WIRC of ICAI
Beginners Study Course on International Taxation

INTERNATIONAL TAX STRUCTURING

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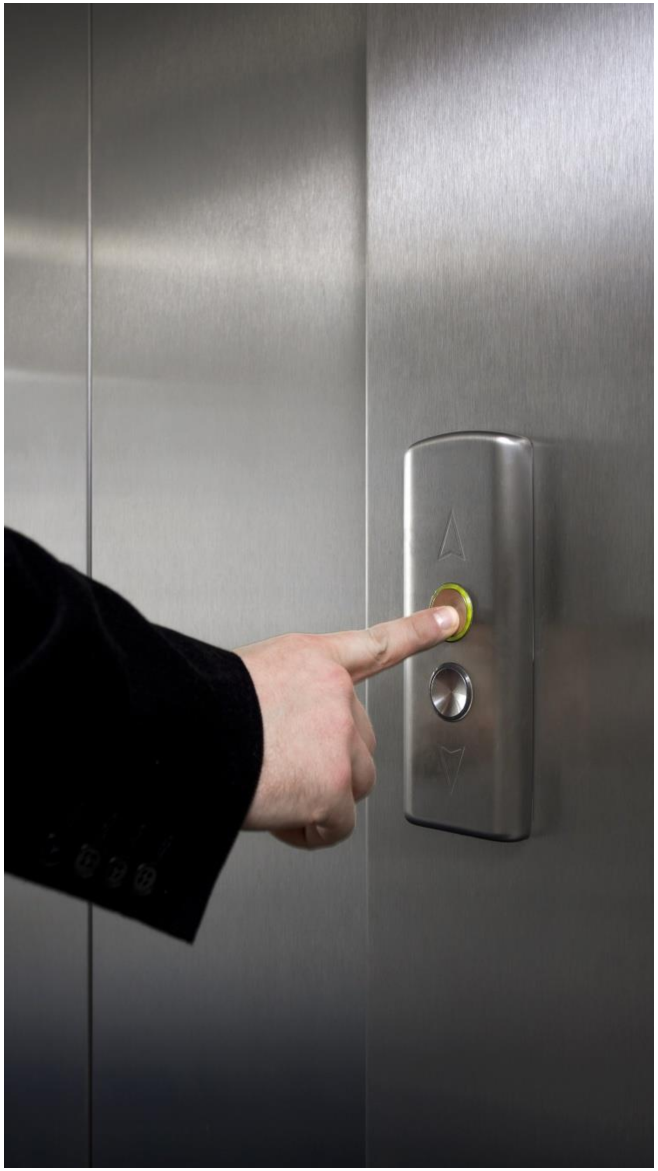


AGENDA:

- Basic Considerations
- India Inbound
- India Outbound
- Case Studies
- Anti-Avoidance Measures

CROSS BORDER TAXATION
Tax Considerations

Parameters	Description
Treaty Network	The number of treaties (tax and investment protection) that a country has entered into with other countries
Repatriation of Income	Taxability and foreign exchange regulations (if any) applicable on repatriation of income from the investee jurisdiction to the jurisdiction of the shareholder
Capital Gains on Exit	Tax cost in the hands of the shareholders at the time of winding up / exiting the investee entity
CFC Rules	Controlled Foreign Corporation Rules; features of income tax systems in some countries designed to limit the deferral of tax using offshore entities (usually low taxed and having no active operations)
GAAR	General anti-avoidance rules; anti (tax) avoidance rules which give the rights to the tax authorities to scrutinize and tax transactions which are structured mainly to avoid taxes
Thin Cap	Thin Capitalisation rules; Rules framed to disregard excessive leverage by disallowing interest deductibility beyond reasonable limits

CROSS BORDER TAXATION

Other Considerations

Parameters	Description
Corporate Laws	The extent to which the shareholders could be held liable for the acts of the investee entity
Setting Up and Maintenance	Ease of setting up entities in the jurisdiction; requirement of local directors/ record keeping etc on incorporation etc; annual cost of maintaining the business entity
Funding options	Whether the investment could be funded by way of equity and/ or debt; restrictions on such funding
Other directives / incentives	Directives (like the EU Directives) providing tax deferral/reliefs, investment incentives, etc
Ease of winding up business	Ease of winding up including dissolution / liquidation of the company, bankruptcy laws
Exchange Control Regulations	Like FEMA, each country may have its Exchange Control Regulations, which need consideration before finalising an investment structure

INDIA INBOUND

INBOUND TRENDS
Background

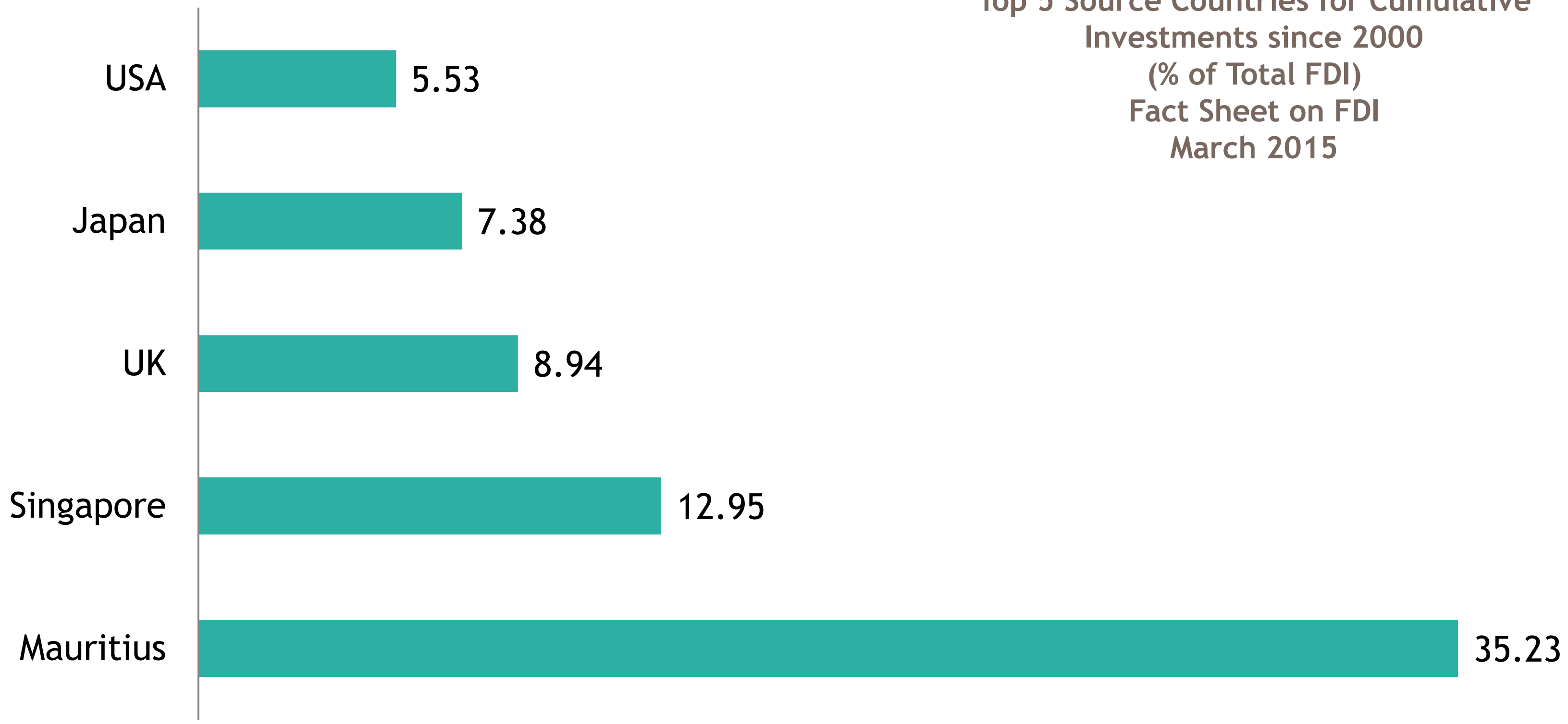
- Under the leadership of Hon'ble Prime Minister, Mr Narendra Modi, India has seen a plethora of reforms conducive to attract foreign investment during the year that has gone by
- Growth is picking up pace, the economy is stable & resilient and FDI is poised for a spurt. This is visible to an extent as follows:
  - Foreign Direct Investments at the end of February 2015 were **USD 32.5 bn**, **up by 38%** over the previous 12 month period
  - Foreign Institutional Investment at the end of April 2015 were **USD 47.2 bn**, **up by 640%** over the previous 12 month period
  - Inflation rate is going down gradually
  - India's economic growth is expected to rise to 7.5% in 2015-16
- But there is a sense of shortcomings in certain quarters mainly on account of the fact that the Government has not been able to move as fast as expected

