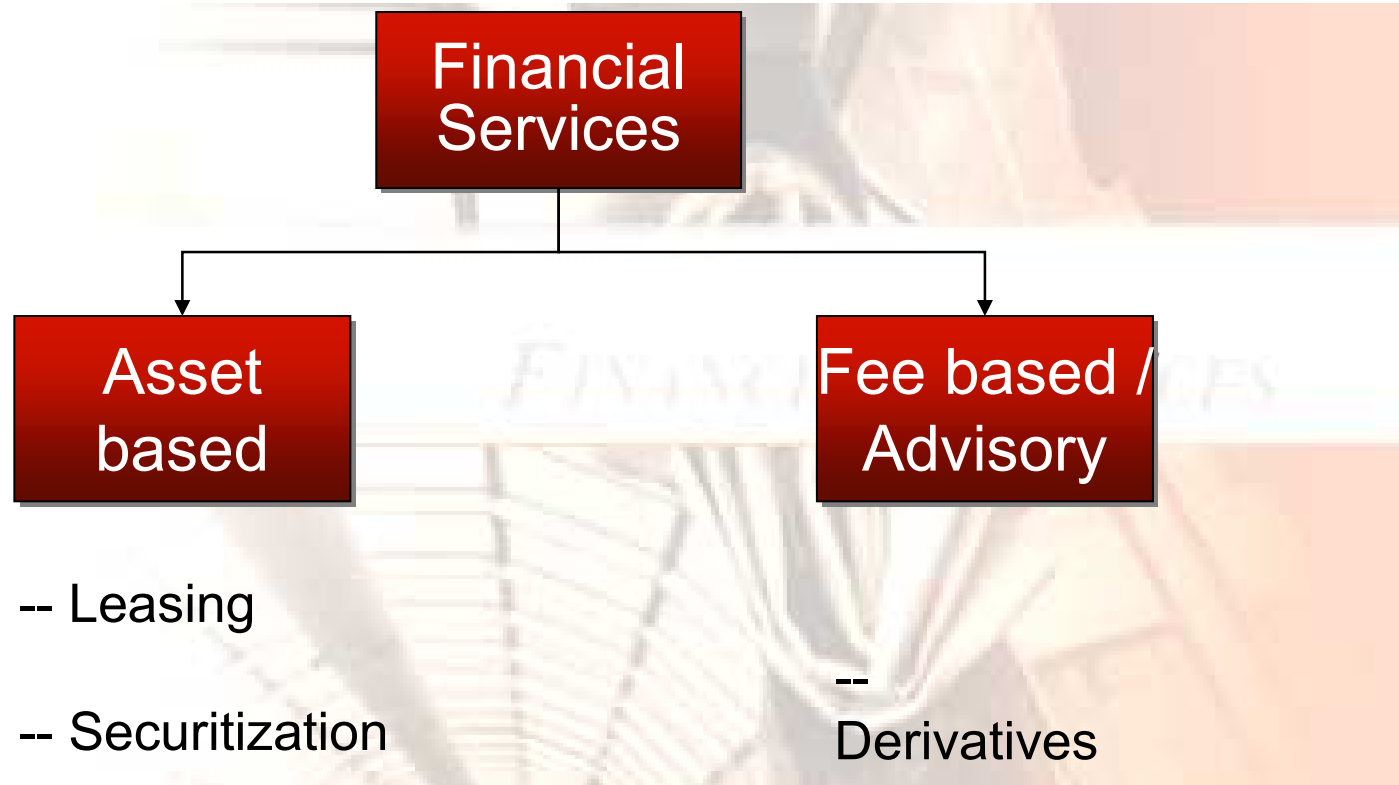


Tax Issues Impacting Financial Services in India



Rupak Saha
GE

Tax Issues Impacting Financial Services in India





Leasing : Case For A Safe Harbor ?

