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Quarterly top 10 tax topics

September 2023

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Hong Kong

1 IRD adopts plain definition of "resident of Hong Kong" for treaty purposes

On 8 June 2023, the Inland Revenue Department (IRD) announced on its website that it will now issue certificates of "resident of Hong Kong" (CoRs) based on the plain definition of the term as defined in its comprehensive avoidance of double taxation arrangements (CDTA). Such an approach will apply to all Hong Kong's CDTAs.

Most of Hong Kong's CDTAs define a company, partnership, trust, or body of persons to be a "resident of Hong Kong" if it is incorporated or constituted under the laws of Hong Kong. Otherwise, such an entity will be regarded as a "resident of Hong Kong" in most Hong Kong's CDTAs if it is "normally managed or controlled in Hong Kong".

This IRD announcement indicates a change from its previous administrative practice, as the IRD will generally no longer examine whether such an entity has "sufficient economic nexus with Hong Kong" before the IRD issues a CoR for CDTA purposes.

Where an entity is incorporated or constituted under the laws of Hong Kong, a CoR will, subject to the potential application of the tie-breaker rule, be issued as a matter of course. This would seem to be the case given that such an entity will plainly satisfy the definition of the term in all Hong Kong's CDTAs. This is with the exception of the Hong Kong-Japan CDTA where the resident test is worded differently.

However, although such an entity will be a resident of Hong Kong, it could also be regarded as a resident of the contracting party of a CDTA, e.g., if its effective place of management is located in the jurisdiction of the contracting party. In such a case, the residence of the entity would then have to be decided by the tie-breaker rule contained in the CDTA and the IRD would need to consider the issue when processing the CoR application.

Separately, the IRD has also formalized the application procedures under which CoRs will be issued to more than one applicant where (i) an investment in a mainland China entity is owned via a multi-level ownership structure; and (ii) the entity in Hong Kong that directly owns the mainland China investment cannot be regarded as the beneficial owner of a dividend income on its own, but an upper-level entity in the ownership structure can.

In such a situation, more than one entity in the ownership structure will need to obtain a CoR in Hong Kong under Public Notice No. 9 (PN 9) issued by China State Taxation Administration in 2018, if a reduced withholding tax rate on dividends in mainland China is to apply under the Hong Kong-mainland China CDTA.

It is however unclear whether in processing CoR applications under PN 9, the IRD will, in addition to examining the Hong Kong residence of the entities involved, also examine whether the upper-level entity in Hong Kong is the beneficial owner of the dividends before it issues the CoRs required.

In any case, any claims for tax benefits will also be subject to the examination of the tax authorities of the CDTA partners under the terms of the CDTAs concerned.

The terms of a CDTA that affect the eligibility of an applicant for the tax benefits sought include the resident status of an applicant under a tie-breaker rule, whether the applicant is the beneficial owner of the income concerned and whether a principal purpose of the arrangement in question is to obtain such benefits. Any adverse conclusion of any such other terms of a CDTA could result in the denial of the tax benefits.

Claiming tax benefits under a CDTA is by its nature a complicated process and clients should seek professional tax advice, where necessary.

2 Hong Kong-Mauritius tax treaty in force

The CDTA with Mauritius signed in November last year came into force on 23 June 2023 and will take effect in respect of Hong Kong tax for any year of assessment beginning on or after 1 April 2024.

Under the CDTA, residents of Hong Kong and Mauritius will not have to pay tax twice on a single source of income. The CDTA will bring a greater degree of certainty on tax liabilities for those who engage in cross-border business activities, and help promote bilateral trade and investment activities between Hong Kong and Mauritius.

Details of the CDTA can be found here:
www.elegislation.gov.hk/hk/cap112DS!en?INDEX_CS=N

Singapore

3 Proposed tax for gains from the disposal of foreign assets in Singapore

The Ministry of Finance has issued for consultation the draft Income Tax (Amendment) Bill 2023. It includes a new Section 10L that aims to bring tax gains from the sale or disposal of foreign assets and received in Singapore on or after 1 January 2024 by consolidated entities unless the entity is a financial institution, exempt from tax under a specified exemption regime, or an "excluded entity". The proposed Section will not apply to Singapore-only groups without foreign operations, or to individuals.