INBOUND TRENDS
Ambition & Challenges

Ambition	Challenges
India to move on the World Bank's 'Doing Business' index from number 142 to number 50	India ranks behind in various parameters such as global competitiveness, macroeconomic environment, infrastructure and labour efficiency
Develop India as a manufacturing hub by promoting ‘Make in India’	Enabling environment which shall improve the ease of doing business in India
Development of 100 smart cities over a period of time	Power outages, poor infrastructure and dearth of clean drinking water
End tax terrorism and bring a tax certain regime in India	Ghosts of Vodafone - retrospective applicability of indirect transfer provision and MAT to foreign investors still hang on

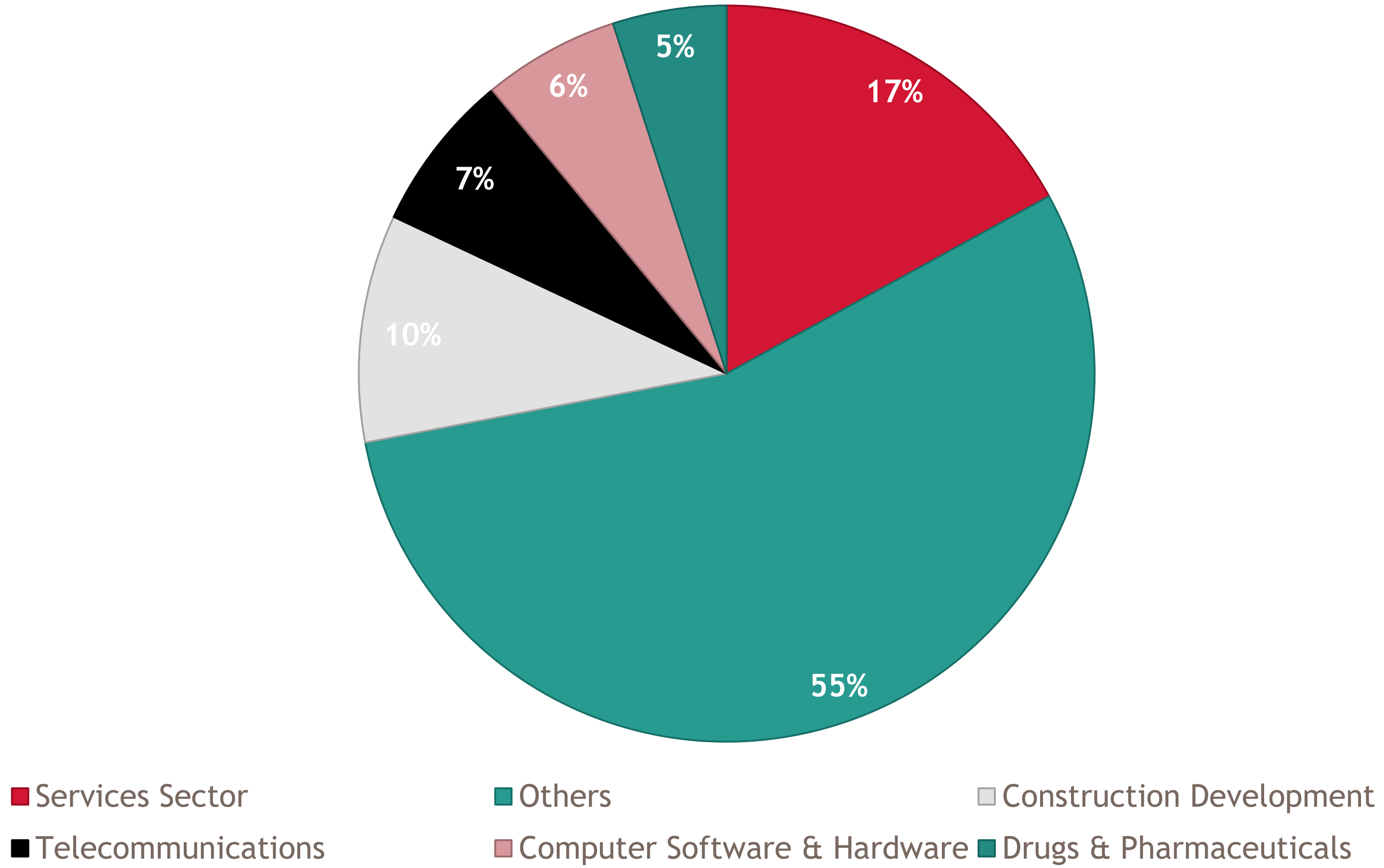
INBOUND TRENDS

Investments - Source Countries



Top 5 Source Countries for Cumulative Investments since 2000
(% of Total FDI)
Fact Sheet on FDI
March 2015

