India

India

General

1. What are recent tax developments in your country which are relevant for M&A deals?

The Finance Act 2015 amended the requirements for determining the tax residency of companies. Earlier a foreign company could be considered an Indian tax resident only if the whole of the control and management was situated in India during the year. Now, companies having a place of effective management during the year in India would be considered as tax resident in India and hence the global income of these companies for that year would be taxable in India. The place of effective management has been defined to mean a place where the key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made. This amendment is therefore expected to widen the scope for companies to be considered an Indian tax resident.

The incidental draft guidelines were released in December 2015 for further deliberation by the stakeholders and the final guidelines are awaited. The amendment is intended to align the provisions of the Indian Income Tax Act with the Double Taxation Avoidance Agreements (DTAAs) entered into by India with other countries and is expected to be in line with international standards. However, pending finalisation of guidelines as to determination of place of effective management, the Finance Bill 2016 has proposed deferral of the applicability of the place of effective management based residence test by one year, and accordingly, the same shall be applicable from the financial year beginning from 1 April, 2016.

The said Finance Bill also proposes a reduction in the existing corporate tax rate from 30% to 25% for domestic companies set up after 1 March, 2016 engaged in manufacturing / production activities, and which do not claim specified tax holiday and incentives. Further the Bill also provides for the roadmap for phasing out of the current tax exemptions and incentives under the overall plan of the Government to bring down the effective tax rates for Indian corporates while doing away with the exemptions and deductions

However, at the time of publication of this guide, the Finance Bill, 2016 has not yet been passed by the Indian Parliament, and accordingly, the proposals thereof are yet to be made part of the statute. It is possible that till the time the requisite formalities for the enactment of the Finance Bill, 2016 are completed, some of the proposals mentioned therein could undergo modifications.

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

India is not a member of OECD group but has always asserted on principles similar to BEPS in trying to protect its corporate tax base and has thus welcomed the recommendations made thereunder. The revenue authorities in India have been particularly aggressive in their tax policy and assessment approach whilst establishing presence of an Indian PE or making transfer-pricing adjustments on the basis of the perceived value creation.

Action 6 regarding preventing treaty abuse prescribes a Limitation of Benefits (LoB) clause besides a Principal Purpose Test (PPT) clause, currently forming part of some Indian tax treaties. The Government has already introduced the General Anti-Abuse Rules (GAAR) prospectively in its domestic tax law with effect from April 2017, which addresses PPT to some extent by way of a treaty override in case of any “impermissible avoidance arrangement”. The detailed guidance is awaited and could be in alignment with the BEPS outcome. Emphasising the principle of substance over form, India also amended the residency requirements of companies in Finance Act 2015 as stated above, introducing the concept of place of effective management.

Taking this further, it is also understood that the Indian Government is in talks with Mauritius to amend the India-Mauritius tax treaty to incorporate a LoB clause to restrict treaty shopping and disallowing treaty benefits aimed at avoiding Indian taxes. Considering the erosion of such large tax bases through profit shifting, the European Council of the European Union had formally adopted the GAAR provisions by way of amending the EU Parent-Subsidiary Directive, however this has not evoked any response or in any way affected India.

Furthermore, the Finance Bill, 2016 has proposed certain amendments in line with the recommendations under the BEPS Action Plan 1, Action Plan 5 and Action Plan 13 respectively where under it is proposed to introduce an equalisation levy for specified services received by a resident, or a non-resident having a PE in India, from a non-resident (Action Plan 1), a patent box regime incentivising the companies by way of taxing the income derived from exploitation of patents in India at a concessional tax rate of 10 percent (Action plan 5) and also prescribed a reporting regime in respect of country by country reporting and a master file in line with the Action Plan 13.