3 Proposed tax for gains from the disposal of foreign assets in Singapore (cont.)

The Section is proposed to apply to gains from the sale or disposal of foreign assets and received in Singapore on or after 1 January 2024 by entities that are part of a multinational group and that do not have reasonable economic substance in Singapore.

- Any entity is a member of a group of entities if its assets, liabilities, income, expenses and cash flows are included in consolidated financial statements prepared by the parent entity of the group or would be required to consolidate if consolidated financial statements are prepared. It is important that similar wording in various OECD tax rules have been interpreted, by OECD, to mean that that if accounting standards do not require an entity to consolidate (e.g., investment entities), then it would not be treated as "required to be consolidated". If investment funds would not be required to consolidate, this would mean that such investment funds could potentially fall outside the purview of Section 10L.

Under the proposed Section, if an entity is required to be consolidated, this proposed Section should not apply if the entity meets the definition of "excluded entity". The "excluded entity" definition includes "pure equity holding entities" and entities that have "reasonable economic substance" in Singapore.

- The definition considers operations managed and performed in Singapore (whether by its employees or other persons) as one of the relevant factors. It also provides for other substance-based indicators such as the number, qualifications and experience of its employees, the amount of business expenditure incurred in Singapore by the entity and whether its key business decisions are made in Singapore.
- Given that Section 13O/13U/13D conditions are substance-based, it would have been ideal for the ministry to explicitly list companies approved under Section 13O/13U/13D as excluded entity. However, since this is not the case and subject to how the final legislation reads, we expect that the Inland Revenue Authority of Singapore may issue FAQs and e-tax guidelines to clarify their position on incentivized entities.
- For special purpose vehicles (SPVs) which are not under Section 13O/13U/13D incentives, and if they are a part of consolidated financial statements, then there might be a need to review and form conclusion on reasonable substance of overall operations carried out in Singapore with respect to such entity earning capital gains.

Australia

4 Major legislative changes and tax audit trends in Australia

New draft legislation has been introduced in Australia with immediate and far-reaching consequences for multinational enterprises (MNEs) in relation to (1) mandatory public reporting and tax transparency requirements; and (2) payments relating to intangible assets made to low-tax jurisdictions.

Multinational enterprises – Tax transparency and extraterritorial reporting

A new draft tax legislation has been introduced which will impact both Australian MNEs and foreign-owned MNEs with Australian operations where annual global revenues exceed AUD1 billion (approx. USD670 million). The law changes seek to impose an Australian regime of mandatory public tax transparency and are expected to take effect from 1 July 2023. There are immediate consequences for PE groups with Australian operations.

The law changes originate from the OECD recommendations for country-by-country (CbC) reporting under Global Reporting Initiative 207 and European Union Directive 2021/2101, but extend well beyond those requirements. The key proposed measures impose mandatory reporting obligations to be published on an Australian government website in an approved form, facilitated by the Australian Taxation Office (ATO). Affected MNEs will need to:

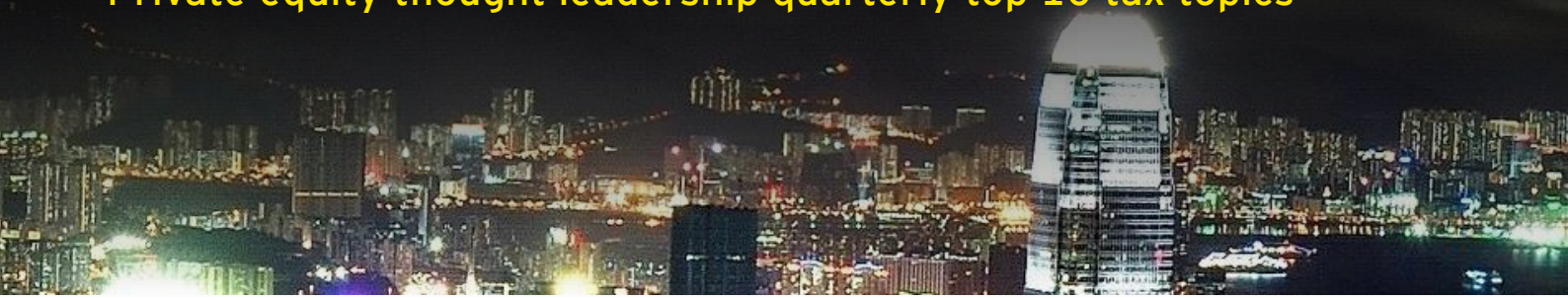
- Disclose confidential CbC reporting details including the identity of group members, certain group businesses, number of employees and tax information by jurisdiction.
- Describe the group's approach to tax (including its tax approach) which will be formulated in a tax statement or tax report.
- Disclose the group's effective tax rate in each jurisdiction along with details of income tax paid and income tax accrued (and the currency in which the information is presented).
- Disclose revenue from unrelated and related parties and expenses from related-party transactions in each jurisdiction.
- Provide details of tangible and intangible assets held in each jurisdiction.
- Ensure compliance with these new measures as heavy penalties will apply for non-compliance (AUD 156,000 penalty for reports which are 1 day late and up to 28 days late. AUD 782,500 for reports which are 112 days late or more).

The legislation will apply to all MNE groups that have a presence in Australia and have a global consolidated revenue in excess of AUD1 billion, where the entity or another member of the CbC reporting group is either an Australian resident or a foreign resident who operates an Australian permanent establishment. The lodgment obligation applies to the global parent entity regardless of whether that entity is Australian or foreign.

The legislation will also capture any MNE which breaches the threshold in the first year (whereas confidential CbC reporting applies from the year after which a group breaches the threshold). MNEs need to start considering how the relevant information will be identified and captured within their organization.

Significant global entities – new anti-avoidance rule

This proposed anti-avoidance measure will limit deductions for certain payments in respect of the exploitation of intangible assets that a significant global entity (SGE) makes either directly or indirectly to associates in a low corporate tax jurisdiction.



4 Major legislative changes and tax audit trends in Australia (cont.)

The key features of the proposed legislation relevant to PE groups with annual global income of AUD1 billion (USD670 million) or more with Australian operations are as follows:

- The rule is intended to apply to payments made after 1 July 2023. This does not leave much time for consultation or for SGEs to consider the impact of the rule on their arrangements.
- The rule is deliberately broad in its scope. This may pose some challenges for compliance and will mean most SGEs will need to turn their mind to the impact of the rule.
- The wide definitions of "intangible assets" and "exploitation" will result in many arrangements being captured.
- The rule may enable the ATO to "unbundle" payments and hold the view that a component of a broader payment is attributable to intangible assets.
- The low-tax jurisdictions which are in scope go beyond traditional "tax havens" and will include countries which Australia has entered into double tax agreements with.

The rule will apply to credits made by an SGE to associates or liabilities incurred by an SGE from an associate in the same way that the rule will apply to payments. For the purposes of this rule, the term "associates" takes its meaning from the controlled foreign corporation provisions in the Australian tax law. However, the term should exclude, as a general matter, independent third parties.

The fundamental elements of the proposed measure are considered below:

Payments

The rules are intended to apply where payments are made directly or indirectly through interposed entities. This will require SGEs to consider tracing beyond the immediate recipient of a payment. It will not be sufficient that the immediate recipient is not in a low-tax jurisdiction.

Arrangement

The rule will apply where the payment or credit is made, or liability incurred, under an arrangement or a related arrangement. The term "arrangement" uses the existing broad definition in Australian tax law to cover any arrangement as well as any agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.