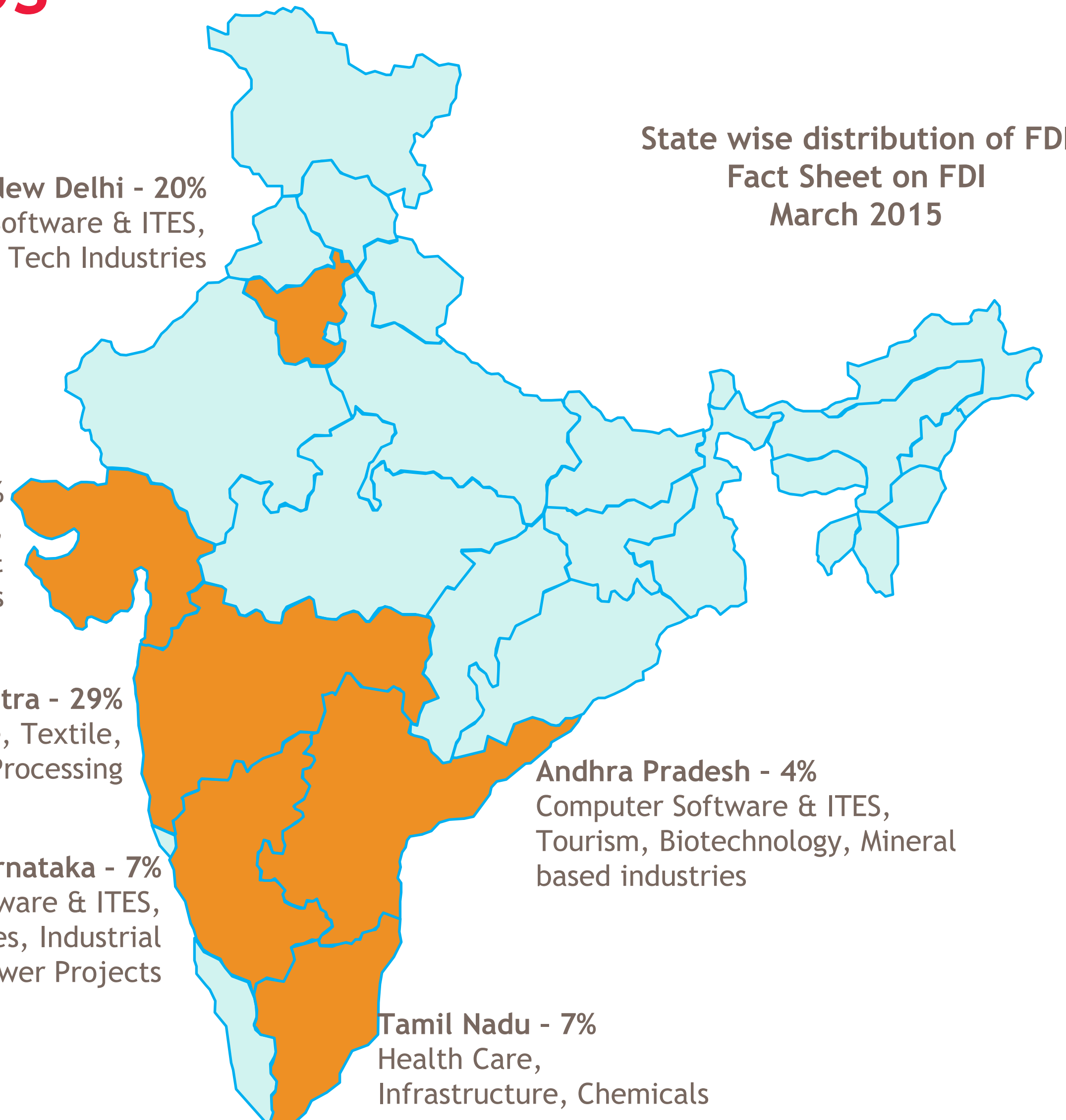
INBOUND TRENDS
Sectors



INBOUND TRENDS

Destinations

State wise distribution of FDI
Fact Sheet on FDI
March 2015



New Delhi – 20%
Computer Software & ITES,
Electronics & High Tech Industries

Gujarat – 4%
Food Processing,
Port related activities &
Infrastructure, Chemicals

Maharashtra – 29%
Automobile, Textile,
Food Processing

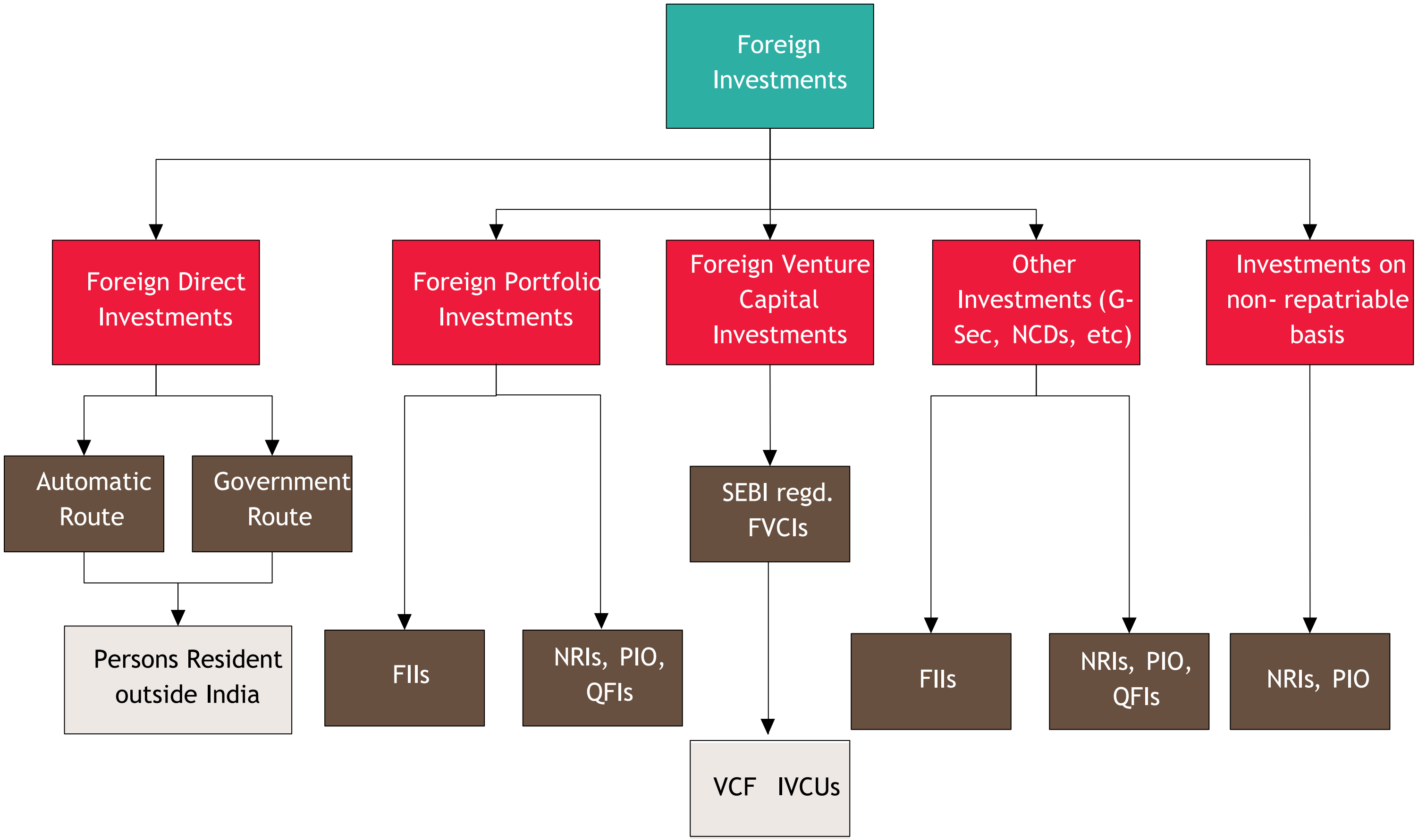
Karnataka – 7%
Computer Software & ITES,
Telecom, Automobiles, Industrial
Parks, Power Projects

Andhra Pradesh – 4%
Computer Software & ITES,
Tourism, Biotechnology, Mineral
based industries

Tamil Nadu – 7%
Health Care,
Infrastructure, Chemicals

EXCHANGE REGULATIONS

Schematic Representation



EXCHANGE REGULATIONS

Caps on Foreign Investment - Key Sectors

Sector	Foreign capital allowed (in %) *
Cash & Carry Wholesale Trading	100%
E-commerce Activities (B2B transactions only)	100%
Single Brand Product Retailing	100%
Multi Brand Retail Trading	51%
Telecom	100%
Asset Reconstruction Companies	100%
Defence	Subject to approval
Broadcasting Services (DTH, FM, News channels etc)	26-100%
Print Media	26%
Passenger Airlines	49%
Private Sector Banking	74%
Insurance	26-49%

*** - May require prior approval of the regulatory authorities and may be subject to restrictions**

EXCHANGE REGULATIONS
Legal Structures

Company

- Foreign investors allowed to float new companies
- Foreign Investment permitted in existing companies as well
- Investments subject to sectoral caps and conditions prescribed

Limited Liability Partnership / Partnership Firm

- Contribution to the capital of the partnership firm/ LLP subject to approval by the regulatory authorities
- Investment by Non-Resident Indians permitted without prior approval, provided the investment is on a non-repatriable basis

