EY Asia-Pacific private equity tax network

Private equity thought leadership
Quarterly Top 10 tax topics

July 2021

EY 安永
Building a better working world

Hong Kong tax developments

1 Tax concession for carried interest in Hong Kong

The Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021 has been gazetted into law on 7 May 2021 which provides profits tax and salary tax exemption for eligible carried interest satisfying the eligibility conditions and the prescribed compliance requirements.

The Hong Kong Monetary Authority (HKMA) has also issued the final guideline on the certification of funds and the application forms on 16 July 2021 after considering comments collated from the industry.

Further guidance will be issued in due course. In particular, there should be guidance on the form of the Auditor's Report which should be an opinion on whether the carried interest qualifies for the concession. In addition, the Inland Revenue Department (IRD) will also issue guidance in the form of a Departmental Interpretation and Practice Note (DIPN).

Along with the tax concession for carried interest in Hong Kong under the new legislation, there are also enhancements to the Unified Funds Exemption regime such as the alignment of exemption at the fund level and holding company level. This is a critically important change that should simplify the Unified Funds Exemption rules and provide more certainty to the exemption(s) available to funds.

Clients who wish to learn more about the new legislation and the HKMA guideline can reach out to us for more information.

Australia tax developments

2 The Australian Budget and Patent Box Tax Concession System

The Australian Federal Government released its budget for 2021/2022 in May. The winners from the budget tax measures are small and medium businesses. Measures which support business investment such as the 12-month extension to the immediate expensing of assets and tax loss carry backs and the new Patent Box Regime are particularly welcome. Noteworthy tax measures in the budget include:

- Extension of temporary full expensing and temporary loss carry back measures until 30 June 2023
- A concessional patent tax rate of 17% to apply to income derived from medical and biotechnology patents – disappointingly, this has not been extended to broader industries, etc.
- Individual tax residency based on 183 days (or more) physical presence in Australia as a 'bright line' test
- Employee share scheme reforms
- Other business measures including intangible asset depreciation rates, removal of AU$450 superannuation guarantee threshold, etc.

Patent Box Tax Concession System

Globally, many jurisdictions offer patent boxes, including the United Kingdom (UK) and many European countries. These provide a concessional rate of tax for companies that derive income from their Intellectual Property (IP), to encourage them to perform Research and Development and house their IP in those countries. Currently, Australian businesses that generate IP do not have access to these same incentives, leaving them in an uncompetitive situation, with companies either forced to pay much higher tax rates, or relocate their IP to other jurisdictions.

This budget proposes a new patent box system to curtail this drain on Australian jobs and revenue, with a concessional patent tax rate of 17% to apply to income derived from medical and biotechnology patents. In effect, this reduces the applicable tax rate due to income from a patent in Australia from the current 30% rate (for large business), down to 17%. As part of this process, it will be necessary to differentiate between income derived due to the patent, and income due to manufacturing, branding, and other attributes. This will be one of the key design elements of the proposed patent box.

The new patent box will be limited to patents granted in the biotechnology and medical industries. It is expected that the government will follow the OECD design principles for patent boxes.

There is expected to be a consultation period (including the potential to extend to clean technology industries), with changes due to come into effect from 1 July 2022, and will be applicable to any granted patents that were applied for after the Budget announcement.

3 Review of Venture Capital Tax concessions

Treasury has released the Terms of Reference for a review of the tax concessions for the Early State Venture Capital Limited Partnership ESVCLP and the Venture Capital Limited Partnership VCLP regimes. The review was foreshadowed in the May Federal Budget with the objective to ensure the tax concessions "support genuine early-stage Australian start-ups".

EY Asia-Pacific private equity tax network

Private equity thought leadership Quarterly Top 10 tax topics

3 Review of Venture Capital Tax concessions (cont.)

The Terms of Reference indicate the review will consider how the tax concessions operate in practice and whether they are achieving their objectives. This will also take into account recommendations in other relevant reviews where the Government has not yet made a response such as the Board of Taxation's Review of taxation arrangements under the Venture Capital Limited Partnership regime in 2011.

