

India

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TAX AUTHORITIES

1. What are the main authorities responsible for enforcing taxes on corporate transactions in your jurisdiction?

The Central Board of Direct Taxes (CBDT) is the main authority for formulating policies and enforcing direct taxes and the Central Board of Excise and Customs is the main authority for formulating policies and enforcing indirect taxes. Both boards are part of the Department of Revenue under the Ministry of Finance of India.

2. Is it possible to apply for tax clearances or obtain guidance from the tax authorities before completing a corporate transaction? If yes, provide brief details, including whether clearance or guidance is binding.

Advance rulings

Income tax. Where the issue is in relation to Indian direct taxation implications of a transaction which has been or is proposed to be undertaken by a non-resident, the non-residents may approach the Authority for Advance Rulings (AAR) for an advance ruling.

The AAR was created by the Finance Act 1993, by introducing an additional chapter in the Income Tax Act, 1961 (ITA). Over the last few years, AAR rulings have gone a considerable way in removing uncertainty in the tax administration. They have instilled confidence in non-residents who, through obtaining a ruling, have a precise idea of their tax liability, as a result of which they can plan their income tax affairs well in advance.

AAR rulings are equivalent to US private letter rulings. Like private rulings, they can be obtained for prospective transactions, and are only binding on the parties involved. However, while private rulings involve a process that is more consultative (involving the request of a determination letter by the relevant revenue official), AAR rulings involve an adversarial process, where counsels from both sides argue before the AAR, subsequent to which a ruling is given.

The AAR consists of a Chairman, who is a retired judge of the Supreme Court and two members who are Additional Secretaries to the Indian Government, one each from the Revenue Service and the Legal Service. The AAR is a quasi-judicial authority and operates like a tribunal or a court.

Further, every proceeding before the AAR is deemed to be a judicial proceeding, and the AAR must follow the principles of natural justice in hearing a matter. Statutorily, the AAR must dispose of an application within six months of filing of the application, and therefore, the AAR mechanism is helpful in avoiding long and expensive litigation at a later stage.

An advance ruling can only be sought for determination of the tax liability of:

- Non-residents in India.
- Resident Indians for transactions with non-residents.

The application can be made concerning transactions which have already been undertaken or are proposed to be undertaken.

An advance ruling cannot be applied for if:

- The applicant already has a case pending before any income tax authority, the appellate tribunal or any court.
- The issue under consideration involves determination of fair market value of any property.
- The issue relates to a transaction which is designed prima facie for avoidance of income tax.

However, no application is rejected without giving the applicant an opportunity of being heard.

Advance rulings are private in nature and are binding only on the parties involved, and only in relation to the transaction for which the ruling has been sought, subject to the condition that there is no change in law or facts on the basis of which the advance ruling has been given. AAR rulings are not considered as legal precedents, though they have persuasive value before other judicial and quasi-judicial authorities in similar cases.

Indirect taxes. Similar to the AAR for income tax determination, an Authority for Advance Rulings (Central Excise, Customs and Service Tax) (AAR(CECST)) has also been set up to give binding rulings, in advance, on indirect tax matters concerning a foreign investment venture in India. The legal provisions of advance rulings were introduced through the Finance Acts of 1998, 1999 and 2003. Advance rulings afford far greater certainty to foreign investors concerning their prospective indirect tax liabilities.

AAR(CECST) is a quasi-judicial body headed by a retired judge of the Supreme Court. Besides the Chairman, there are two members (of Additional Secretary rank) who have wide experience in technical and legal matters.

The process of obtaining a ruling is highly expeditious as the AAR(CECST) must pronounce the ruling within 90 days of receipt of an application. Advance rulings pronounced by the AAR(CECST) are binding on the departmental officers engaged in assessment of goods and services and on the applicant. A ruling given in relation to an applicant is binding only in that applicant's case. Further, advance rulings are not appealable by the department or the applicant, under the central excise, customs or service tax law.

The following categories of applicants may seek an advance ruling:

- Any person who is a non-resident setting up a joint venture in India in collaboration with a non-resident or a resident.
- Any person who is a resident setting up a joint venture in India in collaboration with a non-resident.
- A wholly owned subsidiary Indian company of which the holding company is a foreign company.
- A joint venture in India, that is to say a contractual arrangement whereby two or more persons undertake an economic activity which is subject to joint control and one or more of the participants or partners or equity holders is non-resident having substantial interest in such arrangement.
- A resident falling within any such class or category of persons as the Central Government may by notification in the official gazette specify.