Office in India (PO, LO, BO)

- Prior approval required for setting up of an office in India; generally such offices are prohibited from carrying on core business activities in India
- Automatic route available in certain cases
- Banking companies are required to obtain specific approval for their business

REGULATORY IMPLICATIONS
Company

Overview:

- Set up of subsidiary companies in India either as a private or a public company, limited by shares / guarantee or an unlimited liability company
- Subsidiaries can either be wholly owned or in joint venture with some Indian partner
- All types of business activities like manufacturing, marketing, services etc permitted
- Sectoral caps as listed under the FDI policy to be adhered to; approvals to be sought wherever required
- Funding in the form of share capital, hybrid instruments, loan or a combination thereof

Tax Implications:

- Companies incorporated in India and hence tax residents of India
- Interest payments on debt allowable as a deduction subject to meeting with the 'business purpose' test
- Dividend Distributions taxable at an effective rate of 20.36%, dividends exempt in the hands of the shareholders
- Capital gains on sale of unlisted shares held for 36 months or more taxable at a base rate of 10%/20%, as the case may be

EXCHANGE REGULATIONS

Funding Options

Funding

- Equity / Contribution to Capital
- Compulsorily convertible Preference shares/ Debentures
- Optionally convertible preference shares / debentures
- Foreign Currency Convertible Bonds
- Debt ie. External Commercial Borrowings

No end use restrictions

Specified end use restrictions; ceiling; maturity

REGULATORY IMPLICATIONS

Company v LLP

Consideration	Company	LLP
Tax Rate	34.608%	
Distribution Tax	**DDT payable @ 20.36% of dividends distributed**	No distribution tax
Profit in the hands of partner / shareholder	Dividends are exempt in the hands of the shareholder	Profits are Exempt in the hands of the Partner
Transfer of Interest/ Shares	Taxable in India, subject to exemption under applicable tax treaty	
Repatriation of Cash/ profits	Company distributing dividends/ undertaking buy-back would be subject to tax	Withdrawal of profits does not invite any tax event
Approval	Investment under the automatic route would not require any government approval	**Permitted only in those sectors where FDI under automatic route is allowed; further, prior approval of the Government must**

REGULATORY IMPLICATIONS
Project Office

Overview:

- General permission granted by RBI to foreign companies to establish POs in India, if they have secured a contract from an Indian company to execute a project in India and the project has been funded by way of any of the prescribed modes
- Prior approval of RBI required in case above criteria are not met
- Compliances to be undertaken at the time of establishment and subsequently on an annual basis

Tax Implications:

- Typically, PO would constitute an Indian PE of the foreign company since business of the foreign company is carried out through such PO
- Income attributable to Indian operations would be taxable in India at a base tax rate of 40%
- Deductibility of HO expenses restricted to 5% of total income
- Transactions between Project Office and Head Office may be subject to transfer pricing regulations

REGULATORY IMPLICATIONS

Setting Up Liaison/ Branch Offices

Application:

- Foreign body corporate (includes a firm or association of individuals) has to make application to the RBI through AD Category-1 bank in form FNC
- Applications considered under 2 routes
  - RBI Route: Where principle business of foreign entity falls under sectors where 100% FDI allowed under automatic route
  - Government route: Other cases. Considered by RBI in consultation with Ministry of Finance
- Criteria for foreign entities:

Criteria	LO	BO
Track record of profits	Preceding 3 financial years	Preceding 5 financial years
Net worth	Atleast USD 50,000	Atleast USD 100,000

Compliances:

- Submit a report to the Director General of Police
- Annual Activity Certificate certified by Chartered Accountants to be submitted to RBI, DGP, AD Bank and the Directorate General of Income-tax (International Tax) within 6 months of B/S date, along with audited financial statements having Receipts & Payments A/c

Applicants who do not satisfy the eligibility criteria and are subsidiaries of other companies can submit a Letter of Comfort from their parent company, subject to the condition that the parent company satisfies the eligibility criteria as prescribed here.

REGULATORY IMPLICATIONS

Liaison Office

Overview:

- Prohibited from undertaking any **commercial / trading / industrial activity, directly or indirectly**
- Allowed to represent the foreign company; promote its products and services; act as a communication channel between Indian companies and foreign company
- Required to maintain itself out of inward remittances received from parent company through normal banking channels
- Prior approval of RBI required

Tax Implications:

- Since no commercial activities could be undertaken, no income could be said to be taxable; however, **courts have held that the real nature of the activities need to be ascertained to determine taxability**
- An annual Statement (Form 49C) under Sec 285 of IT Act within 60 days from end of FY to be filed
- Transactions between Branch Office and Head Office may be subject to transfer pricing regulations

REGULATORY IMPLICATIONS

Branch Office

Overview:

- Foreign companies engaged in manufacturing or trading activities are allowed to set up BOs in India with specific approval of the RBI
- Normally engages in the same operations as that of the head office
- Funding can be done either through receipts from the parent company or from Indian business operations
- **Branch offices are not permitted to undertake retail trading activities of any nature OR Manufacturing or processing activities (except manufacturing within SEZs)**

Tax Implications:

- Typically, branch would constitute an Indian PE of the foreign company where the business of the foreign company is carried out through such branch
- If so, income attributable to Indian operations would be taxable in India at a base tax rate of 40%
- Deductibility of HO expenses restricted to 5% of total income
- Transactions between Branch Office and Head Office may be subject to transfer pricing regulations

REGULATORY IMPLICATIONS

Key Considerations while selecting a structure

- Choice of **legal entity** in light of the business considerations & exchange regulations
- **Funding** of investment in India – Equity/ Debt/ Hybrid instruments or a combination of these instruments
- Preferred jurisdictions for **intermediate holding companies** for effective cash repatriation in light of the distribution tax on dividend & buy-back
- **Transfer pricing considerations** for Investment & Income structuring
- Tax efficient **cash repatriation** from India
- Shelter for **gains on divestment/ exit**; Implications of the Indirect transfer provisions; Stamp Duty Cost at the time of exit (Presently levied @ 3-5% on transfer of assets; a lower rate (0.1%) prescribed for transfer of shares)
- Implications under **GAAR** for the proposed structure
- **Reporting** requirements in the local jurisdiction for overseas investments (eg: FACTA)

INTERMEDIATE HOLDING COMPANY

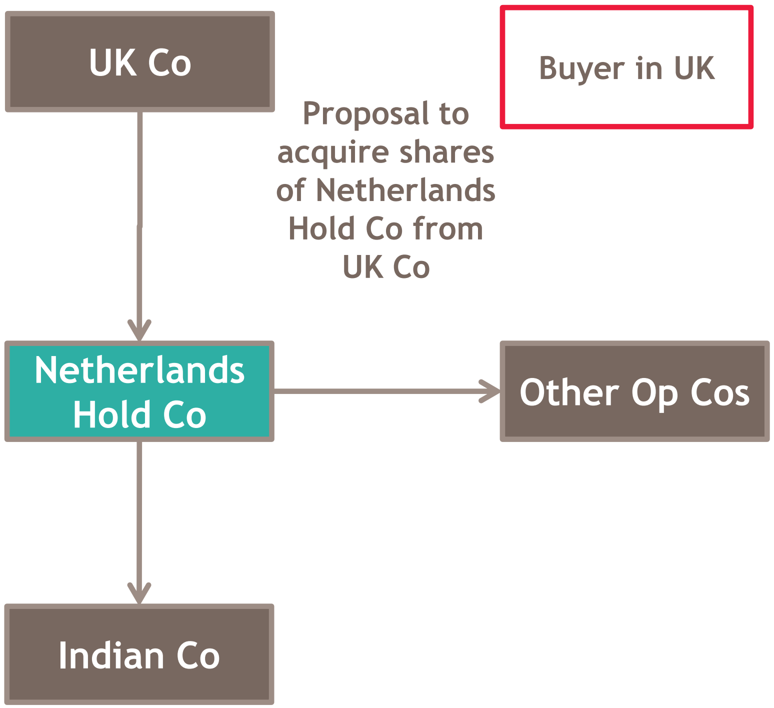
Jurisdiction Comparison

Consideration	Mauritius	Netherlands	Singapore
Corporate Tax Rate	3-15%	20-25%	17%
Withholding Tax in India (Tax Treaty) -Interest -Royalties/ FTS	 As per local laws (20/5)% 15% (No FTS)	 10% 10%	 15% 10%
Capital Gains	Taxable in Mauritius (effective tax NIL)	Taxable in NL (if sold to another resident – effective tax NIL)	Taxable in Singapore (effective tax NIL, subject to LOB)
Tax Treaty Network (Key Countries)	UK, Germany, France	Extensive treaty network with various countries	UK, Germany, France