Intangible assets

The rule will apply where, as a result of the arrangement under which the payment is made, the SGE or another entity acquires an intangible asset or a right to exploit an intangible asset. "Intangible asset" will not only include the ordinary meaning of a right in respect of, or an interest in any asset, but will extend to include a broad list of examples such as intellectual property, copyright, access to customer databases, algorithms, software licenses, trademarks, patents and leases.

Exploitation

The concept of "exploitation" is not precisely defined in the rule, but it is clearly intended to take a very broad meaning including the use of, marketing, selling and distributing the intangible asset; the supply of scientific, technical, industrial, or commercial knowledge; and exploiting another asset that is a right in respect of, or an interest in, the intangible asset.

Attributable

An amount for a payment cannot be deducted to the extent the payment is attributable to a right to exploit an intangible asset. The rule will therefore apply where a payment is made for several things and under the arrangement, the SGE or another entity, exploit or acquire a right to exploit, an intangible asset. This may be the case even if the actual payment is for other items, e.g., tangible goods or services.

ATO focus on PE groups and the use of captive managed investment trusts (MITs)

Over the past 12 months, the ATO has been redirecting its focus to PE groups and the use of MIT structures and arrangements under Australian corporations and income tax law. The ATO focus has centered on the use of certain "captive MIT" arrangements that broadly involve a two-investor holding structure.

Specifically, the ATO is concerned with:

- The use of captive MITs where the investment structure included a conversion to a MIT prior to a property disposal.
- The restructuring of investments or the implementation of arrangements which appear to be commercially driven by eligibility as a MIT to access concessional withholding tax rates.

Engagement with the ATO has been ongoing over the past year to ensure that clear and concise ATO guidance on eligibility to the MIT regime is published. It appears that the ATO is currently reluctant to provide binding rulings in relation to MITs while it is considering its position.

Proposed amendments to general anti-avoidance rule (GAAR)

On 9 May 2023, the Australian federal budget for the 30 June 2024 year was released which included proposed amendments to the scope of the GAAR. It is foreshadowed that the GAAR will be extended to apply to:

- Policies that reduce tax paid in Australia by accessing a lower withholding tax rate on income paid to foreign residents.
- Policies that produce an Australian tax benefit even where the dominant purpose of the scheme was to reduce foreign income tax.

These amendments are proposed to apply from 1 July 2024. While the draft amending legislation is yet to be released, it is anticipated that the amendments could apply to existing or contemplated arrangements. The ATO has advised that it is examining the application of the GAAR across a spectrum of cases to determine a view in relation to MIT arrangements and those features or factors which would heighten the risk of the GAAR being applied.

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5 New thin cap bill introduced into parliament

Prior to 1 July 2023, the thin capitalization regime limited debt deductions up to the maximum debt deduction allowable calculated under three different tests, being:

- The Safe Harbor Test (SHT) – which broadly disallowed debt deductions to the extent debts level exceeds 60% of the taxpayer's assets.
- The Arms' Length Debt Test (ALDT) – which broadly considered what the taxpayer "could" have borrowed from an arm's length external party under certain adjustments and assumptions, and usually requires detailed transfer pricing analysis and documentation support.
- The Worldwide Gearing Test (WGT) – which broadly allowed an entity's Australian operations to be geared at the same level as its worldwide group.

However, on 16 March 2023, Treasury released for comment draft law and explanatory materials to implement the federal government's proposed new interest limitation rules that will replace the existing SHT, ALDT and WGT. On 22 June 2023, the Australian federal government introduced Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023 (the Bill) into Parliament, following consultation on Exposure Draft (ED) legislation.

These new rules will apply for income years commencing on or after 1 July 2023.

Fixed ratio test

- The new fixed ratio test allows an entity to claim net debt deductions up to 30% of its "tax EBITDA" (i.e., taxable income/(current year tax loss) before interest, tax depreciation, capital works under Division 43). Note the following changes from the ED: (1) the depreciation add back has been broadened to include all deductions under Division 40 and Division 43 except amounts that are immediately deductible; and (2) the utilization of prior year tax losses will not be adjusted in the calculation of tax EBITDA.
- A special deduction is allowed for debt deductions that were previously disallowed under the fixed ratio test if the entity's net debt deductions are less than 30% of its "tax EBITDA" for an income year.
- Debt deductions disallowed over previous 15 years can be claimed under the special deduction rule (companies will have to satisfy either a modified continuity of ownership test or business continuity test to be able to utilize the fixed ratio test disallowed amount in a later year).

