Outbound Structuring

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Outbound Structuring- Key Reasons

Business Factors

- IPR exploitation
- Supply chain management – hub for sourcing raw materials and trading operations

Financial Factors

- Access to low cost debt
- Centralized cash and treasury management
- Better returns on factoring trade receivables

Tax Factors

- Efficient ETR for Group
- Leverage extensive tax treaty network of holding company jurisdiction
- Facilitate re-deployment of profits in other group companies

Value Realization

- Participation by financial and strategic investors
- Possible listing outside India

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Key Considerations

Commercial factors

- Alternative forms of business presence
- IPR laws – protection and flexibility
- Exchange controls
- Bilateral Investment Protection Treaties
- Connectivity and political stability

IHC jurisdiction

- Participation exemption / Holding Company regime
- Mild transfer pricing regime
- Local incentives/subsidies (Tax and non-tax)

International tax regime

- Demonstrating substance
- Good tax treaty network
- Concessional tax rates for dividends, interest and royalty

Indian consideration

- Efficient ETR for Group
- Headline tax rate in IHC jurisdiction for CFC risk mitigation
- POEM risk

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Outbound investments

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Exchange control perspective

Company

- To be engaged in *bona fide* business activity excluding real estate or banking business
- Investment in financial services sector subject to additional conditions / approvals
- Financial commitment (capital subscription, loans, guarantees) restricted to 400% of net worth of Indian Company as per last audited balance sheet (subject to exceptions)
  - Ceiling not applicable to balances held in EEFC Account
- Subsequent sale of shares to be at fair value; write off of investments required RBI approval

Branch / Liaison Office / Representative Office

- Limits placed on total remittances during an accounting year
- For initial / setting up expenses – higher of
  - 15% of average annual sales / income of Indian entity during last 2 financial years
  - 25% of net worth
- For recurring expenses – 10% of average annual sales during the last financial year

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Key considerations

Key considerations	Company	Branch Office	Liaison / Representative Office
Legal and contractual risk with parent company in India	No	Yes	Yes
Permanent establishment risk	Low	Yes	May be
Restriction on scope of permitted activities	Low	Medium	High
Tax credit in India for taxes paid overseas	No (unless underlying tax credit allowed)	Yes	Yes
Additional costs on profit repatriation	Yes	No (unless branch profit tax levied)	NA (unlikely to have profits)

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Typical acquisition structures

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Acquisition structures

	DIRECT ACQUISITION	SINGLE – TIER SPV STRUCTURE	TWO – TIER SPV STRUCTURE
INDIA	Indian Co	Indian Co	Indian Co
COUNTRY HAVING GOOD TAX TREATY WITH INDIA			SPV 1
COUNTRY HAVING GOOD TAX TREATY WITH TARGET COUNTRY		SPV	SPV 2
TARGET COUNTRY	Operating company	Operating company	Operating company

Direct acquisition

- Could be tax inefficient
- Dividend withholding tax
- Immediate taxation on income flows in India
- Capital gains on exit

Single – tier SPV structure

- Partially tax efficient
- Deferral of Indian taxes
- Consolidation of earnings – Flexibility in fund movement

Two – tier SPV structure

- Optimal structure from tax and funding perspective
- Expansion opportunity
- Greater compliances
- 2 layer investment companies – FEMA challenges