The structure would have to meet with the commercial substance test under the Indian GAAR provisions

KEY TAX ISSUES

Indirect Transfers (The Vodafone After-effect)



- Shares of Netherlands Hold Co would be deemed to be located in India, if substantial value of such shares is derived from assets located in India (ie. Indian Co)

- Indirect transfer provisions would be applicable only if the value of Indian assets **exceed INR 100 Mn** AND such assets contribute alteast **50% of the total value** of the foreign hold co

- Certain **exemptions to minority shareholders** ie. shareholders having no right in management or control and holding less than 5% of the voting power, directly or indirectly

- Specified foreign amalgamations/ demergers shall not be subject to tax under these provisions

KEY TAX ISSUES

Applicability of MAT to Foreign Investors

- Finance Act 2015 provides that Minimum Alternate Tax ('MAT') shall not apply to capital gains arising to foreign companies from transactions in securities and on incomes such as interest/ royalties/ FTS , which are chargeable to tax on a gross basis, if such income is chargeable to tax at a rate lower than 18.5%.

- However, the above proposals are to take effect from 1 April 2015. Thus, for the cases prior to this date, the law is still unclear

- As per recent news items, the Indian tax authorities have raised demands on several foreign portfolio investors ('FPIs'), levying tax under the MAT provisions on income earned by such FPIs. This action of the tax authorities has been challenged by the FPIs before the High Courts

- As such, the provisions of MAT should apply to companies who are **liable to maintain books of accounts** in India as per the corporate law provisions

KEY TAX ISSUES

Cyprus- A Notified Jurisdictional Area

Cyprus has recently been notified as a notified jurisdictional area. The following are the consequences arising from the said notification:

- All transactions between an Indian resident and a person in Cyprus shall be subject to **transfer pricing regulations**
- Onus on Indian resident to **prove source of money** from any sum received from a person in Cyprus, failing which such sum may be taxable as income in hands of the Indian resident
- **Deduction of expenditure/ allowance** for a transaction with a person in Cyprus may be denied if prescribed information is not maintained and furnished
- Payments made to a person located in Cyprus liable for **withholding tax at 30 per cent** or higher rate (if applicable) prescribed under the IT Act

INDIA OUTBOUND

OUTBOUND TRENDS
Introduction

- India, an emerging market economy, one of the 5 BRICS economies has vibrant Private Sector ('India Inc'), known for its entrepreneurial drive

- The two way globalization process and integration of the Indian economy with the rest of the world has enabled substantial inflow of foreign investments into India

- Also, there has been a significant increase in the investments made from India with a view of global market penetration; accessing to technology and skills; and facilitating research and development activities

- However, owing to high leverage taken for making investment; adverse changes in the business cycle; and global slowdown, most of the India Inc's big ticket overseas acquisition in the past 5-7 years have in fact eroded the wealth

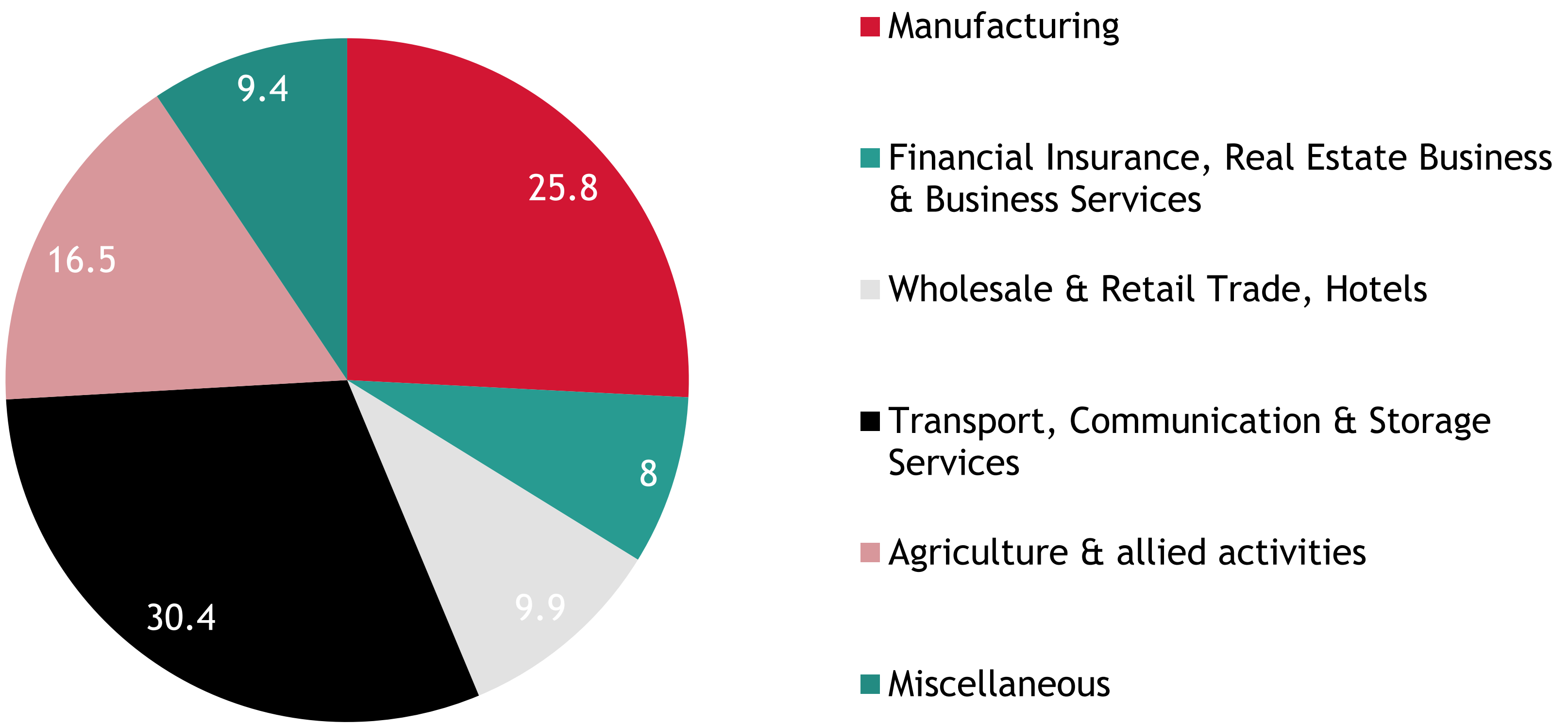
OUTBOUND TRENDS

Investment Destinations

Investment Destinations	Routing Destinations
USA	Netherlands
UAE	Singapore
UK	Mauritius
Switzerland	British Virgin Islands
Singapore	Cayman Islands

