Cross Border Transactions - Recent developments
- Rekha Bagry

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Indirect Transfer
The Vodafone Controversy

Transfer of Shares of Cayman Co.

Hutch Hong Kong Co

Cayman Islands Company

Mauritius Company

Overseas India

Hutch Essar India

Vodafone BV Netherlands

Revenue

- Transaction designed to avoid Indian taxes
- Form of the transaction disregarded - corporate veil lifted
- Transfer of foreign company’s shares resulted into transfer of assets located in India
- Controlling interest is a separate asset situated in India whose transfer gives rise to Indian tax
- Tax withholding obligations extend to non residents

Tax Payer

- Multi-pronged commercial rationale behind tiered structures such as ring-fencing liability, mitigation of risk, enabling separate verticals, etc
- No provision for taxing ‘indirect’ transfers
- ‘Rights and entitlements’ flow from the transfer of shares and are not separate capital assets
- Tax withholding obligations extend to non residents

Supreme Court Judgement*

- Transfer of shares in a foreign company does not lead to the transfer of assets situated in India
- Tax planning is legitimate if within the legal framework
- “Look at” test to be applied to determine true nature of transaction
- Legal form cannot be disregarded unless the transaction is a sham or tax avoidant
- Controlling interest is embedded in the shares and is not a separate asset

[2012] 341 ITR 1 (SC)
**The Sanofi Case**

**Revenue**
- Transaction designed to acquire control, management and business interest of SBL
- MA and GIMD are the beneficial owner and ShanH is merely a nominee of MA
- Alienation of shares under Article 14(5) means direct and indirect alienation
- Alienation not defined under the Treaty, to be imported from the IT Act
- Mode of disposal is immaterial – whether direct or indirect or deemed disposal

**Tax Payer**
- Controlling interest is not a separate asset
- Even if Controlling interest is viewed as separate asset, it is taxable in Frances under Article 14 (6) as the situs is in France
- Justification/ commercial rationale to set up ShanH

**High Court Judgement**
- ShanH is not a sham or conceived only for Indian tax-avoidance, thereby no case of piercing corporate veil
- Controlling Interest is not a separate asset. Further, the computation mechanism fails to attribute the value of controlling interest in SBL by ShanH
- Retrospective amendments do not override the Tax Treaty

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*[2013] 354 ITR 316 (Andhra Pradesh)*
Amendment to Income Tax Act

Supreme Court Positive Judgement

Bombay High Court Negative Judgement

Retrospective Amendment to Finance Act 2012
**Section 2(14)**

- "Rights and entitlements" not identifiable or distinct capital assets from shares held

**Section 2(47)**

- Shares and the rights which emanate from them, flow together and cannot be dissected

**Section 9**

- Situs of shares where the company is incorporated and where its shares can be transferred.

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**Prior Position**

- "Rights and entitlements" not identifiable or distinct capital assets from shares held

- Shares and the rights which emanate from them, flow together and cannot be dissected

- Situs of shares where the company is incorporated and where its shares can be transferred.

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**Amended Position**

- ‘Capital Asset’ deemed to include any rights in or in relation to an Indian Company, including rights of management or control or any rights whatsoever

- ‘Transfer’ deemed to include disposing of or parting with an asset / interest or creating any interest in any manner, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from transfer of a share or shares of a company registered or incorporated outside India;

- Situs of Shares of / interest in certain foreign companies:
  - Deemed to be situated in India, if the share /interest derives, directly or indirectly, its value substantially from the assets located in India
  - The expression “through” deemed to mean “by means of”, “in consequence of” or “by reason of”
Indirect Transfer of shares or interest in a foreign entity

Specified Date

- the last day of the accounting period of the entity preceding the transfer; or
- Date of transfer, if the book value of assets has increased by 15% or more from the date above

Exemptions:
- Foreign amalgamation / demerger – conditions apply
- No transfer of right of management / control in target entity (Foreign or Indian; and Voting power/share capital / interest held by non residents (along-with AEs) < 5% in:
  - Indian entity or assets; or
  - Foreign entity holding Indian entity / assets

