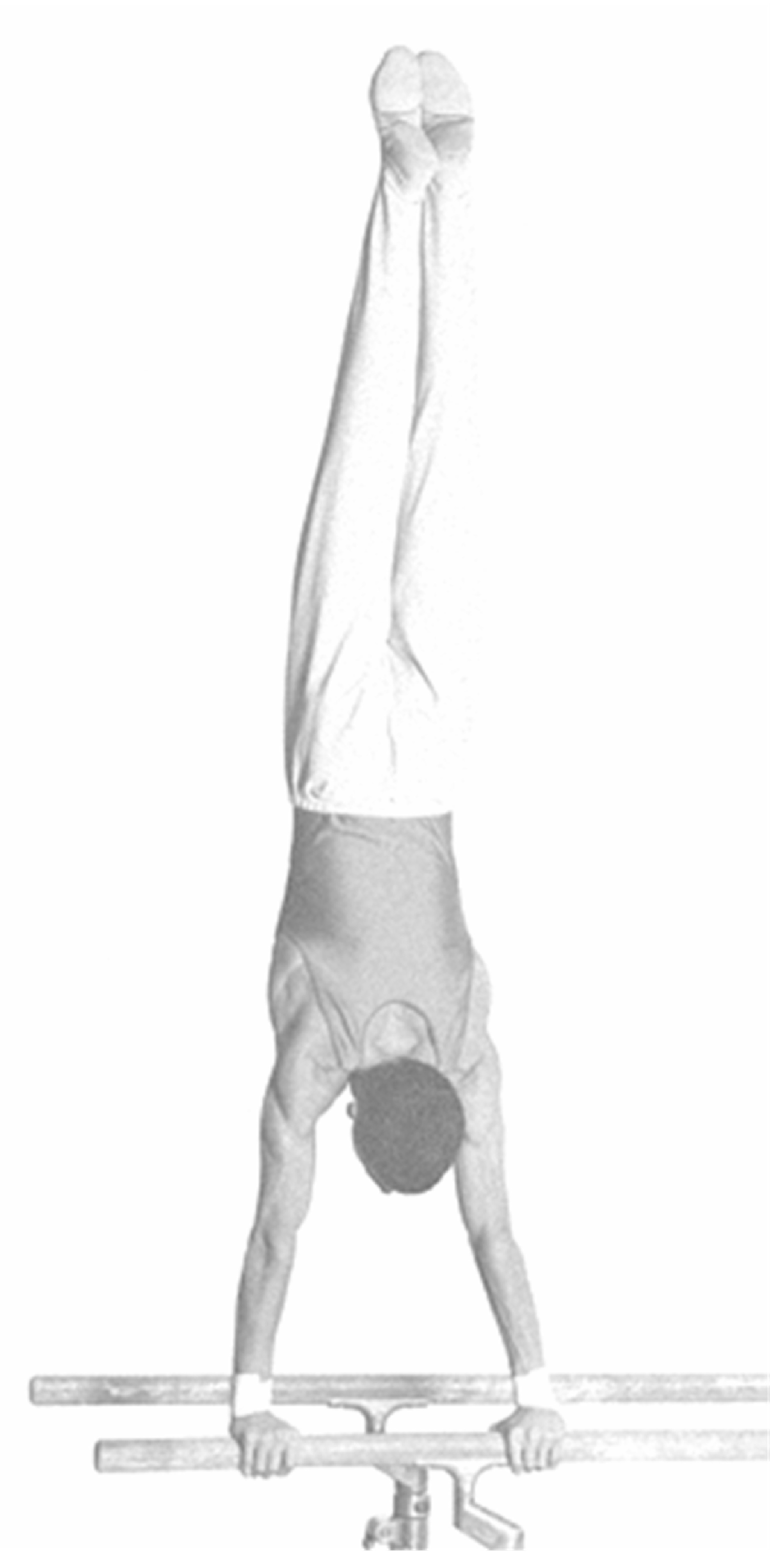
BMR Advisors

Challenge Us

Direct Taxes Code
CFC Regulations



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CFC – The concept

- **Anti – avoidance measure: seeks to curb tax base erosion and tax deferral**
- **Enacted by developed, capital exporting nations: US, UK, Japan, Germany, France , etc have advanced CFC regimes**
- **Two broad approaches:**
  - **<u>Transaction approach</u> - Passive income such as dividend, interest, royalty, rent, etc taxed regardless of the location of the CFC**
  - **<u>Jurisdiction approach</u> - Low tax jurisdictions are identified and all the income of CFCs located in such jurisdictions are taxed**
- **The DTC has adopted a hybrid approach**

CFC – Is India ready?

- **India is a net importer of capital - Annexure**
- **Exchange controls**
- **Tax consolidation**
- **Participation Exemption**
- **Underlying tax credits**
- **Exchange of information**

CFC Regulations – A comparative

General CFC Regulations	Indian CFC Regulations
Control thresholds	50%
Exemption limit	INR 2.5 mil
Tax rate threshold	50% of Indian tax rate
Taxing mechanism	Provided
Tax credit mechanism	Not provided
Motive test	Not provided
Distribution threshold	Not provided

CFC under the DTC

- **A CFC is defined to mean an unlisted company or body corporate which satisfies <u>all</u> of the following conditions:**
  - **It is a resident of a territory with lower rate of taxation**
  - **It is controlled by one or more persons resident in India, such that:**
    - **Indian residents possess or are entitled to acquire directly or indirectly at least 50 percent of the voting power or capital of the company; or**