OUTBOUND TRENDS

Sectors



Source: Outward FDI Investment by India – CARE Ratings dated 14 March 2014

OUTBOUND INVESTMENTS

Exchange Regulations

- Regulated by the Indian Central Bank, the Reserve Bank of India ('RBI')
- Largely, all outbound investment qualify under the **Automatic route**; exceptions are Real estate activities and Banking business
- Indian companies are allowed to invest upto **4 times their net-worth**
- Indian Companies engaged in energy and natural resources sectors such as oil, gas, coal and mineral ores could make larger investment with the prior approval of the RBI
- **Resident individuals** are allowed to invest **upto USD 250,000** annually in their individual capacities

OUTBOUND INVESTMENTS

Comparison Of Tax Laws …

Particulars of Income	India	Rest of the World
Royalty, Interest from foreign source including from WOS	Taxable at a base rate of @ 30% effective rate as any other normal sourced Income	Holding company jurisdictions tax foreign sourced income at concessional rates
Dividend Income from foreign companies	Subject to fulfillment of prescribed conditions, taxable at a base rate @ 15% for this year	Most countries have a favourable tax treatment for foreign sourced dividend income and provide participation exemption or high rate of exemption
Capital Gains	Long term gain taxable at base rate of 20% and short term gains taxable at base rate of 30%	Capital Gains on foreign assets is generally not taxed in the country of residence

OUTBOUND INVESTMENTS

Comparison Of Tax Laws

Particulars of Income	India	Rest of the World
Minimum Alternate Tax	Tax on book profit at base rate of 18.5% that includes foreign source income	Such taxation of income is not seen in most holding company jurisdictions
Fiscal Consolidation	No such option is currently available	Available in many jurisdictions enabling tax efficiency
Intellectual Property	No special incentives are available	Many countries in Europe and Asia offer incentives to set up Research & Development centers
Foreign Tax Credit	India provides unilateral tax credit under Indian Tax Law as well as under respective Tax Treaties	Available under Tax Treaties and possibly under respective Tax Laws

OUTBOUND INVESTMENTS

Key Considerations

Investments routed through special purpose vehicles ('SPV's) or holding company structures for the following reasons:

- **Marry debt** raised for acquisition with the profits of the target operating company which could be utilised for servicing the debt
- Avoid suffering **tax on repatriation of foreign sourced income** in India and then subject further investment to Indian Exchange Regulations.
- Avail **benefit of the tax regimes** in jurisdictions such as Mauritius, Singapore etc which do not tax most of the foreign sourced incomes
- Avail **benefit of exemption of Dividend Income, Capital Gains** and holding cash overseas In case of acquisition in Eurozone, a holding/operating company in EU is preferred to obtain benefit of EU directives
- Raise funds by **overseas listing** without diluting equity base

OUTBOUND INVESTMENTS

New Tax Challenges

GAAR

- GAAR provisions are targeted at arrangements undertaken where the main purpose is to take tax benefit
- The regulations empower the tax authorities to disregard residency of overseas Company, treating them as tax residents of India and the income so earned by them could be brought to tax in India
- GAAR shall be applicable from 1 April 2017

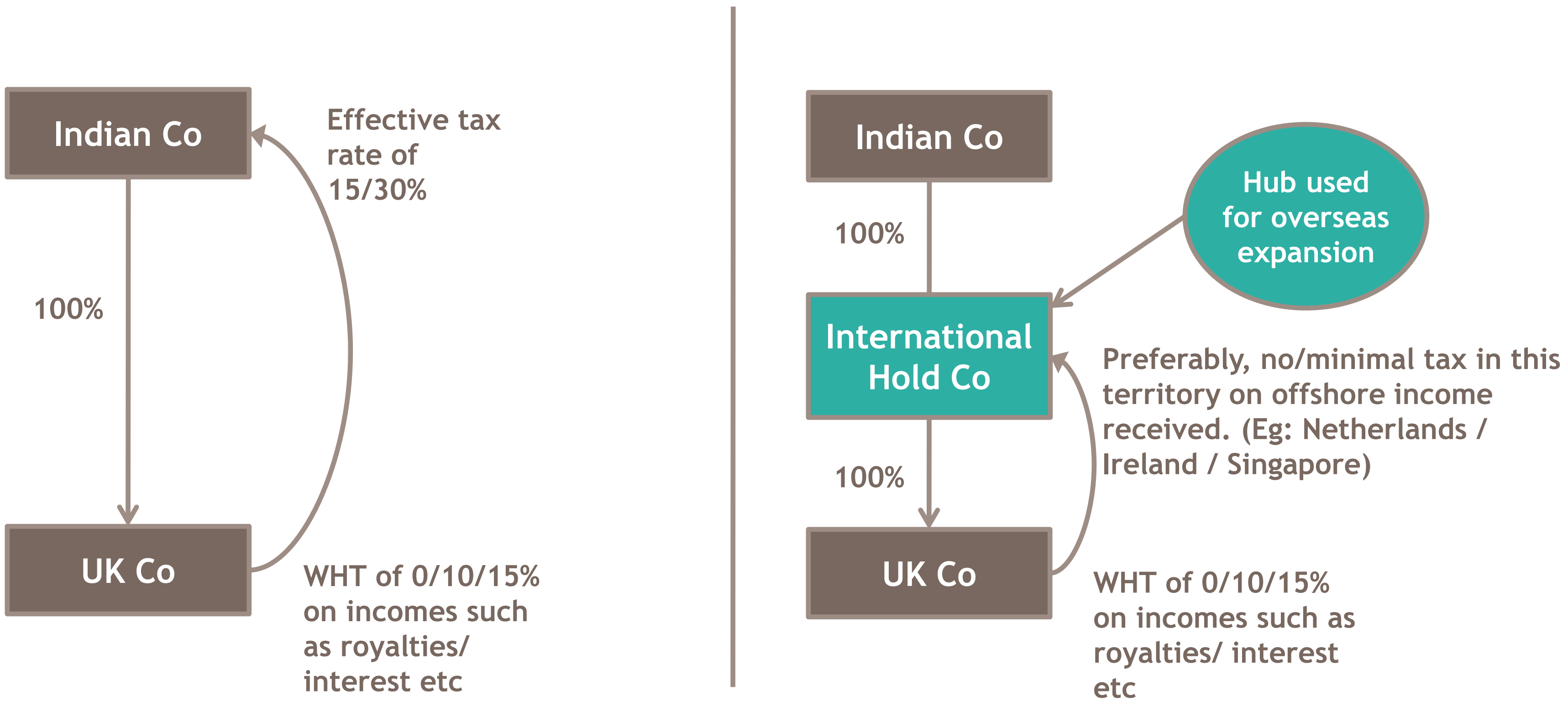
POEM

- Foreign company shall be considered to be a resident in India if its place of effective management, in that year, is in India
- Concept of POEM similar to the one present in various tax treaties, rules to be framed in this regard
- If considered as a resident, worldwide income of foreign company may be taxable in India