Derivation of substantial value from India: If the value of Indian Asset is
- Exceeding INR 10 Cr; and
- Representing at least 50% of value of all assets owned by the foreign entity

Value of Indian assets includes value of assets / operations located outside India

Valuation to be determined by Merchant Banker or a CA

Gain in proportion to stake holding with Non residents to be taxed in India

Enterprise value approach

Transferor to file ROI and CA report (for correct computation)
Indian entity to file Form 49D reporting Indirect Transfer
- Penalty on Indian entity depending upon default:
  - 2% of the fair value of overseas transfer; or
  - INR0.5 million
Indirect Transfer Provisions
Revolving Controversies

Methods for determining fair value
Valuation Date
Scope of ‘substantially’
Transfer of ‘controlling interest’
Debt instruments covered in interest?
Applicability of treaty provisions
Availability of treaty benefits
Withholding tax liability on past transactions
Single stage levy
Intra-Group Corporate restructuring
Transactions in listed securities
**Rule 11 UC - Income attributable to assets in India**

\[ \text{Gains attributable to assets located in India} = A \times \frac{B}{C} \]

- **A**
  - Capital Gain from transfer of shares of foreign entity computed in accordance with Indian laws, as if such share/interest is located in India.

- **B**
  - Fair Market Value (‘FMV’) of assets located in India (as on specified date)

- **C**
  - FMV - Assets of the foreign company (as on specified date)

*The Assessing Officer shall determine the income taxable in India on failure on part of the transferor to provide information required to determine income attributable to Indian assets*
Rule 11 UB - Fair Market Value – Assets located in India

FMV = Observable price of such share on recognized stock exchange
(Higher of average of weekly high and low closing prices for 6 months preceding specified date or 2 weeks preceding specified date)

FMV = Expected price it can fetch in the open market (determined by merchant banker/accountant) + Liability, if any, considered in such determination

FMV = (A + B) / C
A = Market capitalization (basis observable price on stock exchange)
B = BV of liabilities
C = Number of outstanding shares

FMV determined by a merchant banker or accountant as per internationally accepted pricing methodology + Liability, if any, considered in such valuation

FMV of partner’s share = (Value determined by a merchant banker or accountant as per internationally accepted valuation methodology + Liability, if any, considered for such valuation) → apportioned to the partners in capital ratio till the extent of total capital, and then in asset distribution ratio or profit sharing ratio
Rule 11 UB - Fair Market Value – Assets of Foreign Company

- **Transfer between non connected persons**
  - FMV of all assets = A + B
  - A = Market Capitalization of the foreign company or entity computed on the basis of the full value of consideration for transfer
  - B = Book value of liabilities as on specified date, as certified by a merchant banker or an accountant

- **Other cases - Share of foreign company - listed on specified date**
  - FMV = A + B
  - A = Market capitalization of foreign company (based on observable price on stock exchange where it is listed on a stock exchange)
  - B = Book value of liabilities as on specified date

- **Other cases - Share of foreign company - unlisted on specified date**
  - FMV = A + B
  - A = FMV of foreign company / entity & its subsidiaries (on a consolidated basis) computed by merchant banker or accountant as per internationally accepted valuation methodology
  - B = Book value of liabilities as on specified date
**Indirect Transfer Provisions**

*New Controversies after Final Rules, 2016*

- FMV of Indian assets in multi-layered structures
- Availability of information to minority shareholders
- Preference Shares – whether capital or liability?
- Interpretation of “enterprise value”

**Questions:**

1. Reporting Requirement even if covered under treaty benefit?
   - Entities covered under treaty benefit are supposed to file a Return of Income
     Hence, reporting requirements should be adhered to

2. Is there any mechanism to reconcile the variations in the FMV value and the Deal price?
   - As per draft rules, the deal price is not considered relevant for valuation.
     The capital gains will be computed taking into account the deal price and the proportion of such gains taxable in India will be decided by the FMV obtained as per the rules
**Case Study 1**

Consider the following scenario:

- F Co 1 holds 100% in F Co 2
- F Co 2 holds 100% in I Co with some nominal cash
- The cost of F Co 2 shares for F Co 1 is INR 100 crores
- F Co 1 transfers the shares of F Co 2 to F Co 3 for INR 525 crores
- Gains = INR 425 crores

\[\text{Whether indexation is available?}\]
Case Study 2

Consider the following scenario:

- F Co 1 holds 100% in F Co 2
- F Co 2 holds 100% in I Co with some nominal cash
- Merger of FCo 1 into FCo 3
- Transfer of shares of F Co 2 to F Co 3 upon merger

Indirect Transfer of shares of I Co?
**Case Study 3**

Consider the following scenario:

- F Co 1 holds 100% in F Co 2
- F Co 2 holds 100% in F Co 3
- F Co 3 holds 100% in I Co
- Merger of F Co 2 into F Co 1
- Transfer of shares of F Co 3 to F Co 1 upon merger

Indirect Transfer of shares of I Co?
Buy-back Tax
Background – Advance Ruling*

Brief Facts
- A Ltd. was held by A USA (48.87%), A Mauritius (25.06%), A Singapore (27.37%) and General Public (1.76%)
- A Ltd. declared dividends up to 2003; no dividends declared pursuant to introduction of dividend distribution tax (‘DDT’) in 2003
- A Ltd. made a buyback offer in 2010; only A Mauritius accepted the offer
  - Even in buyback offer of 2008, only A Mauritius tendered its shares

AAR Ruling
- No dividends were declared by A Ltd. since 2003; reserves were allowed to be accumulated
- No proper explanation provided for non-declaration of dividends
- Buyback of shares held by other entities may have been subject to tax; for A Mauritius, totally out of Indian tax net
- Arrangement to be treated as a distribution of profits to its shareholders which does not attract DDT; hence a colourable device
- Distribution to satisfy definition of dividend under the Act; hence taxable in India as per Article 10(2) of India Mauritius tax treaty

*A.A.R. No. P of 2010
**Buy-back Tax**

| section 115QA | • Introduced w.e.f. 1st June 2013  
| • Levy tax @ 20% on distribution arrangement by way of buy back of shares of unlisted companies |

| Applicable on unlisted shares | • Section 115QA is applicable on unlisted shares.  
| • For listed shares, tax is computed in the hands of shareholders as capital gains. |

| Taxed on distributed income | • Buyback Tax= Consideration paid on buy back of shares less *amount received by the company* on issue of such shares |

| Exempt in the hands of shareholder u/s 10(34A) | • Akin to dividend, it is exempt in the hands of shareholders u/s 10(34A) of the Act |
Buy-back Tax: Controversies

Applicability of Section 115QA on buyback prior to June 1, 2013

Determination of amount received by the company in different situations

Identification of shares to be bought back vis a vis issued

Applicability to Buy-back u/s Scheme of Arrangement?

Clarification: Not applicable

Amendment: Applicable to buyback under any laws

Draft Rules issued

Applicability of section 56(2)(viia) of the Act

Draft Rules issued
Draft Rules - July 2016

CBDT has released the draft rules for determining the amount received by the company for the purpose of computing distributed income under different scenarios:

- **Shares issued upon subscription**
  - Paid up amount, including premium, actually received by the company

- **Shares issued upon amalgamation**
  - The amount received by the amalgamating company in respect of such share or shares

- **Shares issued upon demerger by resulting company**
  - Amount received by demerged company in proportion to book value of assets transferred which bears to its net worth

- **Buy-back by demerged company**
  - Amount received by demerged company less proportionate amount eligible for shares of resulting company.

- **Shares issued without consideration**
  - NIL

- **Conversion of convertible debt instrument**
  - Amount received in respect of the instrument so converted

- **Capital Repayment prior to buy back**
  - The amount received by the company as reduced by the sum so returned

- **Residual category**
  - Face value of share to be bought back
## A few concerns...