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3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

Asset acquisitions

In asset acquisitions, a company's assets and liabilities are transferred for a consideration specified separately for each asset or set of assets, typically in the form of cash or shares. Under the said mode of acquisition, the target company's historical business liabilities are not carried over to the buyer, and the tax exemptions and incentives available to the seller are normally not available to the buyer after the asset acquisition. The assets acquired are recorded in the books of account at the amount actually paid for the particular asset.

An asset acquisition may also be subject to Value added tax (VAT). VAT is levied on the transfer of movable or intangible assets. In India, VAT rates range from 4% to 12.5%, depending on the classification of the asset or goods. However subject to conditions, the VAT paid by the buyer may be offset against the buyer's future output VAT liability.

A transfer of movable and immovable assets is also subject to stamp duty. A stamp duty is a state levy and is imposed in the state where the assets being transferred are located. Transactions may be structured so as to minimise stamp duty, particularly in certain cases involving the transfer of movable assets. It is important to assure that the entire transaction is carefully documented to support the valid legality of the transfer and the protection of the rights of the buyer and the seller. The transaction must also meet the requirements supporting the contention of a lower or nil stamp duty liability on the transfer.

Stamp duty may also be levied in the state where the agreement to sell is executed between the parties, in addition to the state in which the assets are located.

Other Modes of transferring assets

A transfer of assets from one entity to another may be structured using other mechanisms in a more tax-efficient manner, such as a "slump" sale, or a demerger.

Slump sale

In India, a "slump" sale is a sale of a business undertaking as a going concern involving the transfer of the identified business by the seller to the buyer for a lump sum consideration. The transfer of a business by way of a slump sale is generally perfected with the execution of a business transfer agreement, which regulates the transfer of business itself, including its various components, such as the assets, liabilities, employees, licenses and existing contacts. The consideration for the transfer may be discharged by way of a payment in cash or shares. As it involves a transfer of the business as a whole without allocating value to the individual assets, the lump sum consideration would need to be split by the buyer among the various assets acquired for which a valuation of such assets would need to be undertaken.

This opens up some planning opportunities for the buyer in terms of ensuring that the depreciable base is of the asset is recorded in a tax-efficient manner.

Further, in a slump sale, the tax benefits and incentives available to the business undertaking may be transferred to the buyer, subject to the satisfaction of certain conditions.

Additionally, transfer taxes are lower than in an asset acquisition. Since the entire undertaking is transferred as a whole in exchange for a lump sum consideration, the transaction may be held to be a "sale of business" and not a "sale of goods" and, accordingly, the transfer may be viewed as not subject to VAT.

Stamp duty implications are largely similar to those for asset acquisitions. In a slump sale, structuring options may be adopted to lower the impact of stamp duty to bring in efficiency for the stamp duty on movable assets.

Demerger

A demerger means the transfer of an identified business division from one company to another on a going concern basis through a court approved process. In a demerger, the consideration for the transfer of business is discharged by issuing "shares" to the shareholders of the seller entity in order for the transaction to be tax neutral.

In India, a demerger process requires approval by the high court of the state in which the registered office of the company (ies) is located. The entire process can take between six and eight months, depending on the number of states involved and status of the company, i.e. whether the company is a listed or a closely held company.

In a demerger, the buyer has a compulsory obligation to record assets at their book value as appearing in the books of the seller at the time of the demerger. Further, the tax benefits and incentives available to the business division may be transferred to the buyer, subject to satisfaction of certain conditions.

Typically, no VAT arises in the case of a demerger.

Where the state law has a specific provision on the levy of stamp duty in the approved scheme of arrangement (as approved by the jurisdictional high court), the stamp duty will be levied using the mechanism provided in the law. Typically, stamp duty is levied as a percentage of market value of the shares issued under the scheme of arrangement or as a percentage of the market value of immovable property, whichever is higher. In some states, the possibility of a no stamp duty position may be explored. An amendment to Indian stamp duty laws to levy stamp duty on mergers and demergers had been proposed but had not yet been passed by parliament at the time of publication of this guide.