CASE STUDIES

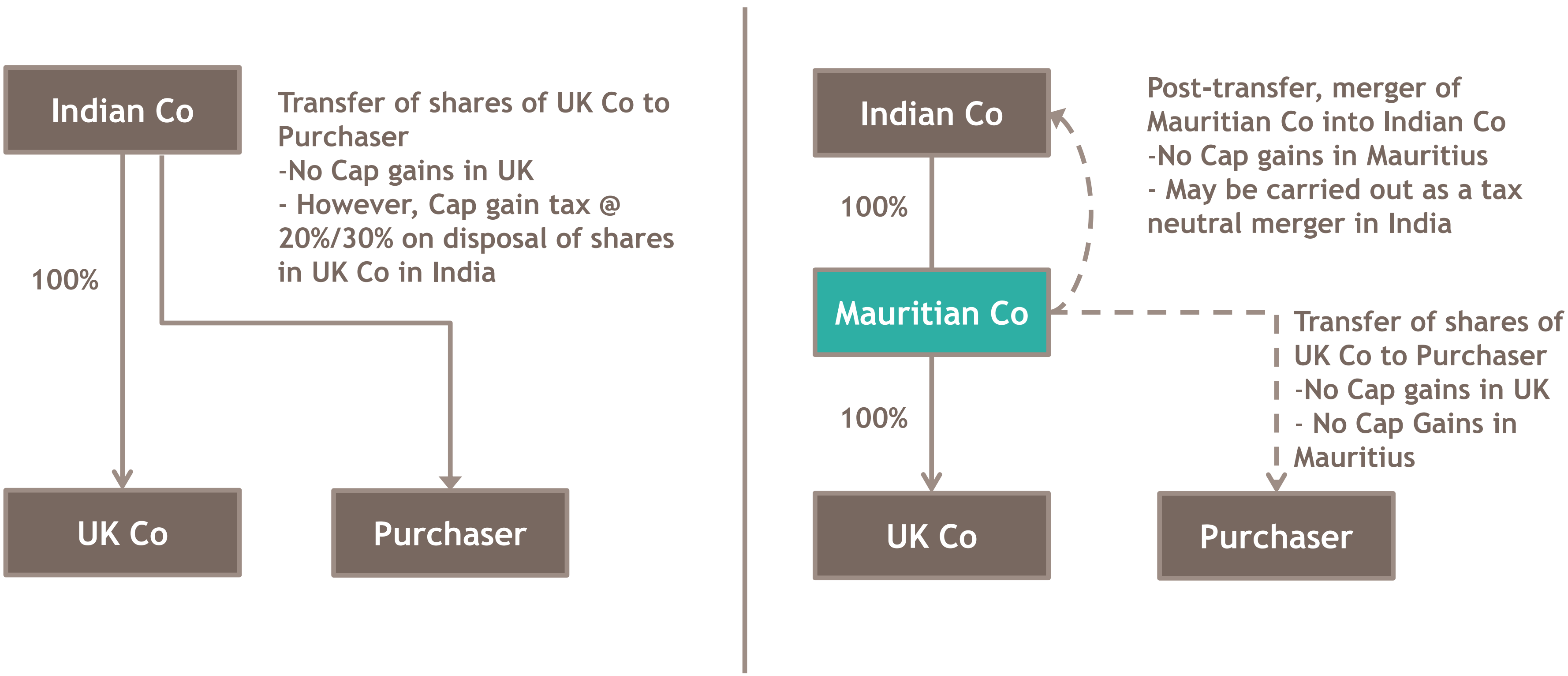
CASE STUDIES

Case 1 - International Holding Co



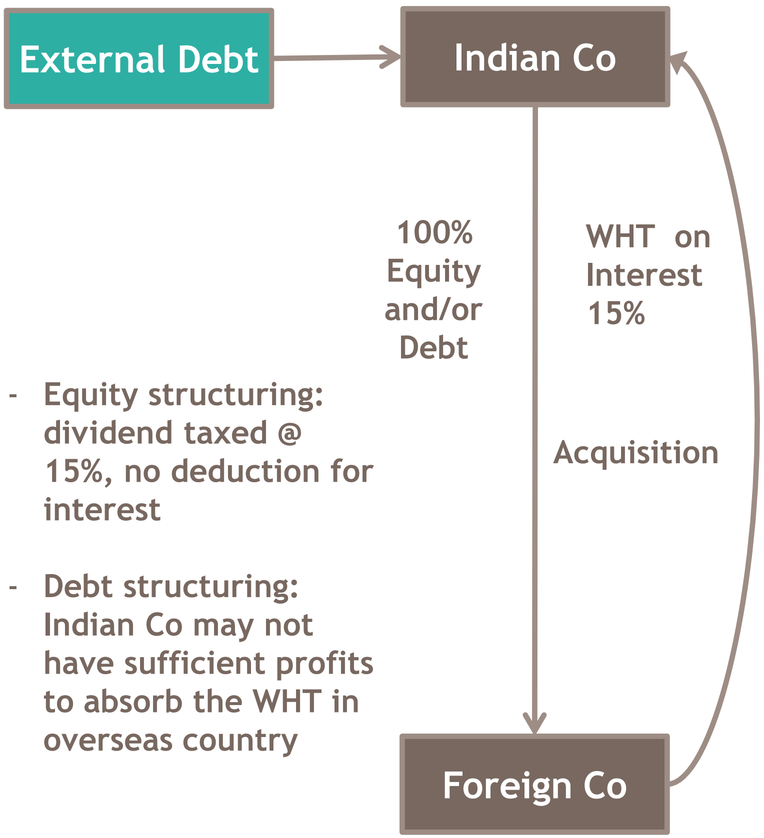
CASE STUDIES

Case 2 - Minimising Capital Gains Tax



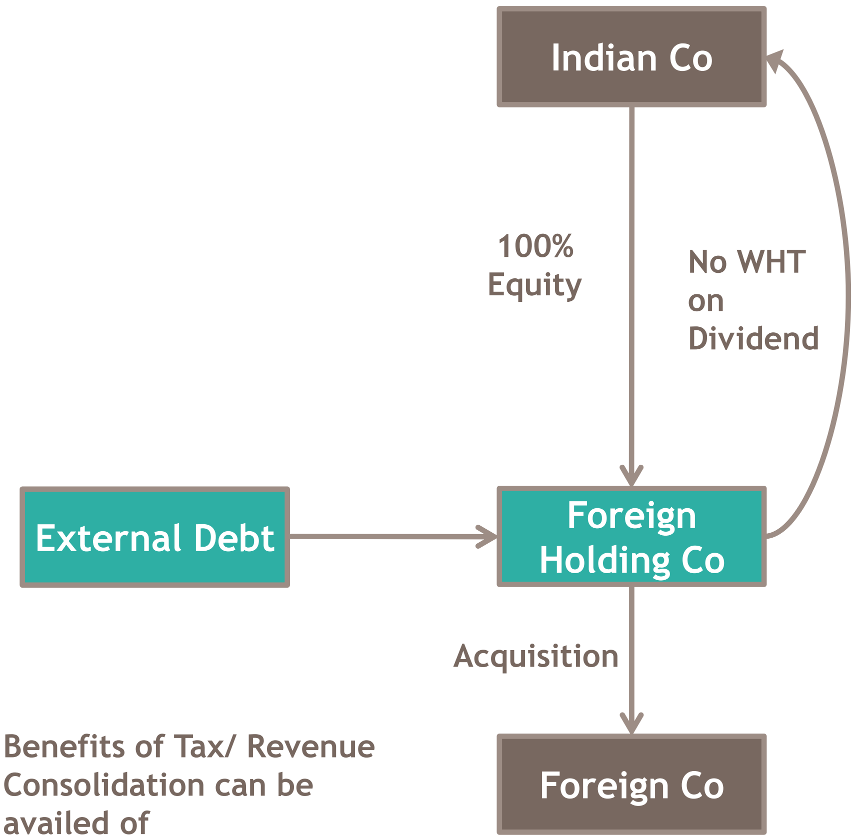
CASE STUDIES

Case 3A - Financing Overseas Companies



- Equity structuring: dividend taxed @ 15%, no deduction for interest

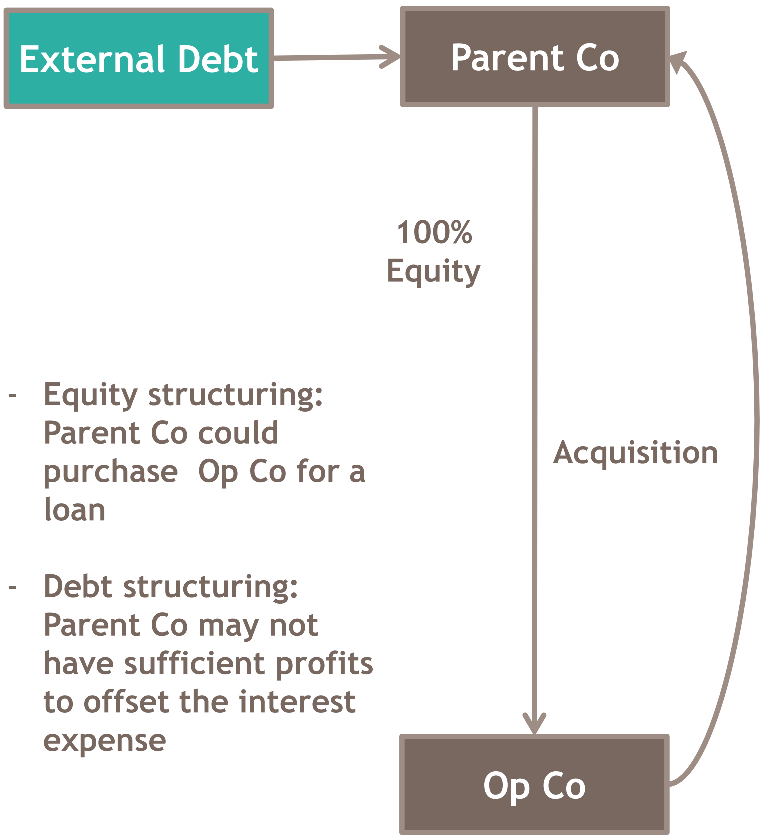
- Debt structuring: Indian Co may not have sufficient profits to absorb the WHT in overseas country



Benefits of Tax/ Revenue Consolidation can be availed of

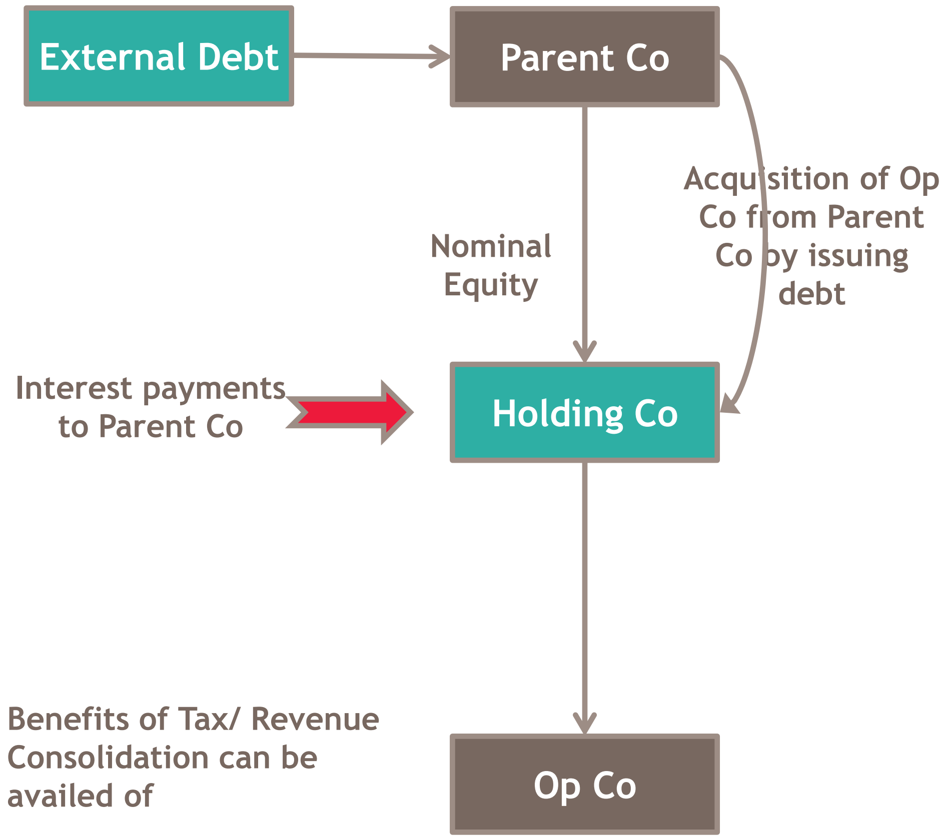
CASE STUDIES

Case 3B - Debt Push Down



- Equity structuring: Parent Co could purchase Op Co for a loan

- Debt structuring: Parent Co may not have sufficient profits to offset the interest expense



Benefits of Tax/ Revenue Consolidation can be availed of

ANTI-AVOIDANCE MEASURES

ANTI-AVOIDANCE MEASURES
Indian Scenario

Judicial Anti-avoidance	• Aditya Birla Nuvo – Prima facie, Disregarding legal ownership of shares • Otis India – Disregarding buy-back scheme whereby only one shareholder had tendered shares
Notified Jurisdictional Areas	• Unilateral act by India to notify a country • Implications include higher withholding tax, applicability of transfer pricing provisions, addition to income for unsatisfactory explanations
Indirect Transfers	• Tax event in India in case of overseas sale of assets which derive their value substantially from assets located in India • Treaty relief may still be available
General anti-avoidance rules	• Targeted at transactions the main purpose of which is to obtain a tax benefit • Fallouts include denying treaty benefits, disregarding corporate structure or form etc

ANTI-AVOIDANCE MEASURES
BEPS

- BEPS is a term used to describe **tax planning strategies** that rely on mismatches and gaps that exist between the tax rules of different jurisdictions, to **minimise the corporation tax** that is payable overall, by the following:
  - Either making tax profits "disappear" or
  - Shift profits to low tax jurisdictions where there is little or no genuine activity.

- BEPS Project is an **OECD initiative**, approved by the G20, to identify ways of providing more **standardised tax rules globally** to avoid/ minimize BEPS

- In general BEPS strategies are not illegal; rather they take advantage of different tax rules operating in different jurisdictions, which may not be suited to the current global and digital business environment.

BEPS - Focus Areas

- Action 1 :Address the tax challenges of the digital economy

- Action 15: Development of a multilateral instrument for amending bilateral treaties

- Action 2: Neutralise the effects of hybrid mismatch arrangements
- Action 3: Strengthen CFC rules
- Action 4: Limit base erosion via interest deductions and other financial payments
- Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance

- Action 11: Establish methodologies to collect and analyse data on BEPS and actions addressing it
- Action 12: Require taxpayers to disclose their aggressive tax planning arrangements
- Action 13: Re-examine transfer pricing documentation
- Action 14: Making dispute resolutions more effective

- Action 6: Prevent treaty abuse
- Action 7: Prevent the artificial avoidance of permanent establishment status
- Action 8: Consider transfer pricing for intangibles
- Action 9: Consider transfer pricing for risks and capital
- Action 10: Consider transfer pricing for other high-risk transactions

TAX & REGULATORY FRAMEWORK

Crystal Ball Gazing

- Introduction of **Controlled Foreign Corporation** in the domestic tax regime to prevent tax deferral
- **Headline tax rate to be reduced to 25%** in the next 4 years; although tax rate for 2015-16 increased
- **Abolishing MAT / Reduction in MAT** rate which is currently close to the corporate tax rate
- A litigation resolution/settlement scheme to **address complex litigation issues**

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