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| **Buy-back of shares issued for consideration other than cash?**        | • Co A transfers IP to Co B at FMV of INR 50 Crs.  
• Co B issues 50 lacs shares of face value INR 10 each and records premium in its books  
• Co B does buyback at INR 150 per share.  
• **Amount received?**                                                   |
| **Buyback of shares post consolidation/split?**                         | • Co A issues shares of face value INR 10 at INR 50.  
• Co A does share split wherein the face value per share becomes INR 2 each  
• Co A does buyback at INR 20 per share.  
• **Amount received?**                                                   |
| **Identification of shares to be bought back?**                        | • Co A had issued shares in 3 tranches - INR 20, INR 40 and INR 50.  
• Co A does buyback of shares  
• **Identification of shares?**                                         |
General Anti-Avoidance Rules (GAAR)
Avoidance v/s. Planning - the difference

Thin line

Avoidance ???
- Main objective - tax
- Loopholes in law
- Sequence of steps
- Parties to arrangement
- Share issue + buy back
- Benefit of NOL
- Demerger of immovable property
- Related party mergers

Planning !!!
- Tax holiday
- Issue of shares at premium
- GIFT to relatives
- Transfer of shares at fair value
- Transfer of immovable property at fair value
Relevance of GAAR

1. Tax Evasion
   - General term for efforts to not pay taxes by illegal means
   
   Even otherwise prohibited – GAAR irrelevant

2. Tax Avoidance
   - Legal utilization of tax regime to reduce tax payable
   - Using loopholes and gaps in tax
   
   GAAR applicable

3. Tax Planning
   - Looking at various tax options in order to determine when, whether and how to conduct transaction to reduce/eliminate taxes

   GAAR v/s legal provision
Few Indian Rulings

1 [1968] 67 ITR 11 (SC)
2 [2003] 263 ITR 706 (SC)
3 [2012] 341 ITR 1 (SC)
4 [2010] 326 ITR 1 (SC)
5 [1985] 154 ITR 148 (SC)
6 [2014] 227 Taxman 244 (Karnataka)
7 [1958] 34 ITR 888 (SC)


**GAAR trigger points**

- **First Condition**
  - There is an ‘Arrangement’

- **Second Condition**
  - There is an ‘Tax Benefit’

- **Third Condition**
  - Impermissible Avoidance Arrangement based on prescribed parameters

Allows tax officer to invoke GAAR and declare transaction as Impermissible Avoidance Arrangement (IAA)
What is tax benefit

1. Reduction or avoidance or deferral of tax
2. Increase in refund of tax
3. Reduction or avoidance or deferral of tax as a result of treaty
4. Increase in refund of tax as a result of treaty
5. Reduction in total income or increase in losses
Parameters for determining tax benefit

1. Connected persons may be treated as one and the same

2. Accommodating party may be disregarded

3. Accommodating party and any other party may be treated as one

4. Looked through disregarding corporate structure
Conditions for impermissible avoidance arrangement

Arrangement – Main purpose is to obtain tax benefit

AND

OR

Creates rights or obligations which would not ordinarily be created between dealing at arm’s length

OR

Results in misuse or abuse of the provisions of the Act

OR

Lacks commercial substance or is deemed to lack commercial substance in whole or in part

OR

Carried out by means or in a manner, which would not normally be employed for bona fide purposes
Lacks commercial substance

An arrangement shall be deemed to lack commercial substance if:

- Substance/ effect of arrangement as whole is inconsistent with or differs significantly from its individual steps or parts
- It involves or includes:
  - Round trip financing
  - Accommodating party
  - Offsetting or self cancelling elements
  - Transaction which disguises value, location, source, ownership or control of funds which are subject matter of transaction
- It involves location of an asset/transaction/place of residence of any party which would not have been so located for any substantial commercial purpose other than obtaining a tax benefit
**Tax consequences**

- Disregard/look through any corporate structures
- Treat place of residence, situs of asset/transactions at different place
- Reallocate income/expense/relief
- Disregard/combine any steps or parts
- Treat as if Impermissible avoidance arrangement not entered into
- Disregard/treat any parties as same person

**GAAR Impact**
**Tax consequences**

Such manner of determination may include:

- Treating Debt as Equity and vice versa
- Re-characterisation of expenditure, deduction or relief
- Treating accrual or receipt of capital as revenue and vice versa
**Introduction of GAAR rules**