An advance ruling cannot be sought where the question either:

- Is already pending, in applicant's case, before any officer of the central excise, customs or service tax, the appellate tribunal or any court.
- Is the same as in a matter already decided by the appellate tribunal or any court.

Withholding tax certificate. Where any income of a person is required to be deducted at the time of payment, under the ITA, this person can approach the assessing officer for a certificate for lower or no income tax deduction.

Further, where a person is responsible for making a payment to a non-resident chargeable to tax under the ITA, and he considers that the entire amount to be paid is not chargeable to tax in India, he can approach the assessing officer to determine the appropriate proportion of the sum chargeable to tax.

The withholding tax certificates given by the assessing officer are not a final determination of the taxpayer's income tax liability in India and it is possible that a different conclusion is reached at his assessment.

MAIN TAXES ON CORPORATE TRANSACTIONS

3. What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions? In relation to each tax/fee identified, explain briefly:

- Its key characteristics.
- What triggers it.
- Who is liable.
- The applicable rate(s).

Stamp duty

Stamp duty is a duty payable on certain specified instruments or documents. When there is a conveyance or transfer of any movable or immovable property, including transfer of shares or assets, the instrument or document effecting the transfer is liable to payment

of stamp duty at the rates specified in the relevant state Stamp Act or the Indian Stamp Act 1899. If a state does not have a Stamp Act, the Indian Stamp Act 1899 applies.

In corporate transactions, stamp duty is payable on:

- Shareholder agreements.
- Joint venture agreements.
- Share or debenture purchase agreements of a company.

In addition to the above, stamp duty is also payable on a share transfer form executed in connection with a transfer of shares as a percentage of the value of, or the consideration paid for, the shares as per the state specific stamp law.

In relation to mergers or demergers, since a court order approving a merger of two or more companies or demerger has the effect of transferring property to the surviving or resulting company, the court order may require stamping. State stamp law typically requires the stamping of these orders. As above, the amount of the stamp duty payable depends on the specific state stamp law.

The buyer typically bears the stamp duty, however, the parties involved in the transactions may commercially agree on who bears the stamp duty or in what proportion the liability is shared.

Registration fee

Documents relating to immovable property (barring a few exceptions provided under the legislation such as a lease of immovable property for a term not exceeding one year) are compulsorily registered under the Registration Act 1908. If a document is not registered, it does not affect the immovable property, confer any power or provide evidence of the transaction.

4. What are the main corporate and/or capital gains taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- Its key characteristics.
- What triggers it.
- Who is liable.
- The applicable rate(s).

Corporate tax

Domestic companies in India are taxed at 30% on their profits from the business profits.

The Finance Act 2011 has recently introduced an amendment under which from 1 April 2011, the dividends received by an Indian company from a foreign company in which it holds 26% or more of the equity share capital of the foreign company, are taxable at a reduced rate of 15%.

Dividends

Dividend distribution tax (DDT) is payable by an Indian company on the dividends distributed by the company (see Question 8). Provided the company has paid DDT, the dividend is not further taxed in the hands of the shareholders of the company.

Capital gains

A person is taxable on the profits and gains derived from the transfer of a capital asset. Capital gains tax in India is payable at different rates depending on the holding period of the capital asset. There are also differences depending on whether the transferor is an Indian resident or a non-resident. For shares, capital gains tax rates also differ if the shares are listed on the Indian stock exchange.

Capital assets held for more than 36 months are considered as long-term capital assets. Shares held for more than 12 months are considered long-term capital assets. The 12-month holding period applies only to specific securities, including shares in a company. Other kinds of securities such as debentures, options, or bonds must be held for more than 36 months to qualify for the long-term capital gains tax rates.

Long-term capital gains are generally taxable at 20% and short-term capital gains at 30% (see *Question 8* for exceptions). Indexation benefits are available to Indian residents on long-term capital gains except where the long-term capital asset is a bond or debenture other than capital indexed bonds issued by the government. Short-term capital losses can be offset against short-term and long-term capital gains, while long-term capital losses can only be offset against long-term capital gains. Further, capital gains tax is payable in the tax year in which the capital asset is transferred, regardless of the year in which consideration is actually received. This could lead to a situation in which contingent or future consideration may be subject to tax in the year of transfer of the capital asset.

