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LEGAL AND TAX COUNSELING WORLDWIDE

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Indirect Transfers

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Section 4 of Income-tax Act, 1961 ("**ITA**")

Charge of income-tax.

(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates***, income-tax at that rate or those rates shall be charged for that year in accordance with this Act*** in respect of the total income of the previous year of every person :

Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.

(2) In respect of income chargeable under sub-section (1), ***income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.***

Section 5 of ITA

The total income of any previous year of a person who is a **non-resident** includes all income from whatever source derived which

(*a*) ***is received or is deemed to be received in India*** in such year by or on behalf of such person ; or

(*b*) ***accrues or arises or is deemed to accrue or arise to him in India*** during such year.

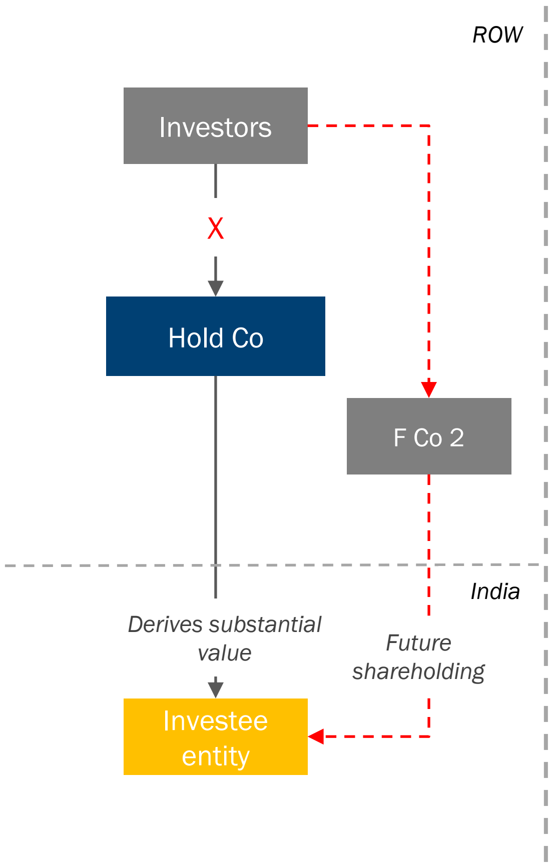
Section 9 of ITA: **Income deemed to accrue or arise in India.**

All income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, ***or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.***

Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India

Indirect transfer provisions - Overview



When can indirect transfer provisions be invoked?

- Exit of investor at Hold Co level; Hold Co derives substantial value from investments in India

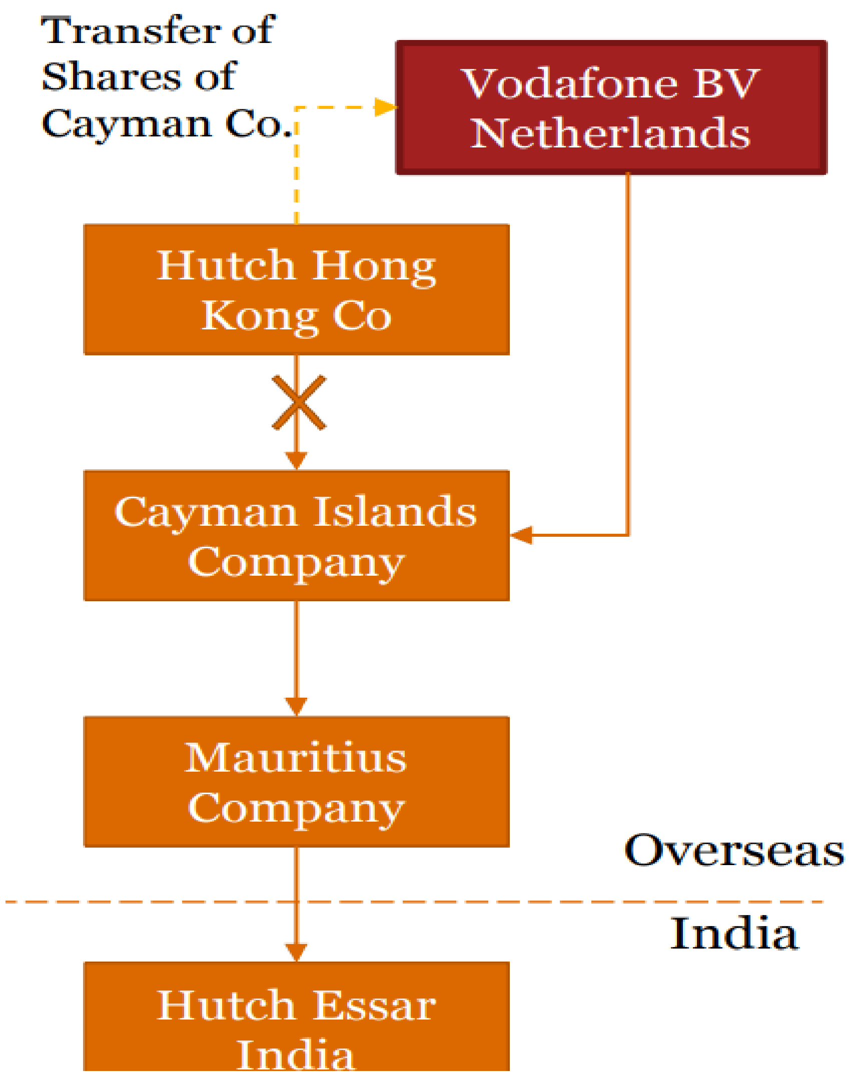
Law in respect of indirect transfer:

- Indian tax law retrospectively amended in 2012 to tax gains arising from transfer of shares or interest in a foreign company or entity, if such **<u>shares or interest derived (directly or indirectly) value substantially from assets located in India</u>** – commonly referred to as the indirect transfer provision
- Share of a foreign company is deemed to derive its value 'substantially' from assets (whether tangible or intangible) located in India in case the following **<u>dual threshold</u>** is met:
  - FMV* of Indian assets exceeds the amount of INR 100 mn; and
  - FMV of Indian assets represents at least 50 percent of the value of all the assets owned by the company
- Exemption from applicability of indirect transfer provisions proposed for FPI's (Category I or Category II) and FII's

Essential to analyze provisions of applicable tax treaty to build non-taxability arguments at investor level

**Rules for determination of the FMV of asset and reporting requirements under the Indian tax law have been prescribed*

Vodafone Case



FACTS:

- Vodafone B.V Netherlands brought 100% shares of CGP Investment Ltd. (Cayman Island Company) from Hutch Hong Kong Co.(HTIL)
- CGP held 67 % stake in Hutch Essar (India)
- While making payment to HTIL, Vodafone did not deduct any tax at source.
- Revenue authorities-Vodafone should be taxable in India by virtue of section 9 of the Income Tax Act, 1961
- Revenue sought to recover around USD 2.1 billion which, in its view, was required to be withheld from payments made to HTIL under domestic withholding obligations

ARGUMENTS AND JUDGMENT

Taxpayer:

- Multi-pronged commercial rationale behind tiered structures such as ring-fencing liability, mitigation of risk, enabling separate verticals, etc
- No provision for taxing 'indirect' transfers
- 'Rights and entitlements' flow from the transfer of shares and are not separate capital assets.

Revenue:

- Transaction designed to avoid Indian taxes
- Form of the transaction disregarded - corporate veil lifted
- Transfer of foreign company's shares resulted into transfer of assets located in India
- Controlling interest is a separate asset situated in India whose transfer gives rise to Indian tax
- Tax withholding obligations extend to non residents

Supreme Court:

- Transfer of shares in a foreign company does not lead to the transfer of assets situated in India
- Tax planning is legitimate if within the legal framework
- "Look at" test to be applied to determine true nature of transaction
- Legal form cannot be disregarded unless the transaction is a sham or tax avoidant
- Controlling interest is embedded in the shares and is not a separate assets

RETROSPECTIVE AMENDMENTS TO INCOME-TAX ACT

Prior Position

Section 2(14)	Section 2(47)	Section 9
"Rights and entitlements" not identifiable or distinct capital assets from shares held	Shares and the rights which emanate from them, flow together and cannot be dissected	Situs of shares where the company is incorporated and where its shares can be transferred.