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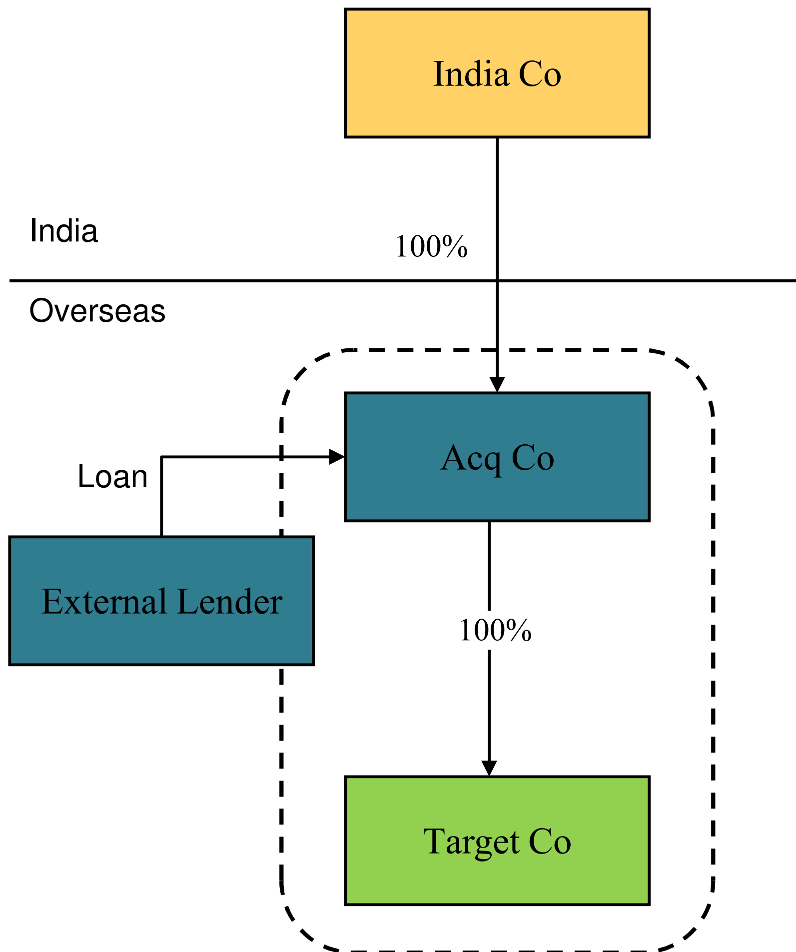
Leveraged buy-out



Mechanics:

- India Co sets up Acquisition Co in jurisdiction of Target Co
- Acq Co borrows funds from external lender
  - Guarantee provided by India Co
- Acq Co acquires shares of Target Co

Objective:

- Profits and cash of Target Co utilized for financing acquisition

Alternative 1:

- Post acquisition, Acq Co is merged into Target Co
- Target Co services the debt payable to external lender

Alternative 2:

- Post acquisition, Acq Co opts for tax consolidation
- No tax leakage on flow of funds between IHC and Target Co (eg dividend, etc.)
- Interest payable by IHC can be set-off against profits of Target Co
- Deductibility of interest cost for tax purposes – could be subject to litigation

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Trading company

Customers

3

Indian company

1

2

IHC

Should be in low tax jurisdiction

Trading Co

Raise low cost external finance

Should be in good CGT regime

Central raw material procurement

2

Customers

3

1

Overseas subsidiaries

Key:

- Sale of goods
- Raw material supply
- Funding
- Shareholding

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Holding company regimes

Parameters	Ireland	Switzerland	Netherlands	Luxembourg
1. EU Member	Yes	No	Yes	Yes
2. Tax rates	12.5% / 25%	12.5% - 25%	25%	28.8%
3. Holding Company regime				
(a) Dividend exemption	No	Yes	Yes	Yes
(b) Capital gains exemption	Yes	Yes	Yes	Yes
(c) CFC rules	No	No	No	No
(d) Transfer pricing	Limited	Yes	Yes	Yes
(e) Treaty network	55+	100+	110+	60+
4. IP tax rate	12.5% / 2.5% (effective)	9 - 11% (effective)	Qualifying assets - 5%	5.76% (effective)
5. IP Regime	Yes – applies to most intangibles	Yes	Qualifying assets - 5%	Yes – applies to most registered intangibles
6. Capital gains on IP	25 %	9 - 25%	Qualifying assets - 5%	80% exemption

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Case Study 1 – Investment in South Africa