Income tax on acquirer

An acquirer (being individual, firm or a company) paying less than fair market value for acquisition of shares in an Indian company is also subject to tax in India. The tax is levied on the difference between fair market value and purchase price of the shares at:

- The slab rates for individuals, with the highest slab being taxed at 30%.
- 30% for Indian companies.
- 40% for foreign companies.

The above does not apply to publicly listed companies and some types of mergers and demergers, though there are no exceptions for acquisitions. Further, the tax is only triggered in case of transfers when the difference between the fair market value and the transfer price is greater than INR50,000 (as at 1 March 2011, US\$1 was about INR45.4).

5. What are the main value added and/or sales taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- Its key characteristics.
- What triggers it.
- Who is liable.
- The applicable rate(s).

Central sales tax or value added tax

On asset acquisitions, central sales tax (CST) or value added tax (VAT) is likely to arise if the transaction involves a transfer of assets situated in India.

CST is imposed on the sale of goods in the course of interstate trade or commerce. Sales of goods are deemed to take place in the course of interstate trade if they result in the movement of goods from one state to another, or if these sales are effected by the transfer of documents of title to the goods during their movement from one state to another. The process of phasing out CST commenced with a reduction in the CST rate from 4% to 2% on 1 April 2008.

VAT is levied on the sale of goods within a particular state at the rate of 12.5%, though some necessary items such as medicines, agricultural products and industrial inputs are taxed as 4% and gold and silver products at 1%. VAT is a state specific levy and most states have introduced specific VAT legislation. Under the VAT regime, a system of tax credits on input goods procured by the dealer is also available, to avoid the cascading effect of taxes that was prevalent under the previous sales tax regime. However, VAT is still at an early stage of development and is in the process of being fully implemented by all states.

6. Are any other taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- Its key characteristics.
- What triggers it.
- Who is liable.
- The applicable rate(s).

Securities transaction tax (STT)

The Finance Act 2004 introduced STT, payable on all transactions entered on a recognised stock exchange in India, levied at varying rates, depending on the transaction value of the securities purchased or sold:

- Equity-oriented mutual funds: seller to pay 0.25%.
- Debt-oriented mutual funds: no STT.
- Delivery-based equity: buyer to pay 0.12% and seller to pay 0.025%.
- Non-delivery-based equity: day traders and arbitrageurs to pay 0.025%.
- Derivative traders: seller to pay 0.017% of option premium in the sale of option, 0.125% of settlement prices in the sale of an option where option is exercised and 0.017% of the price in the sale of futures.
- Government securities: no STT.

7. In what circumstances will the taxes identified in Questions 3 to 6 be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability)?

Corporate tax

Indian residents are subject to tax in India on their worldwide income, whereas non-residents are taxed only on Indian source income, that is, income that:

- Accrues or arises in India.



- Is deemed to accrue or arise in India.
- Is received or is deemed to be received in India.

The business income of a non-resident is taxable in India if it accrues or arises, directly or indirectly, through or from any business connection in India. Therefore, if an Indian company, through its activities carried out in India, is deemed to constitute a business connection of an offshore company, the income of the offshore company is taxable in India to the extent that it is attributable to the business connection at 40%.

Business connection is a broad concept which can include all income directly or indirectly attributable to a source in India. However, the Indian Government may enter into a double taxation avoidance agreement (DTAA) with a foreign government, and the non-resident (that is, a resident of a country with which India has signed a DTAA), has the option of being taxed according to the provisions of the DTAA or the ITA, whichever is more beneficial to such taxpayer.

Capital gains

Capital gains earned by a non-resident are considered to have their source in India and are taxable in India if they arise directly or indirectly, through the transfer of a capital asset situated in India. The rate of tax on capital gains earned by a non-resident varies from 0% to 40% depending on the type of asset, period of holding and special status of the non-resident (for example, foreign institutional investors (FIIs) registered with the Securities and Exchange Board of India receive a preferential capital gains rate under certain circumstances. See *Question 8* for applicable capital gains rates). Therefore, in a transfer of shares of an Indian company, the transferor is taxable in India, unless the transferor is a resident of a country with which India has a favourable DTAA such as Mauritius or Singapore.

