



Outbound Investments from India: Navigating the Brave New World post DTC

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Key considerations for outbound investments

- ▶ Overseas companies should not be tax residents of India
- ▶ Tax deductibility of leverage costs
- ▶ Deferred taxation on dividends not declared by overseas companies
- ▶ Mitigation on capital gains on exit from overseas investments

Key upcoming developments

- ▶ Direct Tax Code (DTC) 2010 proposed to be implemented with effect from 1 April 2012
- ▶ Key proposals impacting outbound transactions
 - ▶ Modification of residence rule
 - ▶ Introduction of Controlled Foreign Company (CFC) rules

Residence rule, overview

- ▶ FCo resident if place of effective management (POEM) in India “at any time in the year”
- ▶ POEM defined to mean:
 - ▶ Place where the board of directors (BOD)/ executive directors (ED) make their decisions
 - ▶ Where BOD routinely approve commercial and strategic decisions made by ED/officers, the place where ED/officers make such decisions

Residence rule, certain design issues

- ▶ Definition does not consider “degree of permanence” for determining POEM
- ▶ Need to emphasize regular “strategic” decisions over “commercial” decisions made by officers
- ▶ What about “virtual technology enabled” Board meetings?

Residence rule, case study



▶ Hold Co.

- ▶ Passive holding company
- ▶ Indian directors attending board meetings through video conference

▶ Operating Co.

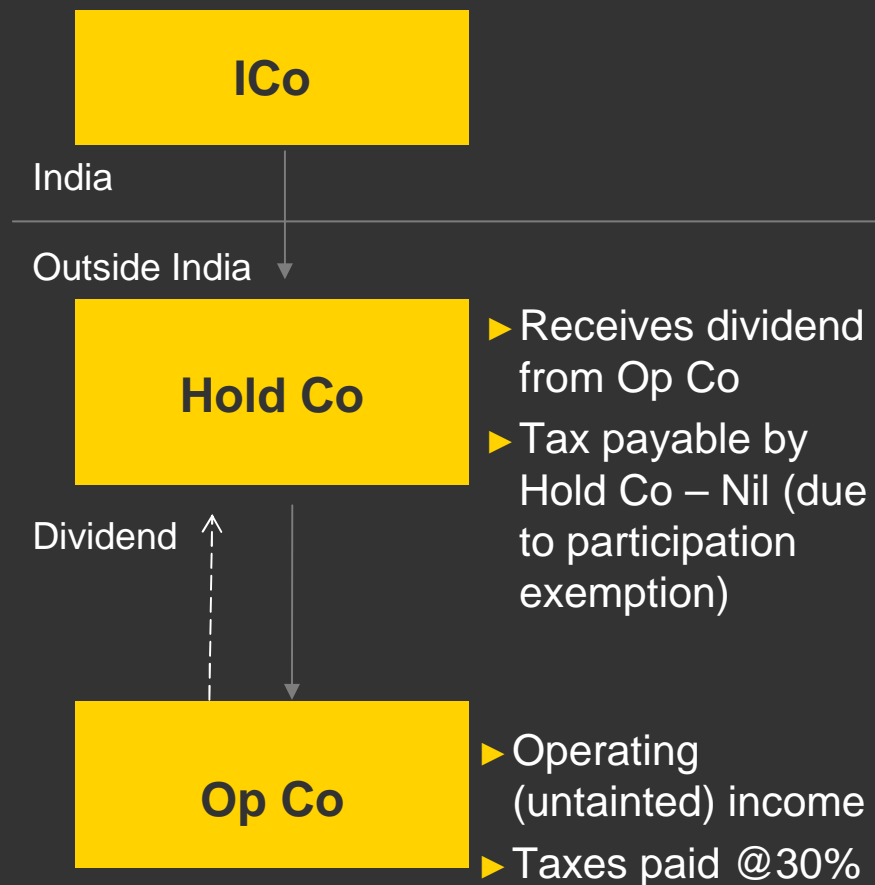
- ▶ Substantial business operations
- ▶ Senior management - Key management decision making
- ▶ Regular consultation with Indian Parent
- ▶ ED of Indian Parent member of BOD of Op Co – majority of the board members are Indians
- ▶ Isolated/ stray BOD meeting may be in India

Risk of triggering POEM in India?