**Question... Will it be deferred?**

**Applicability –**
From 1 April 2017

**Coverage –**
Only impermissible part of the arrangement

**Grandfathering –**
Income from *Transfer* of Investments prior to 31 March 2017

**Exempt –**
Certain specified investments*

**Threshold –**
Tax Benefit on aggregate basis - INR 3 crores

* (A) Non-resident investments in offshore derivative instruments / through FIIs
(B) FIIs (being an assessee under the ITA) not availing treaty benefits having investments done with prior permission
**British American Tobacco Services Ltd v Commissioner of Taxation***

**Mechanics**
1. Merger of BAT Group with RI Group
2. Sale of brands to RI group
3. Actual Sale of brands to third party at a same price

**Tax benefit**
- Rollover relief on capital gain in the hands for BAT and RI group as the company owning the brand in BAT group became the subsidiary of RI group
- RI Group have set off the capital gains against capital loss

**Tax Authority’s contention**
- The Commissioner identified the scheme as consisting of:
  - The decision to interpose RI Group between BAT and third party in relation to the disposal of the 9 Brands from BAT to third party;
  - The disposal of the 9 Brands from BAT to RI Group and from RI Group to third party;
  - The making of the choices by BAT and RI group to obtain rollover in relation to the capital gains made by BAT as a result of the disposal of the 9 Brands to RI Group; and
  - The making utilization of loss capital loss of RI group
- BAT group could have directly sold to the third party but have structured the transaction to obtain tax benefit.

**Tax Payer’s contention**
- Dominant purpose of the entire scheme is commercial to give effect to the entire part of the scheme and tax benefit was one step in wider scheme

**Judgment**
- Dominant purpose is to obtain the tax benefit and hence GAAR was applicable.
- Manner of scheme formulated and carried out explicity only by taxation consequences
- Correspondence mandated to complete merger prior to entering into any contractually binding arrangements for the sale of relevant brands which created the framework for claiming deferment of tax

*Australia - (2010) FCAFC 130*

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*Image Description*
- Diagram showing the flow of the transaction:
  - **BAT Group** 
  - **RI Group**
  - **Third Party**
  - Merger
  - Sale of Brands
  - **9 brands**

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*Note:
- The diagram illustrates the flow of transactions from BAT Group to RI Group and finally to the third party, highlighting the steps of the merger and sales.
- The text elaborates on the mechanics, tax benefits, and the tax authority and tax payer’s contentions.
- The judgment highlights the dominant purpose and applicability of GAAR.*
The Queen v Canada Trust Co Mortgage Co*

Mechanics
1. Vendor sold the trailer to the company.
2. Company leased back the trailer to vendor

Tax Benefit
The Company is eligible for Capital Cost Allowance as the trailer is owned by the company
Deferment of payment of tax

Tax Authority’s contention
The tax authority wants to apply GAAR as to deny the capital cost allowance

Judgment
In order to invoke GAAR there should be 3 requirement as under:
1. There must be a tax benefit from a transaction
2. Transaction has not been undertaken for bonafide purpose other than to obtain tax benefit
3. There must be abusive tax avoidance i.e. the transaction is contrary to the intention of statute

The burden is on tax payer whether transaction does not have tax benefit and transaction has been undertaken for bonafide purpose.

However, the tax authority has to prove that the transaction is contrary to the intention of statute.

If the transaction is accordance with the purpose of the statute then GAAR cannot be applicable. “The courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue.

*Canada – 2005 SCC 54.
Case Studies...

**Facts**

- “F”s” branch in India arranges loan for Indian borrower
- The loan is later assigned to “F” bank's branch in XYZ country to take benefit of withholding provisions of the India-XYZ treaty
- GAAR to be invoked
- Tax motivated transaction

**Facts**

- India-F treaty provides that gains arising from sale of shares will be taxable in India if transferor holds more than 10% in Ind Co.
- A Ltd invests in Ind Co. through K Ltd and L Ltd each holding 9.95%. Subsequently, K Ltd and L Ltd sell shares in Ind Co. and claim treaty benefit.
- Tax motivated – Abuse of Treaty - GAAR invoked.
- No significant change in the economic condition of A Ltd by creating 2 subsidiaries

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**Diagram**

- **Foreign Bank lender** ➔ **F's Branch in XYZ country** ➔ **Branch** ➔ **Indian Borrower**

- **A Ltd** ➔ **Jurisdiction**
- **K Ltd** ➔ **Ind. Co** ➔ **L Ltd**
- **9.95%**
- **9.95%**
- **India**
## Case Studies...

