Taxation of Indirect Transfers

Ashish Bairagra

Regional Chairperson – ITPG Asia Pacific

Director, PeriGrow Consulting

Mumbai, INDIA.

What is an Indirect Transfer

Group A in USA

↓

Company in BVI → **Group B's company in The Netherlands**

↓

Company in Mauritius

↓

Company in India

Company in BVI, sells the shares of the Mauritian company to the Company in The Netherlands, indirectly transferring the Indian business

Why should tax authorities have a problem with this ???

- **In a particular case, the Indian Tax Authorities were of the opinion that by transferring the shares of a foreign entity, Group A effectively sold the Indian business to Group B.**

Still….. What is their problem?

- **The foreign companies :**
  - **were only holding companies,**
  - **with no or very few employees,**
  - **with no additional sources of income; and**
  - **with no investments other than the investment held in the Indian business**

But Still….. What is their problem?

- **The tax authorities claim that though the Indian business got sold from Group A to Group B for billions of $$$, the Indian Tax Authorities did not receive a penny in taxes from the sale of the business.**

Ahhhh….. So what did they do?

- **The Indian Tax Authorities could not issue a notice on Group A because it had no jurisdiction on Group A (Hutchison).**
- **So they issued a notice on Group B, for not withholding taxes on the payment it made to Group A, because as per the Indian Income Tax Act, it was liable to withhold taxes, and hence had jurisdiction on Group B (Vodafone).**

Did they pay up ???

- **OFCOURSE NOT!!!**
- **This later became the hottest controversy around the world called the "Vodafone" case.**
- **Vodafone went on to fight a legal battle in India claiming that the Indian Tax Authorities do not have jurisdictional right to tax such a transaction in India, since it was entered into outside India and involves sale of shares of a company outside India, and hence Vodafone was not liable to withhold any taxes.**

Then what did the tax authorities do?

- **After too many legal cases and losing time and resources in Court, in 2012, the Indian Government behaved like a 'spoilt sport' and introduced a "clarificatory amendment" in its charging provision, clarifying that such indirect transfer of shares are liable to tax in India, if its value is <u>substantially</u> derived from assets located in India.**
- **This clarificatory amendment was introduced retrospectively from 1st April 1962.**

Did that help the tax authorities?

- **In the Vodafone case, not really !!!**
- **In a major relief for Vodafone, the Supreme Court decided in favour of Vodafone**
- **Recently the (new) Indian Government decided not to go after Vodafone on this matter.**
- **But it continues to hound companies that have indulged in such indirect transfers after 2012.**

Is India the only one to do this?

- **Under China's Circular 698** ***(issued in December 2009, but applicable from 1st January 2008)*****, a non resident enterprise transferring shares in an offshore intermediary enterprise that directly or indirectly holds an equity interest in a PRC enterprise are subject to PRC tax on the gains from the transfer……**

On what basis?

- **…… if the PRC tax authorities determine that the arrangement lacks a bona fide commercial purpose and re-characterize the indirect transfer as a direct transfer of the PRC enterprise.**
- **As recent as 6th February 2015, China's SAT issued a new guidance, popularly called, Bulletin 7 on the PRC tax treatment of an indirect transfer of assets by a non resident enterprise**

What about other countries

- **Numerous OECD countries (e.g., Canada, Australia and Japan, among others) already implement such a policy with respect to narrower categories of assets such as domestic real estate.**
- **The concept of taxing indirect transfers of real estate is even enshrined in the capital gains articles of both the OECD and U.N. Model Tax Conventions**

Are there more countries which tax Indirect Transfers?

- **In my humble and personal opinion :**
  - **The US Exit Tax**
  - **The French Exit Tax**
  - **The German Transfer of Functions regulations**
  - **Any other countries from the audience ???**

  are regulations that tax indirect transfers
- **Infact not even current year indirect transfers, these regulations tax future indirect transfers.**
- **DO YOU AGREE?**

So is this a new taxable event?

- **Not really !!!**
- **The core thought behind taxing Indirect Transfers is :**
  - **Substance over form**
  - **Treaty abuse / shopping**
  - **Harmful tax practices**
- **In most cases, Indirect transfers result in 'Double non-taxation' and this is what troubles tax authorities around the world.**

So are there mechanisms in place

- **Other than the countries that have already introduced specific provisions to tax Indirect transfers, some of the existing provisions will automatically take care of such indirect transfers**
- **The OECD's action plan on BEPS contains articles which can directly / indirectly put a check on such indirect transfers**

Action plan on BEPS

- **Action 5 – Counter harmful tax practices more effectively, taking into account transparency and substance**
- **Action 6 – Prevent treaty abuse**
- **Action 9 – Risks and capital**
- **Action 11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it**

Action plan on BEPS

- **And save the best for last !!!**
- **Action 12 – Require taxpayers to disclose their aggressive tax planning arrangements**

Action plan on BEPS

Action 5 - Counter harmful tax practices more effectively, taking into account transparency and substance

Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.

Action plan on BEPS

Action 6 - Prevent treaty abuse

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.

Action plan on BEPS

Action 9 – Risks and capital

Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.

Action plan on BEPS

Action 11 - Establish methodologies to collect and analyse data on BEPS and the actions to address it

Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it…….

Action plan on BEPS

Action 11 – contd…

The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.

Action plan on BEPS

Action 12 - Require taxpayers to disclose their aggressive tax planning arrangements

Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules……

Action plan on BEPS

Action 12 – contd…

The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.

THANK YOU!

Ashish Bairagra

+91 98194 33693

ashish.bairagra@perigrow.com

PERIGROW

ACTIONABLE STRATEGIES. SUSTAINABLE RESULTS.