Foreign companies are not entitled to indexation benefits on shares and debentures. Further, any gains arising from the transfer of shares or debentures are calculated by converting the cost of acquisition, expenditure incurred and the value of consideration received into the same foreign currency as used to buy the asset. The capital gains are then converted into Indian currency for capital gains tax calculation.

Income tax on acquirer

The language in the ITA is wide enough to include non-residents within its ambit (see *Question 4, Income tax on acquirer*). Therefore, if a non-resident receives shares of an Indian company at less than fair market value, there is a possibility that the non-resident would be taxed in India on the difference in value.

However, if the non-resident is a resident of a country with which India has a DTAA, it should be possible to apply the provisions of the DTAA. Income tax on acquirers is levied under the residuary category of other income under the ITA, and not under the heads of capital gains or business income. Therefore, DTAA provisions relating to capital gains and business income may not offer relief to non-resident taxpayers. However, they could rely on the article relating to other income in the DTAA under which residuary income is typically taxable in the state of residence.

DIVIDENDS

8. Is there a requirement to withhold tax on dividends or other distributions? If yes, provide brief details.

There is no withholding tax on dividends in India, though Indian companies must pay DDT on the dividends distributed at 15%. However, the portion of dividends received from a subsidiary is not subject to DDT, provided the subsidiary has already paid DDT, and the parent is not a subsidiary of any other company. For this purpose, a company is a subsidiary of another company where the parent holds more than half in nominal value of the equity share capital of the subsidiary.

Withholding tax of 10% (applicable on a gross basis) is charged on royalties and fees for technical services in India. Further, there is a withholding tax on interest payments which ranges from 10% to 40% depending on the type of debt instrument and the residency of the recipient of the interest.

SHARE ACQUISITIONS AND DISPOSALS

9. What taxes are potentially payable on a share acquisition/share disposal?

Share acquisition

If shares are acquired by a person at less than fair market value, the acquirer may be taxed on the difference between the fair market value and the consideration paid, at 30% for residents and 40% for non-residents (see *Questions 4 and 6*).

Share disposal

Shares are generally considered as capital assets unless the shares are held as stock-in-trade, giving rise to capital gains on disposal. In this context, there has been an ongoing debate on whether investments into Indian companies can be considered to be part of stock-in-trade (therefore, trading assets) of the investor, or as capital investments (therefore, capital assets). The distinction (in the case of a foreign company) would be that, while profits from sale of trading assets would be regarded as business income while profits from sale of capital assets situated in India would be taxed in India as capital gains.

There have been differing judicial pronouncements in India past as to whether gains from transactions in securities by FIIs should be taxed as business profits or as capital gains. However, these pronouncements, while setting out certain guiding principles have largely been driven by the facts and circumstances of the case. Historically, most FIIs have offered sale proceeds from their investments in Indian securities to tax as capital gains. However, there have been instances where FIIs have obtained an AAR ruling in India that the income earned by them from the sale of Indian securities, including exchange traded derivatives, is in the nature of business income. Therefore the income is subject to tax in India only in the presence of a permanent establishment in India. By contrast, the AAR has given rulings on FIIs that their income from sale of shares should be characterised as capital gains and not business income. The Central Board of Direct Taxes (CBDT) issued a circular providing the guiding principles to be followed

by tax authorities in the determination of whether a particular investment would qualify as a capital asset or a trading asset.

- Unlisted shares:
 - for residents: on a long-term capital gain: 20%, on a short-term capital gain: 30%;
 - for non-residents: on a long-term capital gain: 20% (FIIs at 10%), on a short-term capital gain: 40%.
- Listed shares on the stock exchange:
 - for residents: on a long-term capital gain: 0%, on a short-term capital gain: 15%;
 - for non-residents: on a long-term capital gain: 0%, on a short-term capital gain: 15%.
- Listed shares off the stock exchange:
 - for residents: on a long-term capital gain: 10%, on a short-term capital gain: 30%;
 - for non-residents: on a long-term capital gain: 10%, on a short-term capital gain: 40% (FIIs at 30%).

The capital gains tax payable on the disposal of shares is stamp duty which is payable on the share transfer form and the share purchase agreement.