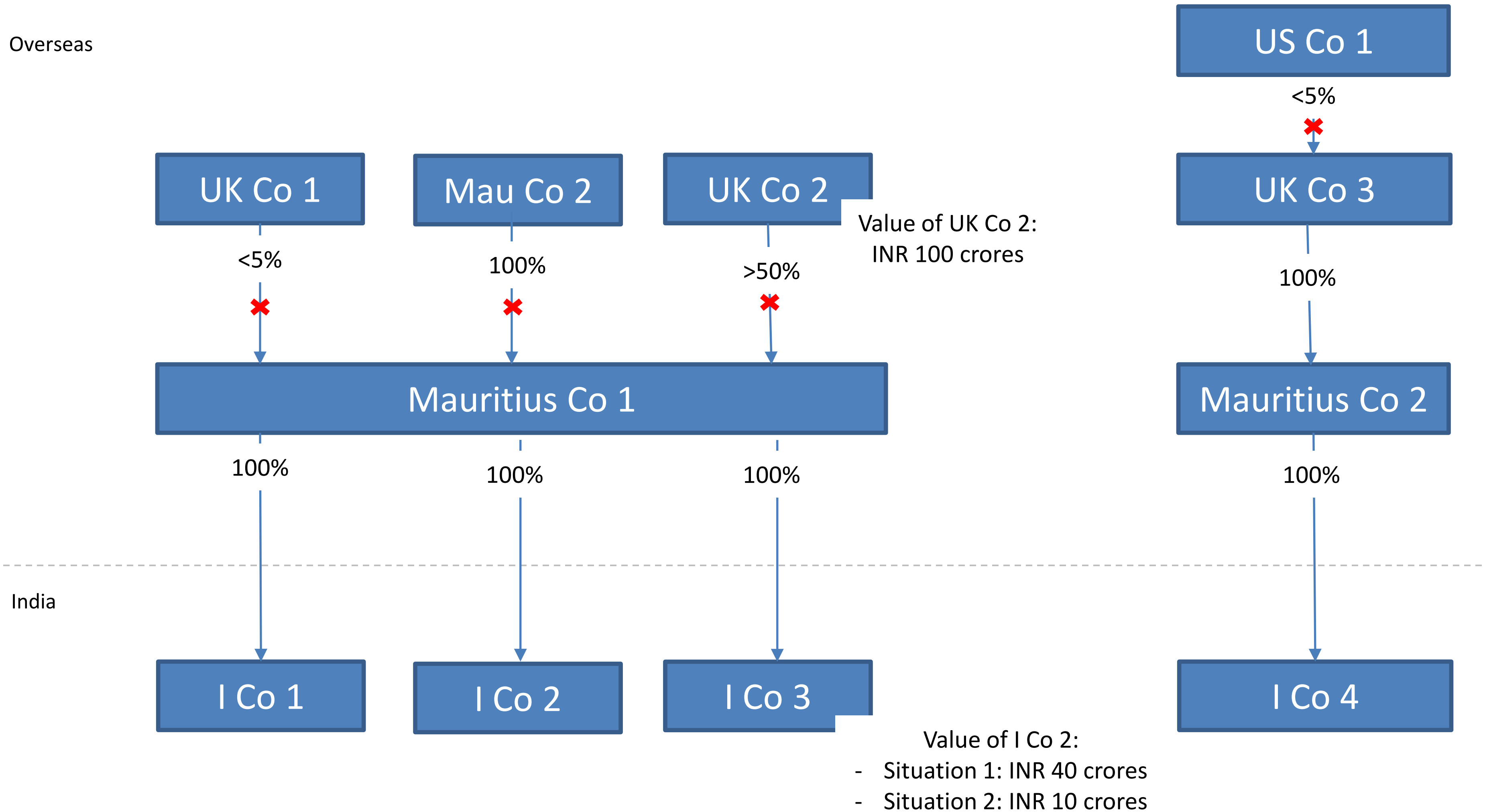
Amended Position

Section 2(14)	Section 2(47)	Section 9
'Capital Asset' deemed to include any rights in or in relation to an Indian Company, including rights of management or control or any rights whatsoever	'Transfer' deemed to include disposing of or parting with an asset / interest or creating any interest in any manner, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from transfer of a share or shares of a company registered or incorporated outside India;	Situs of Shares of / interest in certain foreign companies: Deemed to be situated in India, if the share /interest derives, directly or indirectly, its value substantially from the assets located in India The expression "through" deemed to mean "by means of", "in consequence of" or "by reason of"

- *Introduced by the Finance Act 2012*
- *Retrospective effect from 1 April 1962*

- *Relaxations offered by Finance Act, 2015:*
  1. *De Minimis Thresholds*
  2. *Small Shareholder Exemption*