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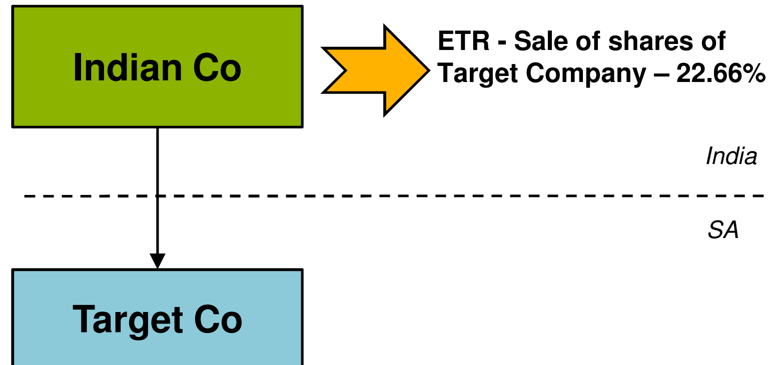
Direct Investment



Key Facts

- Indian Co holds Target Co as WOS in SA
- Target Co is profit making

Key Parameters

- Create an international holding company to facilitate new acquisitions / investments by the Group using profits of Target Co / profits on sale of shares of Target Co

Nature of income	India tax	SA Tax
Dividend from Target Co	17%	15%
Capital Gains	22.66% (if held for more than 36 months)	0% unless sale involves: • disposals of fixed property; • interests in fixed property located in SA; • assets of PE in SA

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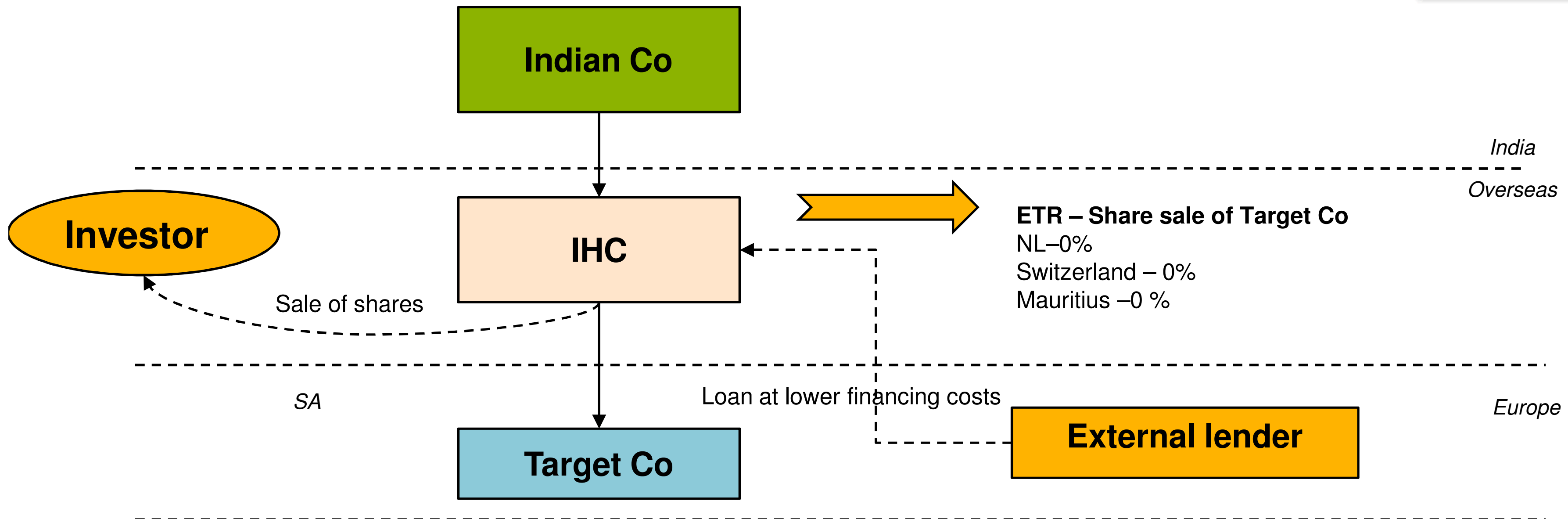
Interposing IHC for investments