Group ratio test

- The group ratio test can be used as an alternative to the fixed ratio test and allows an entity in a highly leveraged group to deduct net debt deductions in excess of the amount permitted under the fixed ratio rule, based on a relevant financial ratio of the worldwide group.

External third party debt test

- The external third party debt test (replaces the ALDT) allows all debt deductions which are attributable to third party debt and can satisfy other conditions in relation to the use of the funds and the assets to which the lender has recourse. Entities and groups are able to elect to use the group ratio or external third party debt test for the financial year, however, once the choice is made for an income year it cannot be revoked.
- The third party debt test includes a condition that the lender only has resource to the Australian assets of the borrower. There is no materiality or de minimis threshold included in the Bill. The third party debt test also prohibits lender's recourse to Australian assets which are in any way guaranteed or secured by any form of credit support (exceptions apply in limited circumstances).
- The previous ED law proposed that an election to rely on this test would apply on a one-in-all-in basis to be applicable to all associates entities of the borrower. Treasury acknowledged the difficulty in taxpayers complying with the one-in-all-in election style, in particular where the application on an associate-inclusive basis would extend to entities which the borrower did not control. Treasury has sought to limit the deemed application to a smaller subset of associate entities of the borrower which are also members of the obligor group in relation to the debt arrangement in question.

Debt creation

- The Bill includes the introduction of debt creation rules some 20 years after the former debt creation rules were repealed. The debt creation rules were not included in the ED law and were not the subject of any government announcement.
- The new rules are intended to deny debt deductions in income years commencing on or after 1 July 2023 in circumstances where, broadly:
    - Interest bearing debt (whether related party or third party) is used to acquire an asset (or an obligation) from an associate.
    - Interest bearing debt (related party debt only) is used to fund a payment to an associate, including a dividend, return of capital or repayments of principal on a debt interest.

Korea

6 Election for flow-through treatment of foreign entities (as a result, some Korean LPs may request info from global GPs regarding investment structures)

There is a recent amendment to the Adjustment of International Taxes Act (AITA) in South Korea, enacted on 31 December 2022. This amendment brings changes to the classification of foreign entities for Korean tax purposes. Consequently, there appears to be

6 Election for flow-through treatment of foreign entities (as a result, some Korean LPs may request info from global GPs regarding investment structures) (cont.)

several Korean limited partners reaching out to private investment funds requesting for information to make an election treating foreign entities as flow-through for Korean tax purposes.

Amended AITA and entity classification

Before this amendment, foreign entities invested in by Korean investors were classified as either a corporation or a transparent entity based on the facts and circumstances test (the former test) for Korean tax purposes. The amended AITA now enables Korean investors to designate a foreign eligible entity as transparent for Korean tax purposes, irrespective of the former test which applies to the special taxation for foreign transparent entity application and a corporate or income tax return that it filed on or after 1 January 2023.

An eligible entity is a foreign corporation, an overseas investment vehicle or an incorporated body, foundation or other organization established in a foreign country prescribed in the Korean tax laws (the foreign corporation, etc.). A shareholder, an investor or a beneficiary in the foreign corporation, etc. (the investor) rather than the foreign corporation, etc. should be directly liable for tax on income derived by the foreign corporation according to the tax laws of the establishment jurisdiction of the foreign corporation, etc. Entities that could have been classified as transparent under the former test will maintain their classification even if a Korean investor does not opt for transparent status under the amended AITA.

We have seen several Korean limited partners intend to file an election form to classify all eligible entities as transparent for Korean tax purposes, with the aim of eliminating uncertainties related to entity classification for Korean tax purposes.