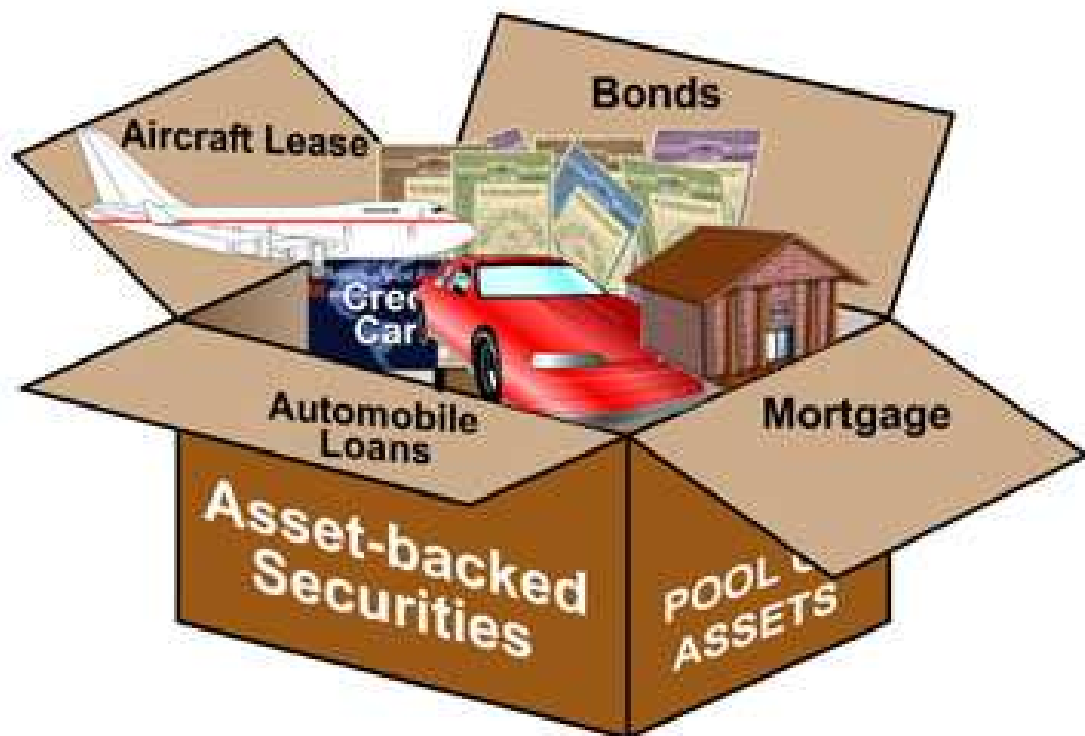
Leasing : Case For A Safe Harbor ?

- February 2001 CBDT Circular clarifies that AS 19 by itself will not change tax treatment of leases
- 1999 CBDT Guidelines to Tax Office points to several criteria to be considered before deciding “genuineness” of a lease .. but does not drive any conclusion on the consequence of their outcome .. discretion lies firmly with the assessing officer
- A 1943 Circular can lend tax uncertainty to an operating lease if it has any built in purchase option, even at a Fair Market Value ..
- A notion of “Beneficial Ownership” often looked at before granting any capital allowances to the lessor .. Accounting distinctions between operating and finance leases normally irrelevant
- Recent Supreme Court decision in ABB Ltd’s case lends controversy to the existing practice of granting depreciation to lessor in the case of a finance lease

Leasing : Case For A Safe Harbor ?