### Facts

- **A Ltd** invests 1 crore in shares and after a year FMV of shares become 11 crores.
- To avoid MAT on Long Term Capital Gains on sale, **A Ltd** forms partnership firm with a nominee and transfers shares at cost price.
- Partnership firm subsequently disposes the shares without any tax cost and gains arising is distributed to **A Ltd** by dissolving the firm which is again exempt.
- **Tax motivated - Transactions undertaken in Abnormal Manner – GAAR invoked**

### Facts

- **Y Ltd** enters into a composite agreement with **Ind Co. (unrelated party)** for set up of power plant in India. Contract split into 3 parts –
  - 'USD 10 million for design outside India (taxable in India)
  - 'USD 70 million for offshore supply of equipment (not taxable in India as no PE) and
  - 'USD 20 million for local installation (taxable in India)
- FMV ascertained - Offshore design under-invoiced and off-shore supply over invoiced
- **Tax motivated – Not at arm’s length - GAAR invoked**

**Prices to be reallocated based on TP Regulations**

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**Diagram**

- **Y Ltd** (Country F)
- **Ind. Co** (India)
- **A Ltd**
- **Partnership**

Transfer of shares at cost price
Shares sold at fair price
Place of Effective Management (PoEM)
## Indian PoEM – Evolution Backdrop

Delhi Tribunal\(^1\) had analyzed facts to determine residential status of Singapore Incorporated Company under the Indian Income-tax laws

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<th>Parameters / Fact Pattern</th>
<th>Decisive factor</th>
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<td>Shareholding composition - Indian residing in India (99%) and Singaporean residing in Singapore (1%)</td>
<td>X</td>
</tr>
<tr>
<td>Place where one or more director(s) normally resides - India</td>
<td>X</td>
</tr>
<tr>
<td>Place of convening Board meetings and taking key decisions - Singapore</td>
<td>√</td>
</tr>
<tr>
<td>Place where decisions pertaining to business taken - Singapore</td>
<td>√</td>
</tr>
<tr>
<td>Place where the business is actually conducted - India</td>
<td>X</td>
</tr>
<tr>
<td>Authority to operate Singaporean bank account - Indian director</td>
<td>X</td>
</tr>
<tr>
<td>P&amp;L statement of Singapore Co. does not reflect any administration / rent &amp; employee costs (Administration done by Indian Parent).</td>
<td>X</td>
</tr>
<tr>
<td>Place of signing &amp; maintenance of financials, minutes to meetings, etc. - Singapore</td>
<td>√</td>
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Held: control and management of Singapore Co was not wholly in India

\(^1\)Radha Rani Holdings v. ADIT [2007] 16 SOT 49 (Delhi Tribunal)
### PoEM – Paradigm Shift in Residency Test

| The erstwhile law | Foreign Co. becomes tax resident in India only if:
|                  | Control and management of company’s affairs situated wholly in India |
| Union Finance Act, 2015 | A Foreign Company can be resident in India if:
|                  | Its place of effective management (‘PoEM’) is in India |
|                  | PoEM means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are, in substance made |

**A higher threshold – Even if “part” control & management overseas no tax residency in India**

- Decision Test
- Necessity Test
- Pervasiveness Test
- Substance Test

Determination of PoEM is subjective based on facts (evidenced by the relevant documentation) – in its current avatar and without adequate ring fencing can have unintended consequences
PoEM – Impact on ‘Indian Resident Foreign Co’

**Cash flow Impact**
- 40% tax on global income
- MAT on book profits?
- Disallowance due to WHT non-compliance

**Other Impact**
- Double taxation & Foreign Tax Credit availability?
- WHT provision applicable to residents may apply?
- Ability to approach AAR?