Information request

According to the amended AITA, in a tiered investment structure, a Korean investor can elect the series of tiered eligible entities as transparent for Korean tax purposes by submitting an election form for the upper-tier entity directly invested in by the Korean investor. By electing the upper-tier entity as transparent for Korean tax purposes, all underlying entities connected through eligible entities will be elected as transparent for Korean tax purposes.

To evaluate eligibility for transparent entity classification under the amended AITA, the Korean limited partners request information about all upper-tier entities directly invested in by them. The Korean limited partners will file an election form to classify all eligible entities as transparent for Korean tax purposes.

Impact of the election

Upon filing an election, the Korean tax authority will stamp on the election form confirming that the elected entity and all underlying entities connected through eligible entities are transparent for Korean tax purposes from the 2022 tax year onwards. The election is expected to be particularly advantageous for US Internal Revenue Code Section 894(c) purposes and EU reverse hybrid rule purposes.

7 Changes to method of taxation on foreign investors investing into Korean private equity funds

Key summary

Distributions paid out to non-residents or foreign corporations by the Korean private equity funds (PEFs) under the Financial Investment Services and Capital Markets Act are classified and taxed according to the source of income.

Expected impact

Prior to this change, the distributions received by non-residents or foreign corporations (except for certain categories of foreign investors such as foreign sovereign wealth funds) from PEFs were classified as dividends and taxed accordingly for Korean tax purposes regardless of the underlying character of income earned by the PEFs.

Pursuant to the rule, however, the distributions to general foreign investors would be taxed based on the character of income earned by the PEFs. Accordingly, a capital gain derived by a PEF that could have been deemed to be a dividend under the old rule may now retain its character as a capital gain in the hands of the foreign investor. This may have implications to the tax rate under applicable treaties.

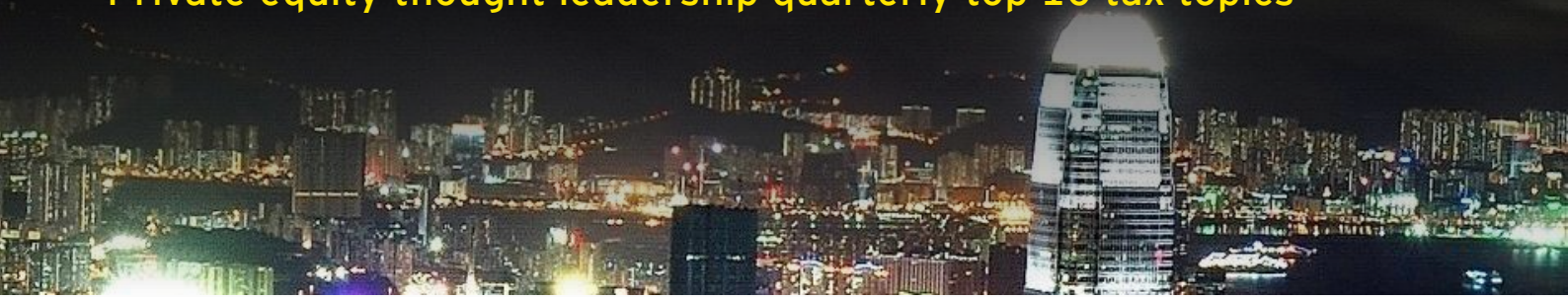
India

8 Angel tax provisions cover investments by foreign investors in Indian closely held company

Indian income tax laws contain provisions which taxes securities premium received by a closely held company on share issuance to the extent it exceeds its fair market value (FMV) (often referred to as Angel tax provision). Prior to April 2023, the Angel tax provisions only applied on share issuance to resident investors. However, Finance Act, 2023 expanded the ambit of Angel tax provision to include non-resident investors as well.

There were representations filed on behalf of global PE and VC investors to exclude certain legitimate share subscription transactions or share issuance to certain category of investors from the ambit of Angel tax provisions to avoid any unintended tax consequences for Indian issuing company.