Nature of income	IHC in NL	IHC in Switzerland	IHC in Mauritius
Capital gains – share sale	• NL - Participation exemption • SA - Exempt under DTAA	• Switzerland - Participation exemption • SA - Exempt under DTAA	• Mauritius – No capital gains • SA - Exempt under DTAA – DTAA under revision
Dividend from Target Co	5% (as per DTAA)	5% (as per DTAA)	5% (as per DTAA)

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Case Study 2 – IPR acquisition

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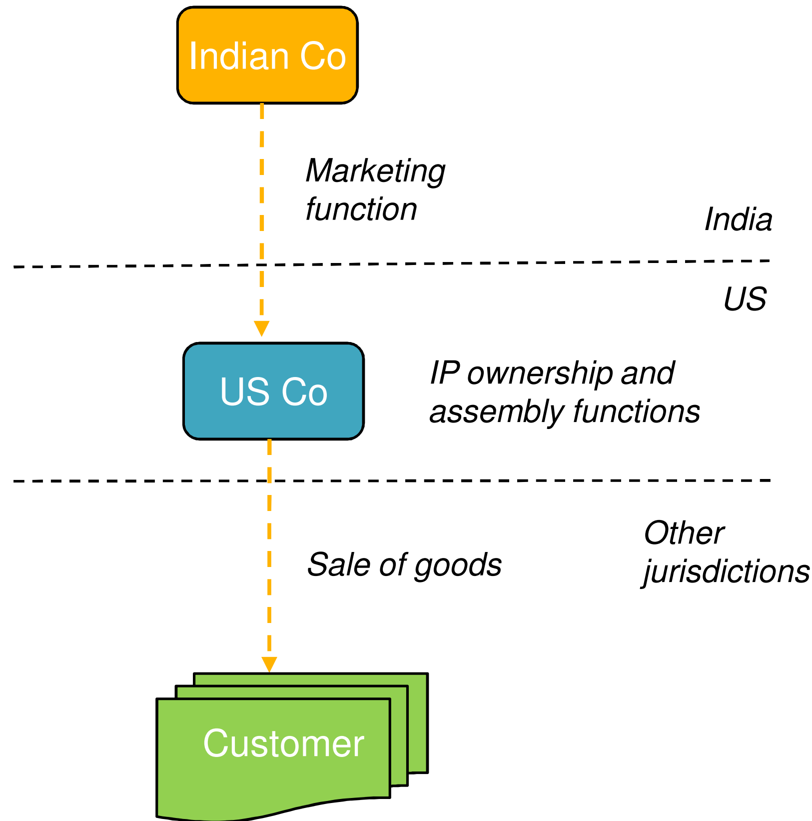
Current structure



Current structure

- US Co owns IPR, carries assembly function and sells goods to customers outside USA
- **US Co pays taxes in USA on its global profits**

Proposed transaction

- Indian Co to purchase entire business of US Co (including IPR and customer contracts) but not shares
- Contract manufacturing by third parties in USA
- Assembly function will take place in a US Co
- Customers are all over the world

Transaction parameters

- Tax liability in **USA to be restricted to assembly function**
- Set up an Operating cum IPR Holding company in a low tax jurisdiction to **lower tax liability**