Where the demerger involves two states (i.e., the assets of the business division are located in two states) and the stamp duty is levied under the stamp duty law of both states, a credit for the stamp duty paid in one state may be claimed in the other state, by carrying out the process prescribed under the state stamp duty law.

Stock acquisitions

In stock acquisitions, the transferee company acquires the shares of the transferor company from its existing shareholders for a consideration. The company's identity remains unchanged, and the company continues to be responsible for all of its liabilities existing before the transfer of shares. In a stock acquisition, the assets continue to be recorded at their book values, as they appeared prior to the transfer of shares. Further, the tax incentives and benefits available to the company prior to the transfer of shares generally continue to be available after the transfer of shares, although the nature of each particular incentive or benefit would need to be analysed to determine its continuity. In certain cases, the brought forward business losses of the target company will not be allowed to be carried forward. (See "available losses after an acquisition" below.)

Gains arising on the sale of shares of an Indian company are normally liable to tax in India as either short term or long term capital asset (if held for more than 36 months, except in case of shares in a listed company, if held for more than 12 months shall be considered as a long term asset), unless specifically exempt or sheltered under a tax treaty. Stock acquisitions could also result in withholding tax obligations for the buyer. Indirect stock acquisitions are also liable to tax in India unless specifically exempt.

Share transfers are also subject to stamp duty. It is possible, however, to reduce such costs by dematerialising the shares of the target company, prior to the transfer of shares.

Other considerations

Foreign Investments in India are regulated by the provisions of the Foreign Exchange Management Act, 2000, and the related regulations and press notes issued by the Indian government. The regulations prescribe the upper limit for equity interest held by a foreign company in an Indian entity, depending on the industry in which the Indian entity operates. At the time of making the Investments in India, the Foreign Company must adhere to the applicable limits. Further, Investment in certain selected industries require the prior approval of the Foreign Investment Promotion Board (FIPB).

When the seller or buyer is an Indian resident and the counter party is a non-resident, the sale or acquisition of shares could also be subject to certain pricing guidelines and filing requirements.

Buy-side

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

Under Indian tax law, in share acquisitions, the value of tangible and intangible assets continues to be recorded at the same values as prior to the transfer of shares. The value of tangible and intangible assets may be stepped up in asset acquisitions (either by way of an itemised sale or a slump sale), as discussed above.

5. What are the particular rules of depreciation of goodwill in your country?

Under Indian tax law depreciation is allowed on intangible assets such as know-how, patents, copyrights, trademarks, licenses, franchisees or any other business or commercial rights of similar nature. Although goodwill is an intangible asset, it is not specifically included in the list provided under the Indian tax law.

While recent rulings have supported claiming of the amortisation of goodwill, revenue authorities at the lower level could still litigate the same basis facts of the specific case. Through appropriate purchase price allocation exercises, the goodwill can also be split among the several business or commercial rights comprised. Subject to facts, depreciation can be claimed on some of these rights.

6. Are there any limitations to the deductibility of interest on borrowings?

Under Indian tax laws, there are no direct thin capitalisation rules, and deductions for interest on borrowings are allowed in the year in which the interest is paid or accrued. However, the interest paid or accrued on capital borrowed for the acquisition of an asset for the extension of existing business, in the period between the date on which the capital was borrowed and the date on which the asset was first put to use, is not allowed as a deduction and instead is considered as part of the cost of acquisition of the asset.

Tax withholding

Payments of interest are subject to withholding tax in India under the domestic law or the applicable tax treaty.

Transfer pricing

An international transaction between two related enterprises must be transacted at an arm's length price. Where the debt is taken by the Indian entity from a foreign related enterprise, the interest must be at an arm's length price. If the Indian Revenue authorities are of the view that the interest is not at an arm's length price, they may make an adjustment to the interest paid and reduce the deduction claimed.

Regulatory provisions

In the case of foreign debt, the provisions related to external commercial borrowings are to be compiled with. For further details, see the following section.