The Indian tax administrator, i.e., the Central Board of Direct Taxes (CBDT) took note of the representations made and took the following steps:



8 Angel tax provisions cover investments by foreign investors in Indian closely held company (cont.)

1) Issued a tax notification excluding following broad classes of foreign investors whose investment shall not attract Angel tax provisions:

   a) Government and its related investors.

   b) Banks or regulated entities involved in insurance business.

   c) Any of the following regulated entities, which is a resident of any of the 21 notified countries:

      - Entities registered with Indian securities market regulator, i.e., Securities and Exchange Board of India as Category-I Foreign Portfolio Investor.
      - Endowment funds associated with a university, hospitals or charities.
      - Foreign pension funds.
      - Broad based pooled investment vehicle or funds (excluding hedge fund or a fund which employs diverse or complex trading strategies) having more than 50 investors.

It may be noted that certain prominent jurisdictions from which India receives significant foreign direct investment (such as Singapore, Mauritius, Netherlands, Ireland, Luxembourg) are excluded from the notified list. Furthermore, the exclusion from Angel tax provision is only granted on investments made by broad based pooled investment vehicle in Indian entity directly and does not extend to SPVs and feeder vehicles through which investments may be made in India owing to various reasons such as leverage and co-investor participation.

Accordingly, primary investments by PE and VC funds through SPVs and feeder vehicles or from non-notified countries may need to additionally factor the implications of Angel tax provisions on the Indian investee company at the time of investment.

Further, it is common for PE and VC funds to structure their investment in India by subscribing to hybrid or mezzanine securities such as compulsorily convertible preference shares to allow acquisition of higher stake in Indian company (i.e., by converting into more number of equity shares) in case of any potential anti-dilution (i.e., down-round) or liquidation preference event. Owing to regulatory restrictions, this was possible by subscribing to such hybrid securities at a price higher than FMV as per the valuation report. However, such structure may now attract Angel tax provisions and therefore may create issues in the negotiation of such rights at the time of fund raising.

2) Draft rule which seeks to rationalize the Angel tax provisions with a view to avoid any unintended tax implications

   Following amendments are proposed to the draft rule:

   a) Valuation methodology

   The existing valuation rule prescribes two methods (viz. net asset value or discounting cash flow) for determining the FMV of equity shares issued to resident investors. The Indian tax Administrator, i.e., the CBDT proposes to include five more valuation methods for issue of equity shares to non-resident investors.

   b) Price matching facility

   The draft rule provides that where any consideration is received by an unlisted company for issue of shares, from any non-resident entity specified in the exclusion notification, the price of the equity shares corresponding to such consideration may be taken as FMV of such equity shares for resident and non-resident investors subject to the following:

      - To the extent, the consideration from such FMV does not exceed the aggregate consideration that is received from the notified entity.
      - The consideration has been received by the company from the notified entity within a period of 90 days of the date of issue of shares which are subject matter of valuation.

   Price matching for resident and non-resident investors has also been specified in case where the unlisted company receives investment from a venture capital company or a venture capital fund or specified alternative investment fund.

   c) Safe harbor limit

   Safe harbor limit of up to 10% in variation in valuation of equity shares vis-à-vis valuation report can be availed by both resident and non-resident investors. The safe harbor is not available in case where FMV is determined through price matching mechanism.

   d) Validity of valuation report

   Valuation report will be acceptable if it is of a date not more than 90 days prior to the date of issue of shares which are subject matter of valuation.

While the changes in draft rules proposed are a positive step and provides certain relief to industry, several larger issues with respect to angel tax still remain. At present, the CBDT have asked for inputs and feedback from the interested parties on draft rules post which final rules will be notified.

Further, in a recent ruling of BLP Vayu (Project-1) (P.) Ltd. [2023] 151 taxmann.com 47 (Delhi - Trib.), the Hon'ble Delhi Income-tax Appellate Tribunal held that angel tax provisions should not be applicable in case of a transaction of issue of shares by a wholly owned subsidiary to its holding company. Reliance was placed to special bench ruling in case of in the case of KBC India Pvt. Ltd. v. ITO (ITA No.9710/Del/2019) where it was observed that angel tax provisions could not be applied in the case of transaction between holding company and wholly-owned in the absence of any benefit occurring to any other investors.