Treasury and Industry Innovation and Science Australia have designated responsibility to oversee the review and will issue a detailed consultation paper for stakeholders to provide views and evidence on the operations of the ESVCLP and VCLP tax concessions.

4 Action Plan – Services Exports

The Australian Government has recently released its Action Plan to boost Australian Services Exports, developed through The Department of Foreign Affairs and Trade, including broad ranging actions/recommendations made by Australian service industry representatives. There were 72 recommendations under three key pillars. Tax related recommendations include:

- Finalize the development of the Corporate Collective Investment Vehicle(CCIV) Legislation
- Work within the Asia Region Funds Passport (ARFP) Joint Committee to encourage use of the passport
- Continue to consider whether Australia's Double Tax Agreements appropriately support key bilateral trade relationships whilst maintaining tax system integrity
- Continue to Chair the Tax Reference Working Group of the ARFP to ensure collaboration and cooperation across participating Passport economies
- Monitor international tax developments and Australia's treaty network to ensure Australia remains attractive foreign investment
- Enhance support for Australian FinTechs to gain a foothold in international markets and attract foreign investment and create jobs

The Australian Government has not agreed to several recommendations yet.

India tax developments

5 India issues thresholds for triggering "significant economic presence" in India

The concept of significant economic presence (SEP) was introduced in India's domestic tax law in 2018, with the intent of bringing income of non-residents operating in the online or digital space within the ambit of Indian-sourced income.

Non-residents having SEP in India would be deemed to have 'business connection' in India and the income earned by them which is attributable to SEP in India would be taxable in India (subject to treaty benefits as applicable).

Recently, the Indian tax administrator (CBDT) issued a notification (effective from 1 April 2022) specifying below thresholds for determining SEP for a non-resident in India as under:

- Aggregate payment in a fiscal year exceeding INR20m (i.e., c. US$ 0.27m) – For transactions in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software; or
- 300,000 user base in India - In case of systematic and continuous soliciting of business activities carried on by non-resident.

The new SEP provisions could have meaningful consequences for non residents on account of the following:

- The lower revenue threshold of US$0.27m may loop in small non-resident taxpayers, which could place disproportionate higher compliance burden on them (with corresponding tax withholding compliance burden for payers) and also higher administrative burden for the revenue department as compared to incremental tax revenues arising from SEP;
- Wide language of the SEP provision which seems to bring even non-digitized businesses within its purview;
- Interpretation of the term "systematic and continuous" which is ambiguous and could be subject to multiple interpretation;
- Manner of attributing income of non-resident constituting business connection/ SEP in India.

6 India – Recent Tribunal ruling on service tax applicability on carried interest and fund expenses

Recently, the Service tax tribunal of Bangalore, India have regarded the Indian domestic venture capital fund set-up as a trust as provider of asset management services to its contributors and liable to pay service tax.

All the expenses incurred and deducted from the NAV of the Fund along with carried interest payable to General partners were treated as consideration on which service tax should be payable. Credit of service tax charged by Investment Manager to the domestic fund were allowed to be set-off.

This is one of the first rulings in the Indian context which has regarded Fund as service provider and recharacterized "carried interest" as "performance fees" or "quasi management fees" for the purpose of service tax levy which is contrary to the position adopted by the Fund. Although the ruling is issued in the context of service tax on domestic fund structure, it could have far reaching consequences including collateral impact on the income-tax characterization of carried interest both by onshore as well as offshore fund structures.

EY Asia-Pacific private equity tax network

Private equity thought leadership Quarterly Top 10 tax topics

6 India – Recent Tribunal ruling on service tax applicability on carried interest and fund expenses (cont.)

Some of the key areas of likely impact on fund structures (including offshore fund structures) are:

- Requirement of domestic funds to seek GST registration and undertake GST compliances – Generally, domestic funds have not been undertaking GST compliances for asset management services;
- Additional service tax/ GST chargeable on carried interest to likely reduce profits allocable to investors/ limited partner's or General Partner depending upon the commercial agreement/ fund documents.
- Risk of re-opening of past assessments and related interest/ penalty exposure. Practical challenges in claiming set-off of input tax credit for past years without registration, claim or after expiry of limitation period resulting in double taxation.
- Impact on the advisory fees chargeable by Indian advisory (IA) entity to Offshore Funds from a transfer pricing/ Advance pricing agreement perspective – Topline to include mark-up on the carried interest payable to deal professionals resulting in higher tax outflow and cash trap at IA entity level.
- Ability of carry participants to take "capital gains" position on carried interest for income-tax purposes could be under scanner and subject to litigation. Relatedly, there could be withholding tax exposure on fund/ carry vehicle if carried interest is recharacterized as "salary income".