7. What are usual strategies to push-down the debt on acquisitions?

The strategies for a push-down of debt on acquisitions have to be analysed under two scenarios: foreign debt and local debt.

Foreign Debt

Foreign Debt raised by an Indian Company is governed by the external commercial borrowing (ECB) guidelines, which apply in the case of a push-down of the debt to the target company. Although foreign debt raised by an Indian company is subject to restrictions which do not typically enable a push-down of the debt to the Indian company, the position needs to be examined based on the facts of each case. Key conditions attached to the raising and utilisation of foreign debt include the following:

- Borrowers may raise foreign debt from internationally recognised sources such as international banks, international capital markets, multilateral financial institutions, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity-holders, etc.
- The foreign equity-holder must have a minimum equity interest of 25% in the Indian company to qualify as eligible lender. Further, in the case of foreign debt raised under automatic route in excess of US$5 million from the foreign equity-holder, the ECB liability-to-equity ratio must not exceed 4:1.
- Borrowings from group companies (having the same parent as Indian company) and direct equity holders with more than 51% equity stake are also permitted, subject to certain monetary limits.
- Foreign debt may be raised totaling up to US$500 million (up to $750 million for companies in infrastructure and manufacturing sectors) during a financial year, subject to prescribed restrictions
- Under the existing regulations, foreign debt is normally allowed for capital expenditure only and for making an investment outside India. Foreign debt can be used to meet working capital needs provided it is raised from the direct or indirect equity holder. However, it is specifically prohibited from being used for investment in the capital market or acquisition of a company (or part of a company) in India, for investment in real estate or for on-lending to other entities for any of the previous mentioned purposes.
- The guidelines prescribe an all-in-cost ceiling on foreign debt sourced by an Indian entity. The all-in-cost ceiling includes interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or Indian Rupees but will not include commitment fees, pre-payment fees / charges, withholding tax payable in Indian Rupees.
- The current all-in-cost ceiling varies between 300 and 500 basis points over the six-month LIBOR, depending upon the tenure of the loan. These rates are regularly revised.

Local debt

A loan taken by an Indian entity from local sources may be pushed down to the target company either by way of the merger of two companies (i.e. the company which has taken the loan and the target company) or by passing on the debt to the target company. For a merger of the two companies, approval must be obtained from the jurisdictional high court by filing a scheme of arrangement. The entire merger process typically takes between six and eight months, depending on the states involved and the status of the company, i.e., whether the company is listed or a closely held company. Alternatively, the company taking the debt may pass on the debt to the target company, subject to the satisfaction of conditions prescribed under corporate law.

8. Are losses of the target company (ies) available after an acquisition is made?

Indian tax law allows business losses to be carried forward and set off within the eight years immediately following the tax year for which the loss was first computed. There is no limitation on carry forward and setting off unabsorbed depreciation.

Certain restrictions have been imposed on carrying forward business losses where the target company is a closely held company. In such a case, the carry forward and set-off of business losses from earlier years are allowed only if the shares of the company carrying not less than 51% of the voting power are “beneficially held” by the same persons on the last day of the tax year in which the loss was incurred and on the last day of the tax year in which the loss should be set-off. The above rule does not apply, however, where the change in shareholder ownership of the Indian company, which is the subsidiary of a foreign company, is pursuant to a scheme of amalgamation or demerger of a foreign company and 51% of the shareholders of the foreign amalgamating company remain as the shareholders of the resulting company.

The above restrictions on the carry-forward and set-off of business losses do not apply to unabsorbed depreciation, which may continue to be carried forward and set-off without any restrictions.

However, in the case of an amalgamation of a specific company or demerger, the accumulated losses and unabsorbed depreciation or amortisation of the amalgamating company or the business division being demerged are deemed to be the accumulated losses and unabsorbed depreciation or amortisation of the amalgamated or resulting company, as the case may be, for the tax year in which the amalgamation or demerger was effected, subject to the satisfaction of conditions prescribed under Indian tax law.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

The transfer of shares attracts stamp duty at the prescribed rates. These costs may be reduced, however, by dematerialising the shares of the transferee company, prior to the transfer of the shares.