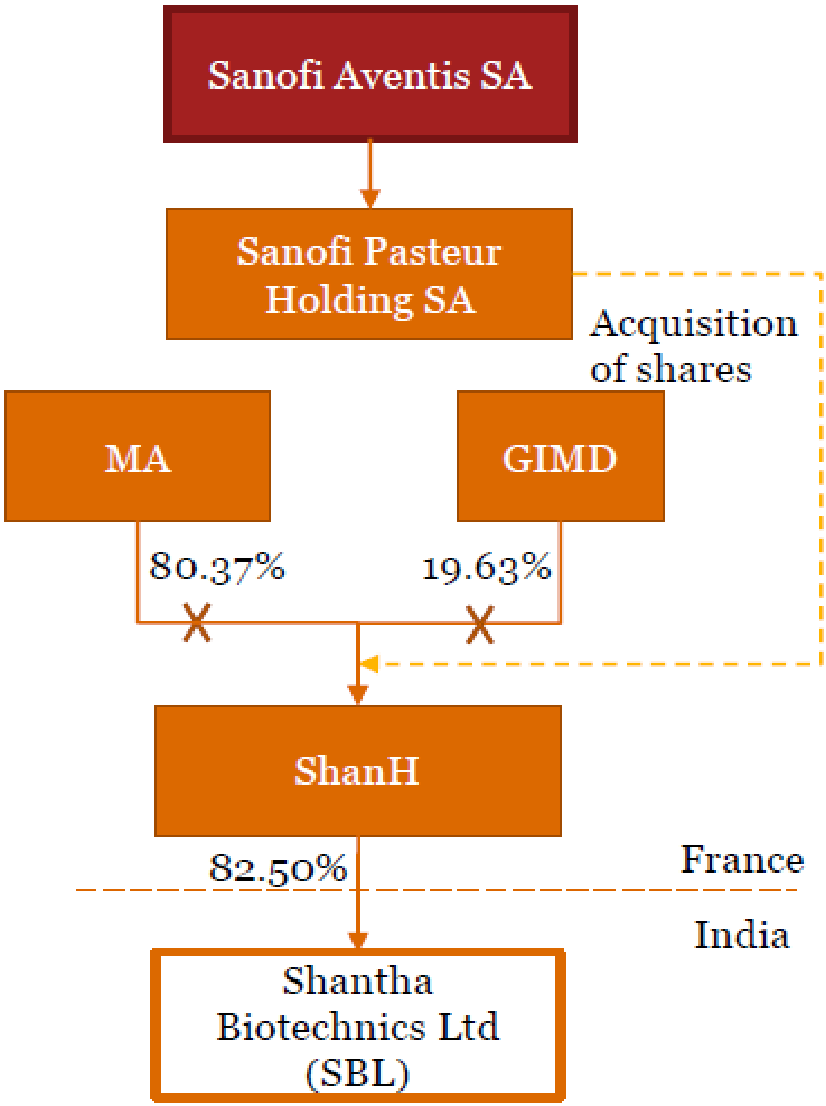
Case Study


Overseas
US Co 1
<5%
UK Co 1
Mau Co 2
UK Co 2
UK Co 3
Value of UK Co 2:
INR 100 crores
<5%
100%
>50%
100%
Mauritius Co 1
Mauritius Co 2
100%
100%
100%
100%
India
I Co 1
I Co 2
I Co 3
I Co 4
Value of I Co 2:
- Situation 1: INR 40 crores
- Situation 2: INR 10 crores

WHAT HAPPENED NEXT?

- The onus to pay taxes fell on Vodafone after the government enacted the retrospective amendments. There was global criticism to the amendment
- Vodafone invoked clause 9 of the Bilateral Investment Treaty signed between India-Netherlands, which mandated fair and equitable treatment to all companies
- The Permanent Court of Arbitration held that an amendment to Indian tax laws was in violation India and the Netherlands agreement.
- It held that the imposition of taxation through a retrospective amendment to domestic tax laws for imposition of tax, was in violation of “fair and equitable treatment” provided under the Agreement between the Republic of India (India) and the Kingdom of Netherlands (Netherlands). Moreover, any attempt to enforce tax demand on Vodafone would amount to breach of international obligations.
- The demand made by India for Rs 22,100 crore by retrospective amendment as capital gains and withholding of imposition of tax for a 2007 deal on Vodafone Company was breaching the provision of agreement regarding fair and equitable treatment

Sanofi Pasteur Holding SA v. Department of Revenue



FACTS:

- The impugned transaction, between three French entities, involved the acquisition by Sanofi Pasteur Holding SA of the entire share capital of
- ShanH from Meriuex Alliance ('MA') and Groupe Industrial Marcel Dassault ('GIMD') in July 2009.
- ShanH held about 80% of the shares in an Indian concern, namely Shanta Biotechnics Limited ('SBL') and hence the question of indirect transfer arose.

