ► Canada: ‘Primary purpose’
  ► Singapore: ‘Primary or dominant purpose’
  ► South Africa: ‘Sole purpose’
  ► Australia lists ‘8 factor test’ for objective determination of sole and dominant purpose
► Should burden of proof be on the Revenue
  ► In South Africa, new provisions have reversed the burden of proof from tax authority to taxpayer
Key considerations

► Impact of GAAR on tax environment and business environment
  ► Impact on genuine business transactions

► Level at which GAAR can be invoked
  ► In certain countries, an approval of the apex body of direct taxes is required for invoking GAAR

► Misuse / abuse of tax laws a must for invoking GAAR
► Granting of corresponding relief to the other transacting party
► Burden of proof on the taxpayer
► Time limit for invoking GAAR provisions against the taxpayer
► Applicability of GAAR to transactions which have received court approvals
► Has GAAR served the purpose – Global experience & Cost/Benefit analysis
Exchange of information – growing consensus

► Recent actions of the Government seem to suggest that India is moving forward on the global transparency and information exchange agenda

► Amendment to the Indian tax law in 2009 indicates the intention of the Government to enter into Tax Information Exchange Agreement to prevent fiscal evasion with these jurisdictions

► Tax Information Exchange Agreements recently concluded with jurisdictions such as Bermuda, British Virgin Islands, Cayman Islands, Isle of Man, Gibraltar, Macau, Switzerland, Jersey, Finland, etc

► Toolbox of counter measures introduced in Finance Act 2011 to discourage transactions with persons located in notified jurisdictional areas

► Government deputing Revenue officials to overseas jurisdictions seen as a step to facilitate exchange of information

► OECD’s Global Forum on Transparency and Exchange of Information continues to play an active role to ensure high standards of transparency and exchange of information are in place worldwide
03.
International tax related developments
Transfer Pricing
Transfer pricing

- The OECD – setting the global standard for transfer pricing since 1970s

- Outreach activities has resulted in establishment of a common ground on interpretation of the arm’s length principle

- But different principles, such as source-based versus residence-based taxation, may influence taxation and lead to different approaches

- Key concerns of developing countries:
  - Desire to influence “rules of the game”
  - “Last to the table” developing countries face a system tilted against their interest
  - Need to re-visit (or atleast have a dialogue) on fundamental TP principles
Transfer pricing

► New player has entered the stage: 2009 UN sub-committee on TP has started working on a TP manual
  ► Represents countries from emerging/ less industrialized countries

► The issue for multinationals: Inconsistency in the approach of the tax authorities
  ► The arm’s length principle of the OECD Guidelines is the official standard, but how that principle is interpreted and applied can vary

► Indian Finance Minister at the OECD meeting in June 2011: India would be setting much stricter standard for TP

► Expectation that OECD TP standards should reflect the needs of the emerging countries
Transfer pricing

► Specific concerns of developing countries on TP:
  ► Lack of comparables: quite possibly the biggest practical challenge faced by taxpayers & tax administration
    ► Tendency to look at applying profit split/contribution analysis
  ► Growth of the “intangible economy”: Inability to tax intangible transactions despite perceived economic connection
    ► Allocation of profits to developing countries that provide the market for sale of products or services for development of IP
    ► Attempts to allocate “economic ownership” IP to local affiliates
  ► Location savings: allocation of economic benefits arising from moving operations to a low-cost jurisdiction
    ► Presumption that all location savings should be factored in the transfer price
  ► Resource constraints in implementing TP rules
Place of Effective Management (‘POEM’)
Concept of POEM

- Concept of POEM introduced in DTC to determine residential status of companies
  - A Company formed or registered outside India may be considered as resident of India by virtue of its POEM in India

- Residential test based on control and management of a company
- Stringent test:
  - Total control and management of a foreign company in India alone makes it a resident in India

- Residential test based on ‘place of effective management’ (POEM) at any time during the year
- Liberal threshold:
  - Literally, if POEM is in India at any time during the year, a foreign company would be resident of India
Concept of POEM

► DTC 2010: Foreign company to become resident, if POEM in India “at any time in the year”

► POEM has been defined in DTC as under:
  ► the place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or
  ► in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions

► POEM in OECD
  ► “The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management”

► Some implications of a Foreign company triggering POEM:
  ► Exposure to Dividend Distribution Tax
  ► Impact of TDS default on audits
  ► Shareholders cannot enjoy ring fencing from transfer of shares of Foreign company
Key considerations

► Impact of “at any time during the year”:
  ► Holding a one-off / single board meeting in India
► Inclusion of “executive directors” for determination of POEM
► Ambit of the term “commercial decisions” for determination of POEM
  ► Requirement to ‘make the decisions’
Controlled Foreign Companies (‘CFC’)

CFC legislation – Background

► Spread of CFC legislation across the world in last 30-40 years

► US – perhaps first country to adopt CFC rules in 1962


► Emerging countries to have joined the ‘CFC club’
  ▶ Mexico, Argentina, Indonesia, South Africa, Estonia, China

► OECD report on Harmful Tax Competition encourages countries to introduce CFC legislation to counter use of tax havens

► CFC proposed to be introduced in India through the DTC
  ▶ CFC’s income computed as per defined formula – “All or nothing” approach
  ▶ No credit for overseas taxes paid by CFC / operating company on its income
  ▶ Proportionate share of CFC income (based on extent of control and number of days) attributed to resident
CFC – proposed legislation under DTC

Foreign company is CFC, if it satisfies *all* of the following conditions:

<table>
<thead>
<tr>
<th>Condition</th>
<th>Description</th>
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<tr>
<td>Condition 1</td>
<td>Person(s) resident in India, individually or collectively exercise control (Control test)</td>
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<tr>
<td>Condition 2</td>
<td>Is not engaged in active trade or business (Active trade/income composition test)</td>
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<td>Condition 3</td>
<td>Shares of company are not listed on a stock exchange recognized under the jurisdiction of the country of tax residence (Publicly traded test)</td>
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<td>Condition 4</td>
<td>It is a resident of a territory with a lower rate of taxation (Comparable tax test)</td>
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<td>Condition 5</td>
<td>Specified income exceeds INR 2.5 mn (De minimis exemption)</td>
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CFC – Global scenario

- Listed company exemption available only in a few countries (eg. Germany, Indonesia) - UK withdrew exemption after its misuse
- Most jurisdictions cover non-corporates as CFC
- Comparable tax test threshold of > 50% in India is comparable/favourable compared to others

| South Africa | > 75% test |
| USA          | > 90% test |
| UK           | Increased from > 50% to > 75% test |

- Shareholding aggregated only if > 10% in Australia, USA, China
  - But, countries like France, Japan, Germany aggregate even small shareholders
- Control test (≥ 50% in India : but > 50% in SA, UK, USA, Germany etc)
- Liberal ‘active trade’ exemption / exclusion of white list countries popular
Key considerations

► Is India ready for CFC
► Do widening of residency test, introduction of GAAR, tightening of TP Regulations, dilute need for introduction of CFC
► Availability of underlying tax credit or participation exemption
► Impact on entities engaged in active and genuine trade or business
► Interplay of GAAR in situations where CFC applies
► Should loss also be picked-up
► Challenge where distribution of income from foreign company is subject to exchange control regulations, lock in period etc.
Thank you

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