CFC legislation, Indian footprint

- ▶ Proposal contained in Non-resident Taxation Working Group (Jan 2003, Mr. Vijay Mathur Group)
- ▶ Taxation of passive income proposed as per Revised Discussion Paper, June 2010
- ▶ Entity level 'all-or-nothing' approach proposed in DTC 2010 – five tests provided for
- ▶ Applies to all residents, overrides tax treaties
- ▶ CFC's income computed as per defined formula

CFC legislation, case study 1



CFC Scorecard

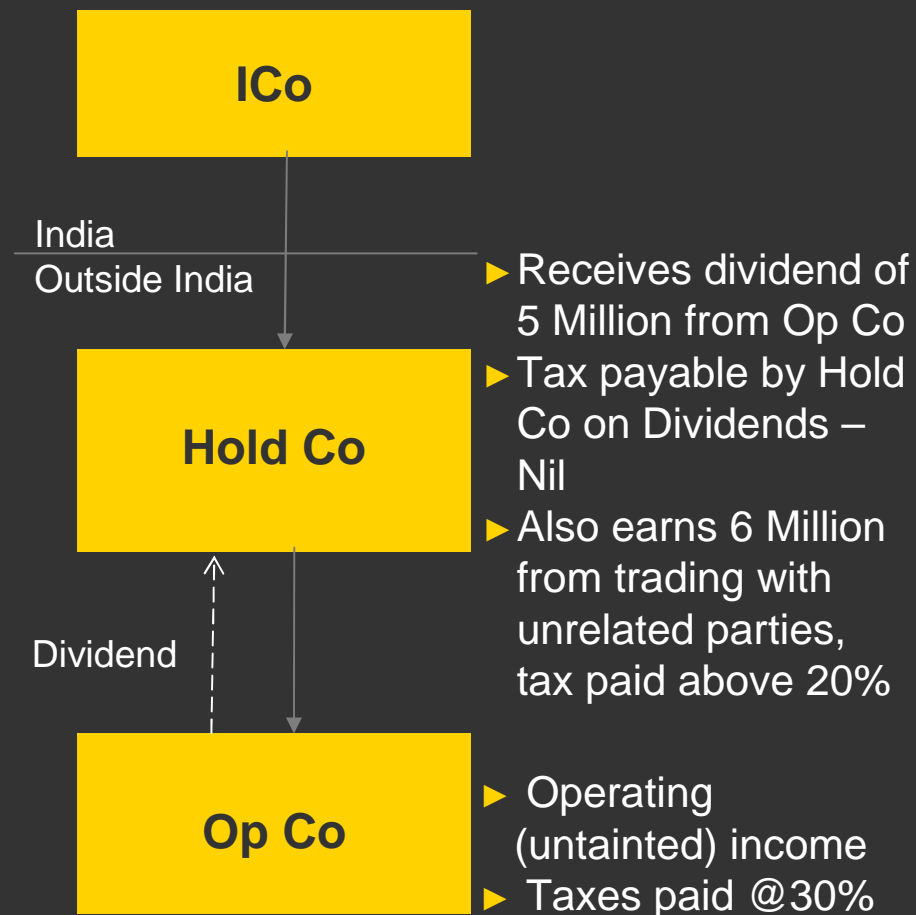
Fails comparable tax test?	Yes
Fails publicly traded test?	Yes
Meets control test?	Yes
Meets tainted income test?	Yes
Fails threshold test?	Yes

Result: Hold Co is a CFC

Consequences for ICo

- ▶ ICo pays tax on entire income of Hold Co
- ▶ Subsequent distribution by Hold Co to be deductible for ICo