ARGUMENTS AND JUDGMENT

Revenue

- Transaction designed to acquire control, management and business interest of SBL
- MA and GIMD are the beneficial owner and ShanH is merely a nominee of MA
- Alienation of shares under Article 14(5) of India-France treaty means direct and indirect alienation
- Alienation not defined under the Treaty, - to be imported from the IT Act
- Mode of disposal is immaterial – whether direct or indirect or deemed disposal

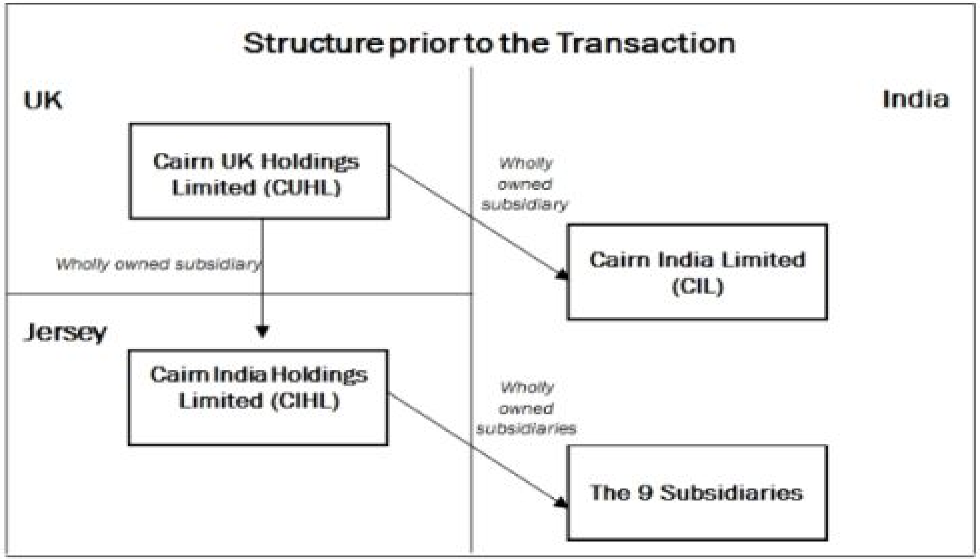
Taxpayer:

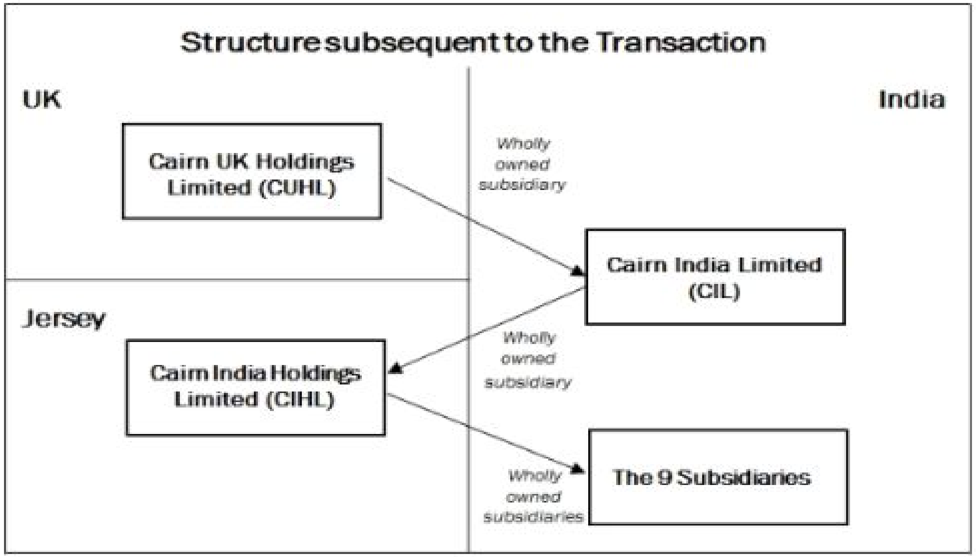
- Controlling interest is not a separate asset
- Even if Controlling interest is viewed as separate asset, it is taxable in France under Article 14 (6) of India- France treaty as the situs is in France
- Justification/ commercial rationale to set up ShanH

High Court:

- ShanH is not a sham or conceived only for Indian tax-avoidance, thereby no case of piercing corporate veil
- Controlling Interest is not a separate asset. Further, the computation mechanism fails to attribute the value of controlling interest in SBL by ShanH
- Retrospective amendments do not override the Tax Treaties
- Transfer of shares of a French entity with underlying Indian assets should not fall under Article 14(5) as it does not have a 'see through approach'. Such a transfer should also fall under Article 14(6) and be taxable only in France.