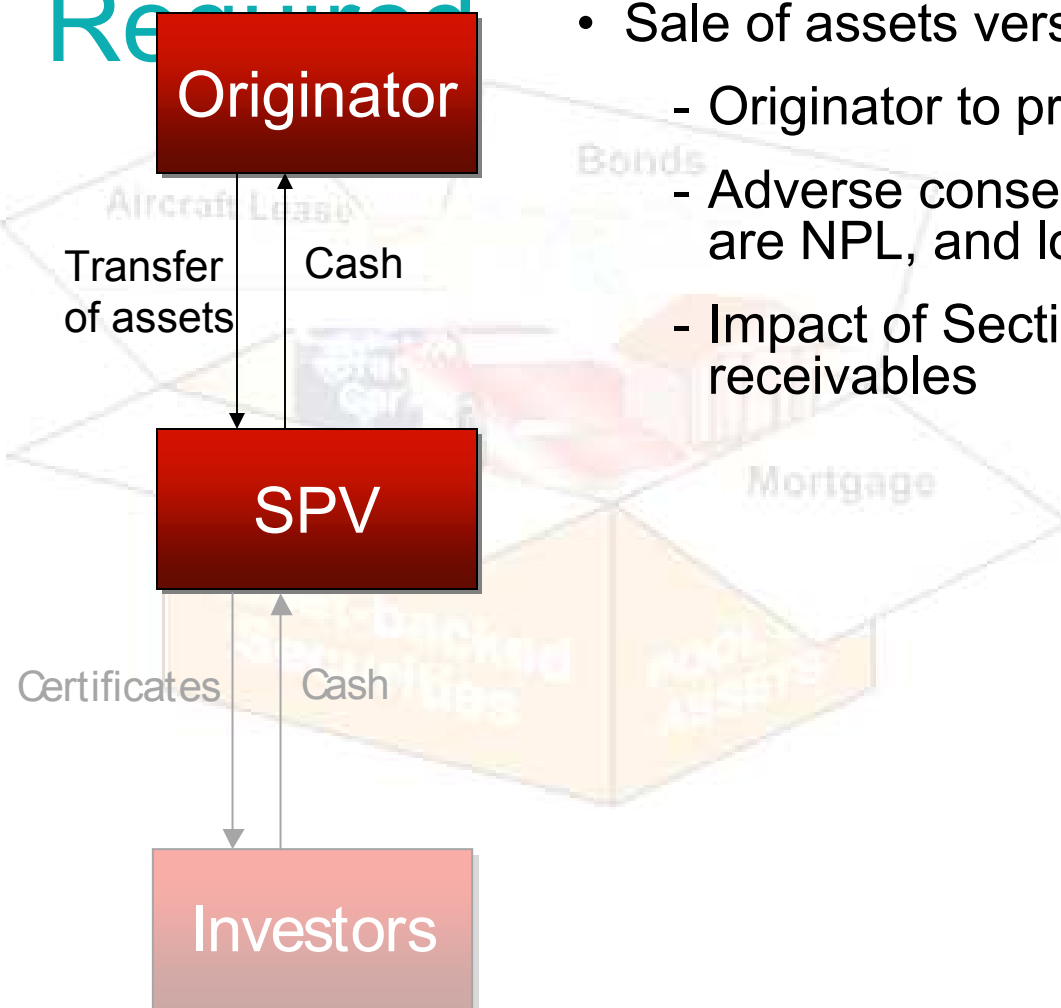
Tax criteria of a True Lease – United States

- Lease term cannot exceed 80% of the useful life of the asset
- At the end of the lease term, the estimated residual value of the asset must be equal to at least 20% of its original cost
- The lessee must not have an option to purchase the asset at a price less than its Fair Market Value determined at the time the option is exercised
- The lessor's minimum at risk investment in the asset must be at least 20% of the asset's cost
- The lessee or any member of the lessee group cannot have an investment in the leased asset or any loans or guarantees
- Use of the asset at the end of the lease by a person other than the lessee should be commercially feasible
- The lessor must expect to receive a positive cash flow as well as an overall profit from the lease apart from the tax benefits