    - **Indian residents are entitled to secure directly or indirectly at least 50 percent of income or asset of the company which shall be applied directly or indirectly for their benefit; or**
    - **Dominant influence is exercised by Indian residents on the company due to special contractual relationship; or**
    - **Indian residents have sufficient votes to exert a decisive influence in a shareholder meeting of the company**

CFC under the DTC …Contd

- **It is not engaged in any active trade / business - A company will be considered to be engaged in active trade / business if:**
  - **It actively participates in industrial, commercial or financial undertaking through employees or other personnel in the economic life of the territory of its tax residency; and**
  - **Less than 50 percent of its income is earned by way of *inter alia* interest, dividend, capital gains, management, holding or investment in securities, shareholdings, receivables or other financial assets and income from supply of services including financial services to (i) persons that directly or indirectly control the company, (ii) persons that are controlled by the company, (iii) other persons which are controlled by the persons referred to in (i), or (iv) any associated enterprise**
- **Its specified income exceeds Rs 2.5 million**

CFC income under the DTC

- **Specified income = (A + B – C – D) x (E / F)**

  Where:

  A – Net profit as per the Profit and Loss account (‘P&L’) of the CFC

  B – Amounts set aside to provisions made for diminution in the value of assets / meeting liabilities other than ascertained liabilities