CFC legislation, case study 2

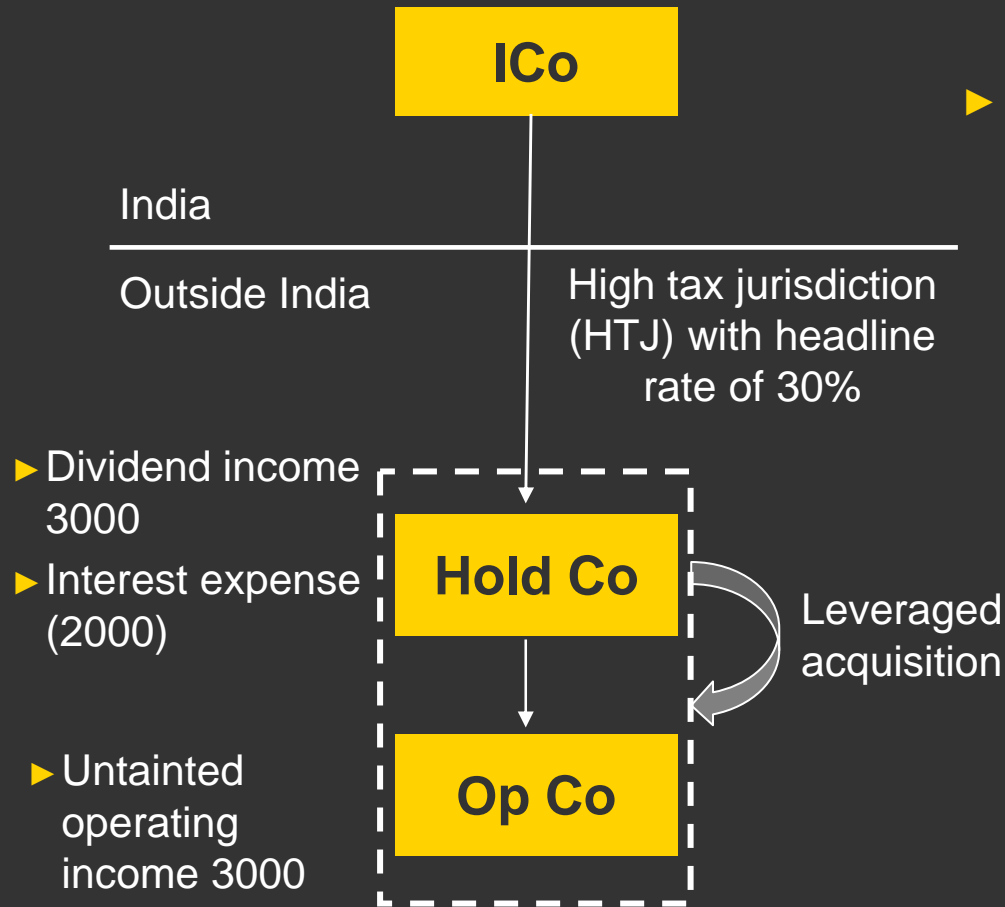


CFC Scorecard

Fails comparable tax test?	Yes
Fails publicly traded test?	Yes
Meets control test?	Yes
Meets tainted income test?	No
Fails threshold test?	Yes

Result: Hold Co is not a CFC

CFC legislation, case study 3



▶ Consolidated tax return filed by Hold Co

▶ Taxable income (a)	1000
(3000 – 2000)	
▶ Tax paid @ 30% (b)	300
▶ Effective rate of tax(b/a)	30%

Does Hold Co qualify as a CFC?

CFC legislation, scope for improvisation

- ▶ Need to adopt a calibrated approach, and tune more with international best practices
 - ▶ Motive test/ commercial justification test/ exempt activities test
 - ▶ Grace period to reorganize acquired structure
 - ▶ Provide for underlying tax credit
- ▶ Need to consider tax exemptions / incentives provided to promote economic development
- ▶ “Active” vs. “passive” income – nature of business to be considered rather than one definition fits all
- ▶ Consider loss offsets

Concluding thoughts

- ▶ Watershed development expected in Indian's tax policy on taxation of outbound investment
- ▶ Tax policy changes on horizon will likely compel India Inc to revalidate the efficiency of existing operating and holding structures
- ▶ International holding structures and sophisticated cross border planning likely to attract increased scrutiny by Indian tax authorities
- ▶ Economic substance and business purpose in tax planning more relevant than before



Thank you

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