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9 Mumbai Tribunal rejected the manner of computation of capital gains derived by a non-resident investor from sale of shares of an Indian company

In a recent ruling, the Mumbai Income-tax Appellate Tribunal (ITAT) rejected the manner of computation of long-term capital gains or loss derived by a non-resident taxpayer from the sale of an unlisted Indian company. The ruling is believed to open new doors of litigation and impact foreign investments. The brief facts of the ruling are reproduced below:

Facts

- The taxpayer earned long-term capital gains from the sale of shares of an Indian private limited company (before taking into account foreign currency fluctuation benefit). Such gains (i.e., without taking into account foreign currency fluctuation benefit) are taxable under Section 112(1)(c)(iii) of the Income-tax Act (the Act) at a concessional tax rate of 10% (plus applicable surcharge and cess).
- However, post taking into account foreign currency fluctuations in accordance with first provision to Section 48 of the Income-tax Act, the computation resulted in long-term capital loss.
- The taxpayer filed the return of income claiming such loss.

Observations by ITAT

- Mumbai ITAT noted that the provisions, i.e., Section 112(1)(c)(iii) of the Act, being specific to the computation of capital gains in case of a non-resident arising from the transfer of unlisted shares and securities should override the normal provisions (i.e., section 48 of the Act) which pertains to computation of capital gains in case of all capital assets.
- The ITAT also stated that it is a well-settled rule of construction that where there are two provisions which cannot be reconciled with each other, the sections should be interpreted in a manner that effect is given to both sections.
- The ITAT rejected the taxpayer's contention that it is governed by both sections and thus, is free to apply the section more favorable to it.

The aforesaid ITAT ruling could have the effect of requiring the non-resident investors to pay capital gains tax even in a scenario where it has made dollar loss but rupee gains. Since the rupee has been consistently falling vis-à-vis dollar and this trend may continue for the foreseeable future, this ruling could further impact the return of investors to foreign investors.

Global

10 BEPS 2.0 – GloBE Pillar Two implementation in the UK and EU

There have been several developments on global anti-base erosion (GloBE) since the last network letter, including, most importantly, the publication of:

- OECD commentary and administrative guidance.
- The Transitional Country-by-Country Reporting (CbCR) Safe Harbors.

The GloBE rules form part of Pillar Two. They provide for a global minimum tax rate of 15% applicable to multinational groups with a global turnover of EUR750 million or more. The EU adopted the minimum tax directive on 15 December 2022, and all EU Member States have until 31 December 2023 to transpose the directive into national law. The rules will apply in the EU for fiscal years on and after 31 December 2023. Germany, the Netherlands and Ireland have published draft legislation. Spain and Sweden have consulted on how to adopt the directive. In the UK, Finance Bill 2023 contains the UK's Pillar Two legislation that will also apply for accounting periods on and after 31 December 2023.

The UK and the Netherlands have also chosen to enact a domestic minimum tax of 15% that should ensure collection of minimum taxes arises locally in those territories. It is expected other jurisdictions may do the same to ensure they can locally collect tax arising as a result of the rules.

Furthermore, traditionally low-tax territories are also responding, with Guernsey, Jersey and the Isle of Man implementing key elements of the GloBE rules, but not until the calendar year 2025.

Before the rules take effect, PE houses will want to review their existing holding structures to establish how the house, funds and portfolio companies will be affected. Important considerations include identifying the following:

- What entities form the Pillar Two group.
- Which entity is the ultimate parent entity (with primary responsibility for filing returns).
- Whether the new CbCR Safe Harbor applies.
- Procedures that will be required to collect relevant data and ensure compliance.
- How the rules will apply in the context of sell-side and buyside due diligence.

In July, the OECD released an administrative guidance which introduces a qualified domestic minimum top-up tax safe harbor that would work as an exemption mechanism rather than a credit against top-up tax.

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