  C – Interim dividends paid out of profits not debited to the P&L

  D – Brought forward losses

  E – No of days during which the company is a CFC

  F – No of days in the accounting period

- **Income attributable = Specified income x (A / 100) x (B / C)**

  A – Higher of: (i) value of capital or (ii) voting share / interest

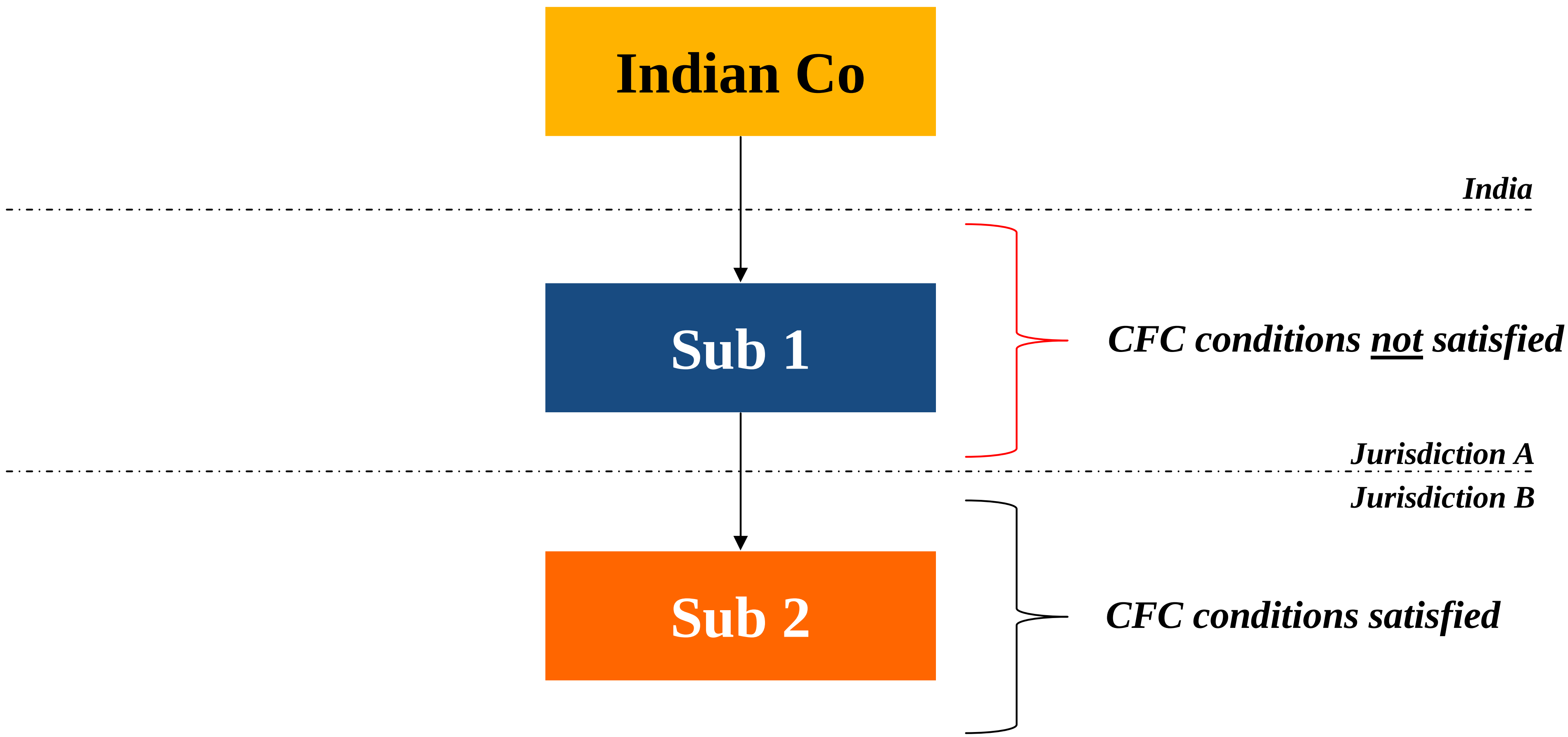
  B – No of days out of C the capital / voting share / interest is held by the taxpayer in the CFC

  C – No of days during which the company remained a CFC

Key issues

- Increase in the compliance burden and complexity coupled with the cost of administering the regime need to be weighed in with potential revenue collection impact
- Applicability of the CFC regime to multi-tiered structures is unclear
- Rules to provide for credit for tax paid by the CFC
- Emphasis on taxes paid may bring income subject to fiscal incentives in the offshore jurisdiction to tax in India
- Clarity on treatment of losses of a CFC is required
- A robust mechanism for exchange of information is critical for effective implementation

Multi – tiered structure



India – Inbound / Outbound Investments

(Figures in USD million)

Financial Year	Inbound Investments	Outbound Investments*
2007 – 2008	62,106	20,947
2008 – 2009	23,983	17,166
2009 – 2010	70,139	17,987
2010 – 2011	61,851	43,929
Till August 2011	17,370	15,552

Source: www.rbi.org.in
www.dipp.nic.in

** Equity loan and guarantees*

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