Tax to be withheld by the buyer

Any person responsible for making a payment to a non-resident, which is chargeable to tax under the ITA, must withhold tax at the applicable rates. The language in the ITA is wide enough to also include a non-resident. Therefore, if the capital gains earned by a non-resident from sale of shares in an Indian company are taxable in India, there is a liability on the buyer (irrespective of the buyer's location) to withhold and deposit the tax with the Indian Government. Failure to deduct tax could result in the buyer being considered as an assessee-in-default, and the buyer may be liable to pay interest and a penalty in addition to the amount of tax in arrears.

However, if the non-resident seller is located in a jurisdiction with which India has a DTAA and India has given up its right to tax the capital gains, there is no obligation on the buyer to withhold tax given the capital gains earned by the seller are not chargeable to tax in India.

10. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

The following transactions are not considered as transfers and consequently do not give rise to capital gains:

- Transfer of a capital asset under a gift or will or irrevocable trust (except transfer of shares, debentures or warrants allotted by a company to its employees under an employee stock option).
- Transfer of a capital asset from a subsidiary to its parent company or vice versa provided the parent company holds the entire share capital of the subsidiary and in both cases, the transferee is an Indian company.

The second exemption is withdrawn if before the expiry of eight years from the date of transfer either:

- The capital asset is converted to or treated as stock-in-trade by the transferee company.
- The parent company ceases to hold the whole of the share capital of the subsidiary.

This withdrawal would result in the gains arising from this transfer becoming chargeable as capital gains in the year in which the transfer took place.

11. Please set out the tax advantages and disadvantages of a share acquisition for the buyer.

Advantages

These include:

- The transfer of shares attracts stamp duty at 0.25%. This rate is less than the rate of stamp duty levied on the transfer of other assets, which varies from state to state.
- A share sale is VAT exempt by contrast to an asset sale, which may be subject to VAT.
- It is possible to carry forward unabsorbed losses and depreciation.

Disadvantages

These include:

- Income tax is imposed on the acquirer on the difference between the fair market value and the cost of acquisition of the shares.
- There is a withholding tax obligation on the buyer irrespective of the buyer's residency.

12. Please set out the tax advantages and disadvantages of a share disposal for the seller.

Advantages

These include:

- The seller can dispose shares of listed companies on the Indian stock exchanges without payment of any capital gains tax.
- If the seller is a non-resident and located in a tax favourable jurisdiction such as Mauritius or Singapore, capital gains earned from disposal of shares of Indian companies may be exempt from tax in India on a joint reading of the ITA and the relevant DTAA.

Disadvantages

These include:

- As a non-resident, STT paid on disposal of listed securities may not be a creditable tax under the applicable DTAA.
- It is not possible to take advantage of losses and unabsorbed depreciation of the company being transferred.

13. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

See *Question 9* for exemptions that may be considered to minimise tax burdens.

In addition, if a non-resident is acquiring shares in an Indian company, the acquisition is typically made from a tax favourable jurisdiction to minimise the tax burden at the time of share disposal. For example, if a non-resident located in Mauritius transfers shares of an Indian company, the capital gains earned by the non-resident are not taxable in India (*DTAA*), and all capital gains realised by the non-resident, whether long term or short term, are subject to tax in Mauritius. Mauritius does not currently impose capital gains tax on the sale of securities. Therefore the effective tax on capital gains is 0%.

ASSET ACQUISITIONS AND DISPOSALS

14. What taxes are potentially payable on an asset acquisition/asset disposal?

Capital gains

In an asset sale, there is a transfer of a capital asset, and therefore there is a capital gains tax liability for the transferor to the extent of gains realised (see *Question 4*). Unless the transfer falls under any of the exceptions, there is tax on capital gains at 20% (long-term capital gain) and 30% (short-term capital gain). The asset should be held for more than 36 months to be considered as a long-term capital asset.

For the purpose of this answer, it has been presumed that the asset is a capital asset. If the asset transferred is a business asset, the transferor is liable to pay tax on the profits on sale of the asset at the rate of tax payable on business income.

Slump sale. Before 2000, any sale of an undertaking through a slump sale was not explicitly subject to capital gains tax. However, through an amendment made by the Finance Act of 1999, with effect from April 2000, the Finance Act now taxes profits and gains arising from a slump sale. A slump sale is the transfer of one or more undertakings through the sale for a lump sum without values being assigned to individual assets and liabilities.

Profits and gains arising from the slump sale are taxed as long-term capital gains if the undertaking or undertakings have been held by the transferor for more than 36 months before the date of transfer. With a holding period of less than 36 months, the capital gains is treated as short term.