10. Are there any restrictions on the deductibility of acquisition costs?

India tax law provides for deductibility of the acquisition costs at the time of subsequent sale of the said asset. However, where the asset acquired is used for the purpose of business or profession of the acquirer, the said acquisition cost would be deductible as depreciation over the life of the said asset.

Further, there is no specific provision for deduction of consultancy /advisory / legal fee paid for acquisitions. Any expenditure incurred wholly or exclusively for the purpose of the business or trade is allowed as a deduction under the Indian tax laws. Therefore, the tax deductibility of such expenditure depends on the facts and circumstances of the specific case. If the acquirer is able to establish business nexus then the acquisition costs could be claimed as deduction for tax purpose. The revenue authorities could however litigate the facts of the specific case.

11. Can VAT (if applicable) be recovered on acquisition costs?

VAT/CST is applicable on sale of goods. There would be no VAT/CST implications where the business is acquired as a whole, on a going concern basis with all assets and liabilities. However if the business is not acquired as a going concern, then the seller may charge applicable VAT on the assets transferred, input credit of which could be available to the buyer.

Further no VAT is applicable to consultancy/advisory/legal fee paid for acquisitions. However such services would be subject to a service tax levy at the applicable taxes.

12. Are there any particular issues to consider in the acquisition by foreign companies? (for example non-resident taxation rules/substance rules and tax efficient exit routes)

Regulatory considerations

Foreign investments in India are governed by the exchange control regulations, namely the Foreign Exchange Management Act, 1999 (FEMA). Acquisition of shares in an Indian target company should comply with the Foreign Direct Investment (FDI) policy. The FDI Policy in India today is fairly liberalised allowing investments into most sectors under the automatic route i.e. without Government approval. There are certain sectors where investments are permitted up to prescribed sectorial caps and few prohibited sectors such as agriculture, plantation, real estate trading etc. Further, till recently, any foreign investment into a holding company required an approval form the Foreign Investment Promotion Board (FIPB). Now foreign investment into holding companies is permitted without any approval for sectors under the automatic route. However, FIPB approval is required if such Indian target engages in any activity under the government route. Additionally, in case of listed target companies, Takeover Code regulations under the Indian securities law, namely Substantial Acquisition of Shares and Takeovers (SEBI) Regulations, 2011 will need to be complied.

Tax Considerations

Setting up an optimal structure for investments in India requires taking into account the relevant tax treaty network and provisions under the Indian domestic law. Planning an efficient holding structure assumes significance in view of the fact that India levies an effective dividend distribution tax of 20.35% on distribution of profits from an Indian company/ target to the shareholder (foreign parent). Secondly, gains arising on the transfer of an Indian company shares by a foreign company held directly or indirectly i.e. qualifying under the indirect transfer rules, is subject to tax in India (except for listed company shares held for more than 12 months).

India's network of tax treaties plays a crucial role in tax structuring of cross border investments into India. Even though most treaties follow source, country taxation for interests, dividends and capital gains from alienation of shares, specific provisions in some tax treaties offer planning opportunities for structuring investments and acquisitions in India. Certain holding jurisdictions which have a favorable tax regime and beneficial tax treaty with India whereby India has foregone its taxing right on capital gains arising to a resident of these countries on alienation of shares, can help structure exits in a tax neutral way. However, the use of these favorable treaties to structure investments and divestments has been a matter of debate with tax authorities if the structure is not backed by commercial substance. Most of India's new treaties or negotiated treaties include a LoB clause to prevent abuse of the capital gains benefit under the said treaty. With the recent developments relating to introduction of GAAR and increased scrutiny, selection of an appropriate tax structure is critical while planning acquisitions in India.