**Compliance Impact**
- Advance tax, Tax Return, WHT return filings
- Transfer Pricing compliance
- Maintenance of prescribed books of accounts

**Carve Outs**
- DDT not applicable
- Concessional tax @ 15% on dividend from overseas entity

Draft guidelines issued by CBDT on 23 December 2015 for determination of POEM

Government to notify enabling transition provision for 1st time POEMED foreign Company
Determination of PoEM - Guiding Principles - draft

Substance over Form to be judged based on facts and circumstances of each case

Primary Test: Active Business outside India
- Yes → Majority Board Meetings In India
- No → Secondary Test: Hold Cos

Secondary Test: Hold Cos
- Yes → PoEM in India
- No → PoEM outside India

Are Indian KMPs taking key management/commercial decisions for conduct of business as a whole?
- Yes → Place where such decisions are taken is India?
- No → Assess Key Guiding Factors

Place where such decisions are taken is India?
- Yes → Summarize
- No → Assess Key Guiding Factors

To check where decisions are taken rather than implemented - Management, strategic and commercial decisions of overseas entities in substance to be made outside India
**Active Business Test: Definition**

1. **Total Income**
   - Passive Income > 50%
     - Yes
     - **No Active Business outside India**
   - Passive Income < 50%
     - Yes
     - **Cumulatively Satisfy**
       - Indian Assets < 50% of Total Assets
       - Indian Employees < 50% of Total Employees
       - Payroll on such employees < 50% Total Payroll
     - Yes
     - **Active Business outside India**

**Passive Income**
Aggregate of the following:
- a) Purchase and Sale from/to associated enterprises
- b) Royalty, dividend, capital gains, interest or rental income
“No automatic PoEM” Scenarios

100% Indian ownership
Fact that foreign company is *wholly owned by Indian company* not conclusive for establishing POEM in India

Directors being Indian residents
Fact that *one or some directors of foreign company resident in India* not conclusive for establishing PoEM in India

India based preparatory and auxiliary support
Existence in India of support activities in the nature of *preparatory or auxiliary activities* not conclusive for establishing PoEM in India

Presence of local management in India
Local management being situated in India in respect of activities carried out by a foreign company in India will not be conclusive conditions for establishing POEM in India
PoEM – In summary

Key Highlights

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<td>To be determined on year to year basis</td>
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1. POEM if situated in more than one country - *POEM of foreign company presumed to be in India* if it is predominantly situated in India

2. Reference to be made to jurisdictional Tax Officer to refer to principal Commissioner or the Commissioner of tax for purpose of initiating POEM;

3. **Opportunity of being heard** to be provided to such foreign company

*Determination to be based on all relevant factors and not isolated facts – snapshot approach not to be adopted*
PoEM Assessment

01 Unbiased ‘As-Is’ assessment

02 Documentation trail critical

03 Anticipate / prepare for aggressive challenge

04 Check for robustness
Need to analyze the transition provisions!
Case Study 1: Overseas Op Co – Board Composition & Meetings

- 3 out of 4 directors (including Managing Director) on Board of F Co are Indian residents
  - 4th director is designated as Executive Director
- 6 Board meetings held of F Co – 4 outside India and 2 in India
- Pre-board meetings between directors took place in India

Whether pre-board meetings in India would have an impact on POEM of F Co?

What if majority Indian directors attend Board meetings through VC in India?
Case Study 2: Overseas Op Co – Senior Management in India

- I Co and F Co have independent distinct Boards
- Group structure has common centralized Senior Management (MD, CEO, CFO) based in India
- Senior Management provides directions to the Board of F Co
  - MD / CEO travel extensively

Whether directions by Senior Management results in POEM in India?
Would F Co Board members’ profile be relevant?
Case Study 3: Overseas Trade Co - Substantial RPTs

- F Co. engaged in business operations (percentage to total business income)
- F Co has substantial executive presence outside India

Whether income arising from genuine business operations with unrelated parties included in ‘Passive Income’?

Senior Management is based in India with regional roles as well as local roles (under dual employment)?
Thank You

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