Cairn UK Holdings Limited v. Deputy Commissioner of Income Tax





FACTS:

- Cairn UK Holdings Limited, a company incorporated in the U.K. (Cairn UK), had a wholly-owned subsidiary, Cairn India Holdings Limited, a company incorporated in Jersey (Cairn Jersey).
- Cairn Jersey owned subsidiaries in India.
- In the year 2006, Cairn UK transferred its entire shareholding of Cairn Jersey to Cairn India. Subsequently, Cairn India acquired the entire business of the Cairn group in India.
- Revenue was of the view that the transfer of shareholding in Cairn Jersey had the effect of transferring the business in India
- The ITAT upheld the retrospective application of the levy and confirmed the tax demand on the basis of the indirect transfer provisions under the ITA.

Cairn UK Holdings Limited v. Deputy Commissioner of Income Tax

- However, the ITAT provided some relief to CUHL by holding that it was not liable to pay penal interest on the principal amount for late payment of taxes which becomes payable by virtue of the confirmation of applicability of indirect transfer provisions.
- As per Article 14 of the tax treaty between India and the UK, each State is permitted to tax capital gains as per its domestic law. Therefore, the relief afforded to the taxpayer under the India-France DTAA in Sanofi as discussed above could not be availed by CUHL in Cairn with respect to the tax treaty between India and the UK.
- Cairn Energy in 2015 initiated an international arbitration to challenge retrospective taxation under the 1994 India – United Kingdom BIT in 2016
- India seized CUHL's shares in another entity, seized dividends due to CUHL, and offset a tax refund due to CUHL as a result of overpayment of capital gains tax on a separate matter, to enforce the tax demand.
- On December 21, 2020, the international arbitral tribunal (the "Tribunal") constituted in the Cairn case held that India had failed to uphold its fair and equitable treatment obligations under the BIT and under international law, by imposing the tax liability retrospectively and adopting measures to enforce the liability. The Tribunal ordered India to pay to Cairn USD 1.2 billion in damages for the 'total harm' suffered by Cairn as a result of India's breaches.
- On May 14, 2021, Cairn filed a lawsuit in the United States District Court for the Southern District Of New York against Air India Ltd ("Air India"), requesting a Money Judgment against Air India and to hold Air India jointly and severally liable in pursuance of the pending petition for the enforcement of the award against India.

Revoking Retrospective Provisions- **Taxation (Amendment) Act, 2021**

Background

- Pursuant to introduction of the indirect transfer provisions, tax demand has been raised in 17 cases.

- The demands raised under the indirect transfer tax provisions also spurred investment treaty arbitration cases against India – among which are Vodafone International Holdings BV v. The Republic of India ("**Vodafone arbitration**"); and Cairn Energy Plc and Cairn UK Holdings Limited v The Republic of India ("**Cairn arbitration**").

- In both the above cases, the arbitral tribunals have ruled in favour of foreign investors.

- In the above background, the government introduced the Taxation (Amendment) Act, 2021, revoking the retroactive applicability of indirect transfer provisions

Taxation (Amendment) Act, 2021

- **An embargo on future tax demands**: the indirect transfer tax provisions would not apply to income accruing or arising as a result of an indirect transfer undertaken prior to May 28, 2012.

Revoking Retrospective Provisions- Taxation (Amendment) Act, 2021

Taxation (Amendment) Act, 2021

- **Nullification of tax demands raised**: demands raised for indirect transfers of Indian assets made prior to May 28, 2012 shall be nullified, subject to following:
  1. Withdrawal or an undertaking for withdrawal of appeal filed before an appellate forum or a writ petition filed before a High Court or the Supreme Court of India;
  2. Withdrawal or an undertaking for withdrawal of any proceedings for arbitration, conciliation or mediation initiated by such person such as under a bilateral investment treaty; and
  3. Furnishing of an undertaking waiving their rights to seek or pursue any remedy or any claim in relation to such income whether in India or outside India.

- **Refund of amounts paid**: The Government shall refund the taxes paid in cases where the application of indirect transfer tax provisions is being withdrawn but no interest shall be paid by the Government on such refund of taxes.

Thank you!