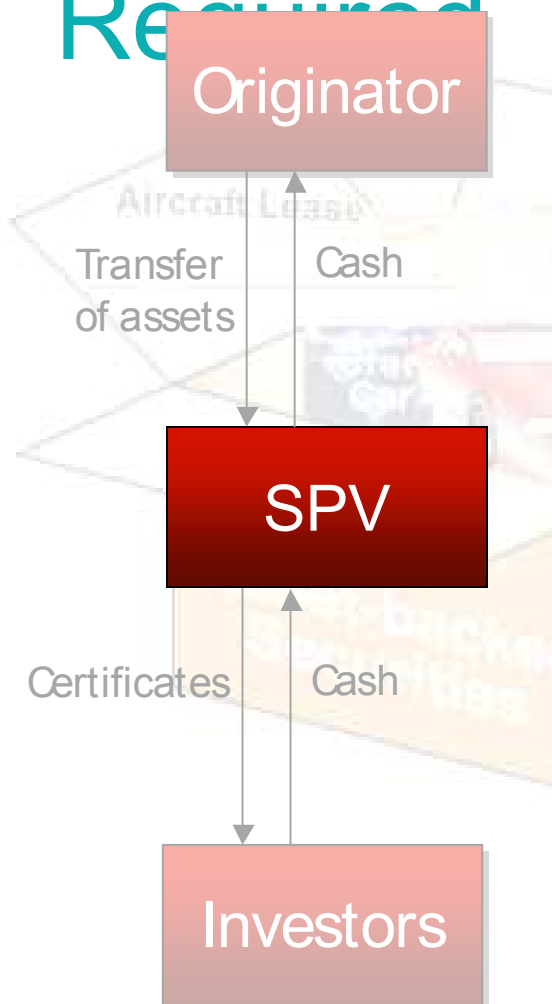
Securitization :
Guidance
Required

Securitization : Guidance Required



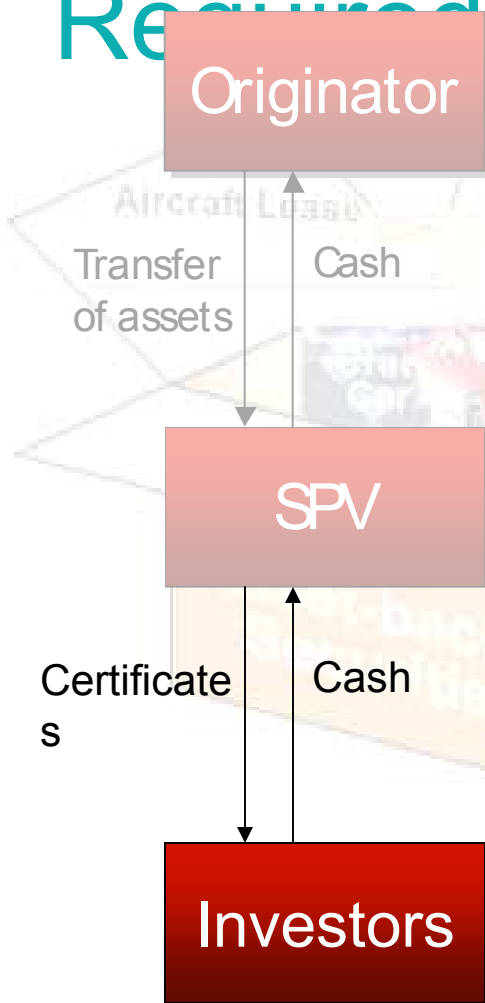
- Sale of assets versus financing transaction --
 - Originator to prefer financing treatment ?
 - Adverse consequences if transferred assets are NPL, and losses on transfer disallowed
 - Impact of Section 60 in the context of lease receivables

Securitization : Guidance Required



- Sale of assets versus financing transaction --
 - Originator to prefer financing treatment ?
 - Adverse consequences if transferred assets are NPL, and losses on transfer disallowed
 - Impact of Section 60 in the context of lease receivables
- Taxation of SPV --
 - Tax Transparency of the SPV .. issues to consider
 - Taxation in a representative capacity of the investor .. AOP risk
 - Taxation as a separate stand alone entity .. Risk of PTC obligations not being considered as debt obligations

Securitization : Guidance Required



- Sale of assets versus financing transaction --
 - Originator to prefer financing treatment ?
 - Adverse consequences if transferred assets are NPL, and losses on transfer disallowed
 - Impact of Section 60 in the context of lease receivables
- Taxation of SPV --
 - Tax Transparency of the SPV .. issues to consider
 - Taxation in a representative capacity of the investor .. AOP risk
 - Taxation as a separate stand alone entity .. Risk of PTC obligations not being considered as debt obligations
- Taxation of Investors
 - Depends on the taxation of the SPV

Securitization : Guidance Required

Increasing
Relevance

Securitization increasingly relevant in -

- Mortgage Backed Securities including Residential Mortgage Backed Securities
- Restructure of Non Performing Assets (NPAs)
- Creation of specialized debt funds in the infrastructure sector