For the purpose of capital gains calculation the cost of acquisition and the cost of improvement of the undertaking or division is the net worth of the undertaking or division. Net worth is the aggregate value of the total assets of the undertaking or division as reduced by the liabilities of the undertaking or division as appearing in its books of account. Further, for depreciable assets, the written down value of the block assets is considered.

VAT

There is liability to pay VAT in the event of an asset sale (see *Question 5*). The rate of VAT depends on the state-specific VAT legislation.

Slump sale. In relation to slump sales, before the enactment of state-specific VAT statutes, judicial interpretation was that sales tax cannot be imposed when a business is sold. There was a standard requirement across all state sales tax legislation that a dealer must be a person carrying on business and sales are taxed when they are in the course of business. A person is generally not carrying on the business of selling businesses, and the sale of a going concern with all movables cannot be considered as a sale in the course of business. Therefore, a slump sale per se should not attract sales tax.

However, with the enactment of VAT legislation, the position has changed under the various states, which deem any transaction in connection with commencement or closure of business a transaction comprised in business. Therefore in a slump sale where the transferor entity would close down its business by completing the sale, this transaction may attract the VAT in some states. However, in states where such a definition of business is not specifically provided in the state specific VAT legislation, VAT should not apply to a slump sale.

Stamp duty

The stamp duty on the asset sale is payable on the deed or deeds of conveyance transferring the movable and immovable assets. This varies in accordance with the state in which the immovable and/or movable property is located and where the deed of conveyance for the transfer of the property has been entered into.

Slump sale. For a slump sale, there is no specific provision in the Stamp Act and the state Stamp Acts in relation to slump sales, however, as per judicial precedents, a slump sale which is a transfer of business is considered as movable property for stamp duty purposes. The rate of stamp duty on movable property varies under the various state Stamp Acts.

Service tax

In an asset purchase or a slump sale, where the object is to acquire the business of the seller, there may be a covenant in the asset purchase agreement that the seller will procure that its employees accept offers of employment with the acquirer. Part of the consideration payable to the seller may be contingent on the number of employees who join the acquirer. It is possible that such a covenant could amount to the provision of manpower recruitment services by the seller on which service tax at 10.3% may be payable.

15. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

See *Question 9* for transactions which are not considered as transfers for capital gains purposes.

16. Please set out the tax advantages and disadvantages of an asset acquisition for the buyer.

Advantages

These include:

- In an asset purchase, the buyer has the benefit of recording assets at the consideration paid to acquire them and therefore can achieve step-up in basis in the business assets to that extent.
- An expenditure incurred for acquisition of a business asset is allowed as a deduction while calculating the business profits of the buyer.

Disadvantages

These include:

- In case of a slump sale, the losses of the company are not transferred to the buyer company (by contrast to a demerger where the losses can be transferred).
- Step-up on the cost of consideration may not be possible in a slump sale since assets and liabilities of a business are transferred as a block, and individual values are not assigned to them.

17. Please set out the tax advantages and disadvantages of an asset disposal for the seller.

Advantages

These include:

- Capital losses can be carried forward for eight years and can be set off against the capital gains.
- In relation to slump sale, individual value is not attached to the assets and therefore for the purpose of capital gains calculation, the cost of acquisition and the cost of improvement of the undertaking or division is the net worth of the undertaking or division (*see Question 13*). Therefore, if the undertaking is owned and held by the transferor for more than 36 months, capital gains arising on slump sale of the undertaking are treated as long-term capital gains even if some of the assets of the undertaking have been owned and held by the transferor for less than 36 months.
- In relation to a slump sale, no distinction is made between depreciable and non-depreciable assets.

Disadvantages

These include:

- Indexation benefit is not available in the case of a slump sale.
- Any change in the value of assets on account of revaluation of assets is ignored for the purpose of computing the net worth for calculation of cost of acquisition in a slump sale.

18. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

As an alternative to an asset sale, a slump sale or demerger may be explored. In the event of a demerger, the transfer of a capital asset is not considered as a transfer for capital gains purposes in the following cases:

- By a demerged company to an Indian resulting company.
- By a foreign demerged company to the foreign resulting company, where the capital asset is shares in an Indian company, provided:
 - the shareholders of the foreign demerged company holding not less than 75% in value of the shares, continue to remain shareholders in the foreign resulting company;
 - the transfer does not attract tax on capital gains in the country in which the foreign demerged company is incorporated.
- Transfer or issue of shares by the resulting company to the shareholders of the demerged company if the transfer or issue is in consideration of demerger of the undertaking.
- To qualify as a demerger under the ITA, it is essential that, among other things, shareholders holding at least 75% of the value of shares in the demerged company also become shareholders in the resulting company.

LEGAL MERGERS

19. What taxes are potentially payable on a legal merger?

Indian corporate law allows a foreign company to merge with an Indian company. However, an Indian company cannot merge into a foreign company.

Amalgamation is a merger of one or more companies with another company or that of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that both (*ITA*):

- All the property and liabilities of the amalgamating companies immediately before the amalgamation becomes the property of the amalgamated company.
- Shareholders holding not less than 75% in value of the shares in the amalgamating companies (other than shares already held in it immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company.

An amalgamation may give rise to tax on capital gains on the disposal of the shares by the shareholder. See *Question 19* for circumstances when transfer of capital asset through a merger may be exempt from capital gains tax. In addition to capital gains, stamp duty also applies.



20. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Transfer of a capital asset through a scheme of amalgamation is not considered as a transfer for the purpose of capital gains in the following cases:

- **Capital gains tax exemption for the amalgamating company.** Any transfer of a capital asset by the amalgamating company to an Indian amalgamated company is exempt.
- **Capital gains tax exemption for the shareholders of an amalgamating company.** Under an amalgamation scheme, the amalgamating company shareholders receive shares in the amalgamated company in exchange of shares of the amalgamating company. A transfer by such a shareholder, where the capital asset is shares in the amalgamating company, is exempt from capital gains tax, provided the transfer is made in consideration for allotment of shares in the amalgamated company to such shareholder and the amalgamating company is an Indian company. Therefore, if the shareholders receive consideration other than shares, the gains are subject to capital gains tax.
- **Capital gains tax exemption for a foreign amalgamating company.** A transfer of capital asset by a foreign amalgamating company to the foreign amalgamated company, where the capital asset is shares in an Indian company is exempt from capital gains tax, provided:
 - at least 25% of the shareholders of the foreign amalgamating company continue to remain shareholders in the amalgamated company;
 - the transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

21. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Given the tax exemptions for mergers under the ITA, most mergers are eligible for these exemptions. For shareholders giving up their shareholding in the amalgamation for consideration other than shares, there may be a tax incidence, which may be reduced for a non-resident if the non-resident is located in a tax favourable jurisdiction.

JOINT VENTURES

22. What taxes are potentially payable on establishing a joint venture company (JVC)?

There are no direct taxes imposed at the time of establishing a JVC, though there may be stamp duty on the joint venture agreement and share issuance. India does not impose capital taxes.

Once established, the JVC is subject to taxes in *Question 4*. In the context of a joint venture with foreign enterprises, as per

the Indian transfer pricing regulations, the Indian joint venture and the foreign shareholders are considered as associated enterprises, and any transactions between them must be conducted at arm's length.

23. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

There are no specific reliefs available to a JVC. It must rely on the general exemptions under the ITA.

24. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Where both the JVC and the joint venture partners are set up companies, there is taxation at both levels. The JVC is subject to corporate tax and DDT, and the joint venture partners are again subject to corporate tax on the dividends received (subject to the exception in *Question 7*) and DDT on dividend distributed by them. Therefore, it may be more tax efficient to set up a joint venture as a limited liability partnership. This structure would be possible where the joint venture partner is a foreign person since foreign investment in an Indian partnership is not allowed under the Indian exchange control regulations.

Distribution of profits by the JVC is possible through buyback of shares. Since buyback results in capital gains, the effective tax burden may be reduced, particularly for non-resident shareholders investing in the joint venture from a tax favourable jurisdiction (see *Question 28*).

COMPANY REORGANISATIONS

25. What taxes are potentially payable on a company reorganisation?

There are no specific provisions under the ITA dealing with company reorganisation and therefore the exchange or transfer of shares is dealt with in accordance with general principles set out in this chapter.

26. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

There are no specific reliefs available.

27. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Depending on the business objectives, it may be possible to minimise the tax burden by using of trusts, limited liability partnerships or specific exemptions.