7 India – Amendment with respect to taxability of business sale transaction impacting business acquisition vs share acquisitions

Income-tax law contains separate provisions for computing capital gains derived from business sale (popularly referred to as slump sale transaction) vis-à-vis share sale transaction.

Recently, the slump sale provision was expanded to include sale of business for non-cash consideration (including shares issued in lieu of transfer of business) which were earlier judicially held to fall outside the ambit of the provision and hence not subject to capital gains tax.

Further, the slump sale provision was amended to incorporate certain anti-abuse measures along the lines of share sale transaction which will set a floor value (i.e., book value of assets/ liabilities being transferred except for certain assets such as immovable properties, investments, jewelry, artistic which needs to be fair valued as per prescribed methodology) for computation of sale consideration even if the actual consideration is lower.

This can pose challenge where the undertaking is bona-fide transferred at its true commercial value. There is no opportunity provided for the taxpayer to rebut such notional valuation which can be prone to legal challenge in appropriate circumstances.

New Zealand tax developments

8 Purchase Price Allocation rules

New legislation has recently been introduced in relation to purchase price allocations (PPA) for asset transactions over NZ$1m. A "mixed supply" transaction is where there is a single sale and purchase transaction which is a mix of taxable and non-taxable property. Share sales are not captured by the new legislation. The legislation is intended to eliminate the ability of vendors and purchasers to use asymmetrical PPAs for the underlying value of assets in their respective tax returns, which Inland Revenue had perceived as a risk to the tax base.

For asset transactions entered into on or after 1 July 2021, the legislation requires:

- Where a seller and a buyer reach agreement on the purchase price allocation, each party must follow the agreed allocation in its respective tax returns.
- Where the parties fail to reach agreement on the purchase price allocation, the right to the allocation is left with the seller (who must notify Inland Revenue and the buyer of the allocations within the specified timeframe from the completion date.
- In the event the seller does not notify Inland Revenue and the buyer of the allocation within the specified timeframe, the buyer is then entitled to set the allocation and is obligated to notify the IRD and the seller.

It is therefore important that due diligence is undertaken on the assets ahead of signing the transaction, in order to understand the implications of any proposed allocations and to support vendors/purchasers with negotiating appropriate asset allocations in the SPA. How offers are put forward by purchasers will now become more critical also, as NBIOs or binding offers may need to actually set out the purchaser's proposed PPA that their bid price is being made on, given the vendor has the power to set the PPA, which could otherwise alter the future tax depreciation profile and value to a purchaser.

EU tax developments

9 Netherlands: Consultation to align legal entity and partnership classification rules with international tax standards

On 29 March 2021, the Dutch Government released for public consultation a draft proposal to revise the Dutch classification rules for entities incorporated under foreign law and partnerships formed under Dutch as well as foreign laws. The proposed new entity classification rules are intended to be better aligned with international tax standards. Under the proposed rules, the current legal form comparison analysis will remain applicable.

9 Netherlands: consultation to align legal entity and partnership classification rules with international tax standards (cont.)

- As CVs (Commanditaire Vennootschap) will be transparent entities for Dutch tax purposes, comparable foreign limited partnerships that are currently nontransparent should become transparent entities from a Dutch tax perspective as well.
- If no comparable Dutch legal equivalent can be found, foreign entities are to be classified based on the tax treatment of the jurisdiction under the laws of which that entity has been established.