Current Tax
Practice

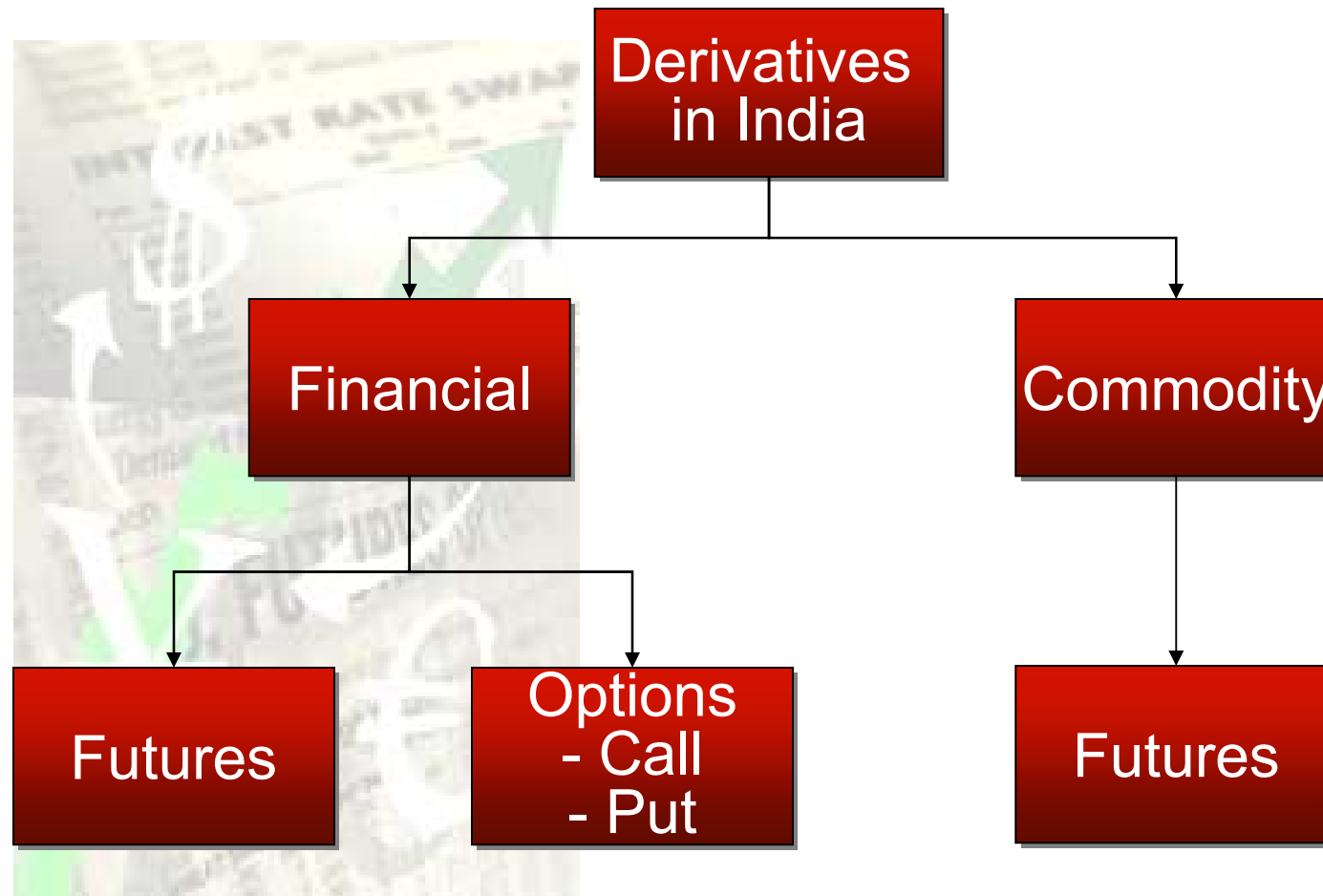
Current practices include

- Structuring SPVs as Trusts
- Possibility for majority of the investors retaining right to revoke their contribution to the Trust
- Trustees making income payouts to the PTC Holders without any withholding tax deductions



Derivatives : Continuing Uncertainties

Derivatives : Continuing Uncertainties



Legality of OTC Derivatives ...

Derivatives : Continuing Uncertainties

- Three ways of approaching to tax a derivative transaction --
 - Decomposition principle
 - Linked approach
 - Separate transaction principle
- Characterization of income ... capital gains versus ordinary income versus other income .. Relevant in the context of Foreign Institutional Investors / consequential withholding taxes
- Speculative or non speculative ..amendment to section 43(5).. Ring-fencing under Section 73
- Timing of taxation .. impact of “mark to market” system for Futures
- Characterization of cash flows under Cross Currency – Interest Rate Swaps or Interest Rate Swaps .. Interest or Business Income
- Taxation of a hedge .. Whether to integrate with the underlying or

Tax Issues Impacting Financial Services in

India Key determinants to taxability of financial services products :

- Substance vs. Form
- Debt vs. Equity
- True Sale vs. Secured Loans
- Sale vs. “Synthetic” Transaction