13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

A group may reorganise in a tax neutral manner after an acquisition by way of (a) a merger of the group companies into a single company; (b) a demerger of non-core businesses of the group into a separate company to attain value for shareholders; (c) a capital reduction whereby a company can cancel its capital for consideration or against accumulated losses, or (d) a buy-back of shares whereby the group company may reduce its capital by buying its own capital from the shareholders and subsequently cancelling it, etc. However, to ensure tax-neutrality in the reorganisation, the conditions laid under Indian tax law must be satisfied.

14. Is there any particular issue to consider in case of companies of which main assets are real estate?

Under the provisions of Indian tax law, no specific regulations apply to the transfer of assets or shares of a company whose main assets are real estate. The transfer of real estate assets directly, however, is subject to capital gain tax computed in the manner specified in the Indian tax laws. Similarly, the transfer of real estate directly is subject to stamp duty at the rates prescribed under the state stamp duty laws or the Indian Stamp Act, where there is no state specific law.

Sell-side:

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

Under Indian tax law capital gains are computed by reference to the holding period for the capital assets by the transferee. There is no provision for participation exemption under Indian tax law.

To compute capital gains assets held for a period of 36 months or less are referred to as short-term capital assets. For shares of any listed security or equity oriented mutual fund unit or zero coupon bond, the period of 36 months is replaced by 12 months. Assets other than short-term capital assets are referred to as long-term capital assets. Gains arising from the transfer of short-term capital assets are known as short-term capital gains. Gains arising from the transfer of capital assets other than short-term capital assets are known as long-term capital gains.

Short-term capital gains are calculated as the sale consideration less the cost of acquisition, less the cost of improvement and expenses incurred at time of sale. Short-term capital gains are taxable at a rate of 30% (or 40% for non-residents), exclusive of the applicable surcharge and education cess. Short-term capital gains resulting from specified securities traded on a recognised stock exchange in India, and on which securities transaction tax is paid, are taxed at a fixed rate of 15% - exclusive of the surcharge and the education cess.

To calculate long-term capital gains, costs are adjusted for inflation based in indices issued by the Indian government. Long-term capital gains are calculated as the sale consideration less the indexed cost of improvement and expenses incurred at the time of the sale.

In case of non-residents, costs are adjusted for foreign currency fluctuation rather than inflation, while calculating long term capital gains. Long-term capital gains are taxable for non-residents at a fixed rate of 10% (exclusive of surcharge and the education cess) in the case of unlisted securities without indexation and foreign exchange fluctuation benefit and at a rate of 20% (exclusive of surcharge and the education cess) in other cases.

Long-term capital gains resulting from the sale of specified securities traded on a recognised stock exchange in India (and on which securities transaction tax is paid) are exempt from tax.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

Under Indian tax law exemption can be claimed for capital gains arising from transfer of long-term capital assets (including shares) if such gains are invested in a long-term specified asset within a period of six months from the date of transfer. However investment in the specified securities may be made up to INR 5 million. Furthermore the investments need to be locked in for the prescribed period (typically three years) to claim the exemption. If the investments are transferred or otherwise converted into cash they are taxable in the year in which conversion takes place.

17. Are there any local substance requirements for holding/finance companies?

Till recently, any foreign investment into a holding company required an approval of FIPB. Under the extant exchange control regulations, foreign investment into holding companies is permitted without any approval for sectors under the automatic route. However, FIPB approval is required if such Indian investee company engages in any activity under the Government Route. Foreign investment into finance companies is permitted up to applicable limits, subject to conditions including minimum capitalisation and prior approval of the FIPB in specified sectors.

Your Taxand contact for further queries is:

India

Vivek Gupta
T. +91 124 339 5000
E. vivek.gupta@bmradvisors.com

Gokul Chaudhri
T. +91 124 339 5040
E. gokul.chaudhri@bmradvisors.com