



Budget 2015: Wishlist For Private Equity And M&A

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The 2015 budget is anticipated to be a 'Big Bang Reforms Budget' introducing comprehensive and outcome-oriented reforms.

The government's focus seem to include making doing business in India easier, promoting manufacturing, overhauling dispute resolution in tax matters, tax incentives for R&D and encouraging Indian companies going global.

In its first few months, some important first steps have been taken towards addressing 'tax terrorism' and creating a tax-payer friendly regime – for example, announcement that no litigation will be initiated based on the retro-amendments of 2012 unless approved by a high-level committee, not appealing the Bombay High Court's Shell and Vodafone transfer pricing rulings, instructing tax officers for a "non-adversarial" tax system.

From a private equity and M&A perspective, there are various concerns from an entry, profit-extraction and exit perspective, which increase costs in terms of obtaining tax indemnities, insurance or opting for other risk-mitigation strategies. Some key areas in need of reform are:

Clarity on entitlement to tax treaty benefits

Tax authorities have been increasing challenging the entitlement of non-residents to treaty benefits alleging tax avoidance, etc. More often, such claims ignore commercial considerations vis-à-vis investing through a holding company and choice of holding-company jurisdiction - such as ring-fencing investment-related losses, availing rights under investment treaties, ease of funds-raising, etc. With GAAR slated to come into effect from April 2015, such uncertainty would increase manifold. The government needs to come up with specific criteria to bring about certainty.

Improving the AAR framework

The introduction of AAR has been important in bringing about certainty of tax costs. However, concerns have arisen over inconsistent rulings and possibility of two-levels of challenge - before the High Court and thereafter, the Supreme Court.

Tax-pass through for pooling entities

Complete tax-pass through should be provided to all pooling vehicles – including AIFs, REITs, InvITs, etc., and not just VC funds. This should not result in any tax leakage for the revenue since the trust or its beneficiaries can be taxed and will give tax predictability to

investors.

Eliminating indirect transfer tax

The infamous retro-amendment of 2012 imposing tax on transfer of offshore shares, whose value is substantially derived from Indian assets (nullifying the Supreme Court's landmark Vodafone ruling) provides no clarity on the scope of this tax - including what constitutes 'substantial' value, method for determining acquisition-cost and sale consideration of Indian assets, etc. This goes against the principle of certainty.

Rationalizing taxation of dividends and buyback

At the time of dividend distribution and buyback, corporate profits are subject to additional tax in the hands of the company, contrary to the practice followed globally of taxing the shareholder for such distributions (though withheld by the company). This creates various difficulties, particularly for claiming tax treaty relief in India, claiming credit in the shareholder's country of residence, claiming interest deduction on borrowings, etc.

Other reforms

Additionally, for attracting entrepreneurs and investors with a long-term outlook, various softer aspects should to be addressed. Particularly, some bold reforms recommended by various forums would be required to bring certainty and to reduce wasteful tax litigation. Such recommendations include: (i) changing the practice of tax officials (initiating tax claims) being evaluated solely by the extent of claim raised and the same officials discharging conflicting roles – making and adjudicating tax claims; (ii) prescribing specific consequences if litigation or other proceedings before tax authorities are not concluded within prescribed time limits – for example, the case lapsing in favor of the taxpayer; (iii) introducing arbitration for tax matters; (iv) rationalizing the requirement of depositing tax claims to pursue appeals; (v) drafting clear objects and reasons for amendments, along with examples; etc.