It is expected that the proposal will result in fewer hybrid mismatches, which may avoid the application of the Dutch anti-hybrid mismatch rules and — in specific cases — the conditional WHT on interest and royalties. The proposal may also have other indirect implications, whereby, among others, the applicability of the nonresident taxation rules and the domestic dividend WHT exemption are of specific relevance for PE headed structures. In addition, there could be an impact on Dutch resident carried interest holders and participants in a management equity plan.

PE structures should monitor the consultation process and consider the potential consequences of the proposal. The consultation closed for comments by the public on 26 April 2021. The Dutch Government will issue a legislative proposal that will be subject to review and the regular parliamentary proceedings. If enacted, the proposed changes will take effect as of 1 January 2022.

10 EU: European Commission publishes Communication on Business Taxation for the 21st century

On 18 May 2021, the European Commission published the anticipated Communication on Business Taxation for the 21st century. The Communication sets out the Commission's short- term and long-term vision to provide a fair and sustainable EU business tax system and support the recovery.

In the Communication, the Commission reiterates the strong support of the EU for a global consensus-based solution by mid-2021. The Commission will propose a Directive for implementation of the OECD Pillar One in the EU to ensure its consistent implementation in all Member States. The principal method for implementing the OECD Pillar Two will also be a Directive that reflects the OECD model rules with certain adjustments.

The Commission does also see areas where the EU might go beyond the OECD agreement. This mainly relates to the Commission's tax agenda for the next two years, which includes the following actions:

- Action 1: publication of effective tax rates paid by large companies to improve public transparency
- Action 2: setting out EU rules to "neutralize the misuse of shell entities for tax purposes," i.e., companies with no or minimal substantial presence and real economic activity
- Action 3: recommendation on the domestic treatment of losses, which will particularly benefit small and medium enterprises, i.e., allowing loss carryback for businesses to at least the previous fiscal year
- Action 4: creating a debt equity bias reduction allowance to encourage companies to finance their activities through equity rather than turning to debt

In addition, as a long-term plan, the Commission aims toward a common tax rulebook to provide for fairer allocation of taxing rights between Member States. The proposal includes consolidation of the profits of the EU members of a multinational group into a single tax base, which will then be allocated to Member States using a formula, to be taxed at national corporate income tax rates. The use of a formula to allocate profits will remove the need for the application of complex transfer pricing rules within the EU for the companies within scope.

The Commission will develop respective legislative proposals. Whether and in what form the proposals will be adopted is yet to be seen, as the adoption of EU tax legislation will in principle require unanimity among all 27 Member States. The Commission has put forward an ambitious tax agenda in the years to come. Taxpayers are recommended to further monitor the developments and assess the impact of the proposed rules on their business.

EY Asia-Pacific private equity tax network

Private equity thought leadership Quarterly Top 10 tax topics

EY Asia-Pacific Key Private Equity Tax contacts

Ian Scott
EY Asia-Pacific Private Equity Tax Leader
+61 2 9248 4774
Ian.Scott@au.ey.com

Adam Williams
EY Asia-Pacific Private Equity Tax Leader (Financial Services)
+852 2849 9589
Adam-B.Williams@hk.ey.com

Darryl Kinneally
EY ASEAN Private Equity Tax Leader
+65 6309 6800
Darryl.Kinneally@sg.ey.com

Leo Chiu
EY Greater China Private Equity Tax Leader
+86 10 58153622
Leo.Chiu@cn.ey.com

Matt Weerden
EY Oceania Private Equity Tax Leader
+61 2 8295 6788
matt.weerden@au.ey.com

Masako Kanaya
EY Japan Private Equity Tax Leader
+81 3 3506 2430
Masako.Kanaya@jp.ey.com

Subramaniam Krishnan
EY India Private Equity Tax Leader
+91 226 192 1949
subramaniam.krishnan@in.ey.com

This Quarter's Contributors

Adam Williams
Bernard Rennell
Christy Ngai
Joost Huisman
Kim Cunningham
Matt Weerden
Miki Pun
Niraj K Shah
Subramaniam Krishnan

EY | Building a better working world

EY exists to build a better working world, helping create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

APAC Number 03012826
ED None

ey.com