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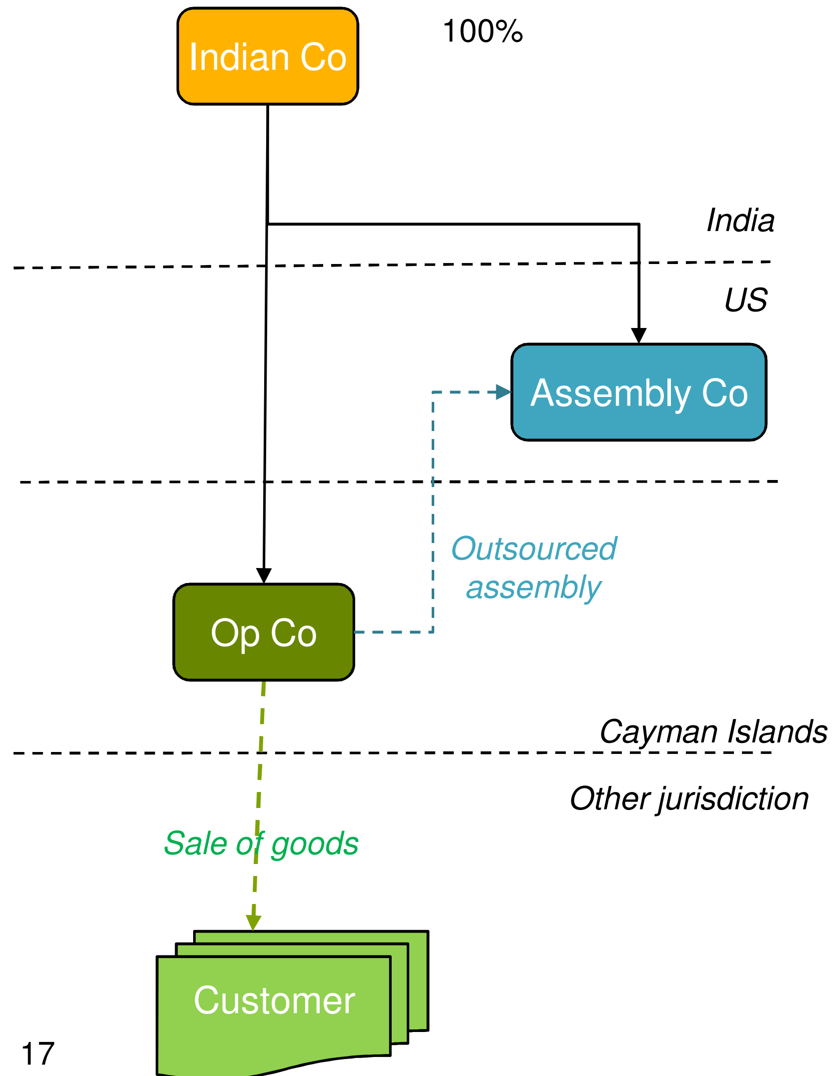
Proposed structure



New operating structure

- Indian Co to set up
  - Op Co in Cayman Islands; and
  - Assembly Co in USA
- Op Co to purchase entire business of US Co
- Op Co to sub-contract assembly function to Assembly Co
- Indian Co to provide marketing services
- Op Co to sell goods to customers

Tax implications under new structure

- **Taxability on assembly function -** Assembly Co to pay tax in USA
- **Taxability on sale of goods -** No tax payable on profits earned by Op Co

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DTC 2013 - CFC

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CFC Overview (1/2)

When CFC constituted

If Indian resident(s) individually or collectively–

- possess or are entitled to acquire 'directly or indirectly' shares carrying 50 percent or more of its voting power or capital
- are entitled to secure 50 percent or more income or assets of the foreign company to be applied directly or indirectly for their benefit
- exercise dominant influence on the foreign company due to special contractual relationship
- has 'directly or indirectly' sufficient votes to exert a decisive influence in a shareholder meeting of the foreign company

What is a CFC

- Tax resident of a territory with a lower taxation rate (ie tax paid in such territory less than 50 percent of corresponding tax payable under DTC)
- Shares are not traded on the stock exchange of such territory
- Indian residents exercise control over it
- It does not engage in active trade or business

Taxability in India

- 30 percent tax payable by Indian resident on attributable income
- CFC income treated as nil if 'specified income' $\leq$ INR 2.5 million
- CFC overrides tax treaty provisions

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CFC Overview (2/2)

Active trade / business

- It actively participates in industrial, commercial or financial undertaking through employees or other personnel in economic life of the country in which it is incorporated **and**;
- Less than 25 percent of income is from sources such as:
  - Dividend / Interest / Income from house property / Capital gains / Annuity payment / Royalty
  - Sale or licensing of intangible rights on industrial, literary or artistic property
  - Income from sale of goods / supply of services including financial services to related parties
  - Income from management, holding or investment in securities, shareholdings, receivables or other financial assets

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