RESTRUCTURING AND INSOLVENCY

28. What are the key tax implications of the business insolvency and restructuring procedures in your jurisdiction?

The distribution of assets by the liquidating company to its shareholders is specifically exempted from being considered as a transfer and therefore the liquidating company is not subject to capital gains tax at the time of distribution of its assets on liquidation. However, any distribution made to the shareholders of a company on its liquidation to the extent the distribution is attributable to the company's accumulated profits immediately before liquidation is deemed as dividends and therefore subject to DDT. The dividends are tax exempt in the hands of the shareholder. The distributions received by the shareholders in excess of the dividends are considered as capital gains and accordingly subject to tax.

SHARE BUYBACKS

29. What taxes are potentially payable on a share buyback?

Capital gains on buyback

Distributions made on the shares held in an Indian company, are generally considered as dividends if paid from the accumulated profits of the company. However for share buybacks, distributions have been specifically excluded from the definition of dividends under the FA.

Further, under an amendment made by the Finance Act, 2000, the ITA now also contains a specific provision dealing with purchase by a company of its own shares. The relevant provision clarifies that where a shareholder receives any consideration from the company for purchase of shares by the company, the consideration is chargeable to tax in India as capital gains. The difference between the consideration received from the company and the cost of acquisition of the shares is the amount chargeable to tax as capital gains in the hands of the shareholders in the year in which the shares were bought by the company.

A buyback of the equity shares is only allowed once in a period of 365 days, and a fresh issue of the same security is not allowed before a period of six months from the date of the buyback. Further, the Indian company is allowed to buy back a maximum of 25% of the outstanding paid up equity share capital in one year.

30. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

If the shares have been held for more than 12 months, the shares are considered as a long-term capital asset giving rise to long-term capital gains on transfer. This is taxed at 20% by contrast to short-term capital gains, which are taxed at 30%.

31. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

For resident shareholders, apart from the relief granted to the shareholder in relation to setting off capital losses and indexation benefit, there is no provision which allows the shareholder to minimise the tax burden on share buybacks. In relation to non-resident shareholders, if the investment has been made from tax favourable jurisdictions, it is possible for the tax burden to be reduced and no capital gains tax is payable in India.

PRIVATE EQUITY FINANCED TRANSACTIONS: MBOs

32. What taxes are potentially payable on a management buyout (MBO)?

Not applicable.

33. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Not applicable.

34. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Not applicable.

REFORM

35. Please summarise any proposals for reform that will impact on the taxation of corporate transactions.

Direct Tax Code

As part of its tax reform initiatives, India is in the process of revising and consolidating its direct tax laws. In furthering this objective, a bill for the Direct Tax Code (DTC) has been placed before the Indian Parliament. After the draft DTC is approved by both Houses of the Indian Parliament and receives the President's assent, it will be enacted as law. Once enacted, the DTC will replace the existing income tax and wealth tax law in India and will be effective from 1 April 2012.

In the DTC, corporate tax rates continue to remain at 30%, while foreign companies would be subject to an additional branch profit tax of 15%, thereby raising their effective tax rate to 40.5%. Further, while long-term capital gains on the sale of shares (held for more than a year) on the stock exchange will continue to be tax exempt, subject to payment of securities transaction tax at the current applicable rates, short-term capital gains on the sale of these shares (held for less than a year) on the stock exchange

would be taxed at ordinary rates subject to a 50% exemption and other capital gains income are proposed to be taxed at ordinary rates applicable to the taxpayer.

Cross-border M&As would also be affected since the DTC proposes to extend the tax net to offshore share acquisitions where the target foreign company holds direct or indirect assets in India that are more than 50% of the fair market value of all assets held by the company at any time within 12 months before the transfer.

Another proposal is to introduce the controlled foreign corporation (CFC) provisions which seek to tax resident companies in

relation to undistributed profits of specific foreign corporations controlled by such resident companies.

The draft DTC (in its current form) also proposes to introduce a general anti-avoidance provision (GAAR). GAAR provisions empower the tax authorities to declare any arrangement as an impermissible avoidance arrangement, provided the arrangement has been entered into with the main objective of obtaining tax benefit under specified circumstances.

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Areas of practice. International taxation; funds.

Recent transactions

- Advising on taxation issues in structuring of inbound/outbound investments, joint ventures, mergers and acquisitions, and e-commerce, pharma and media transactions.
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