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Private Memorandum

For discussion purposes

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Investing through Singapore
Special considerations

This communication is provided to you as our valued client and strictly on a private, privileged and confidential basis. It may only be used for internal discussion purposes and should not be construed as legal opinion.

As you are aware, the wide general anti-avoidance provisions ("**GAAR**") introduced pursuant to the 2012 Finance Act has prompted investors to review their existing structures for investing into India. Several funds and investment managers have considered investing from Singapore on the basis that it is easier to establish and demonstrate commercial substance in Singapore.

Singapore is definitely an excellent platform for setting up new funds and investing into India. Singapore funds and fund managers may also take advantage of tax incentives provided under Singapore law. At the same time, it is important to address certain special considerations and challenges in light of the substance requirements and expanded scope of permanent establishment in the Singapore tax treaty. Should you require further guidance feel free to contact any of our offices in Mumbai, Singapore, Delhi, Bangalore or Palo Alto (Silicon Valley).

A. Impact of GAAR

1. Currently, GAAR is slated to come into force from April 1, 2013. Recently, the Finance Minister announced that suitable amendments shall be introduced to defer implementation of GAAR to April 1, 2015. However, it was clarified that investments made after August 30, 2010 (where the exit is subsequent to April 1, 2015) would not be grandfathered and may hence be subject to the scrutiny of GAAR.

2. If GAAR provisions apply to an arrangement, tax authorities may disregard any entity involved, re-allocate income between such entities, re-characterize debt into equity and vice versa, and deny any tax benefit, including benefits available under a tax treaty.

3. GAAR provisions override all treaties signed by India- including treaties with Singapore and Mauritius. The Shome Committee had recommended that GAAR should not apply if the foreign investor meets certain substance criteria prescribed within the treaty itself. The Singapore tax treaty contains such

substance criteria or limitation of benefits clause which is discussed below. The Government however has not indicated whether this recommendation by the Shome Committee will be implemented.

4. GAAR provisions may apply to an arrangement if both the following tests are met:

    - Tax benefit test: The main purpose or one of the main purposes of an arrangement or any step in the arrangement is to obtain a tax benefit (or a relief or exemption under a tax treaty).

    - Tainted elements test: The arrangement or any step in the arrangement has one or more of the following elements:

        - Lacks commercial substance, in whole or in part.

        - Creates rights or obligations that are not on an arm's length basis.

        - Results in abuse or misuse of tax provisions.

        - Carried out in a manner not ordinarily employed for bonafide purposes.

5. There is no definition of what constitutes 'commercial substance' for purposes of GAAR. The provisions do not indicate that an entity may be considered to have commercial substance if it employs certain number of employees or incurs specific amount of expenditure.

6. The expression, 'commercial substance' is used in wide terms and even covers situations where a part of the arrangement lacks commercial substance.

7. India's GAAR provisions have been borrowed from South Africa (without incorporating some of the safeguards present under South African law). The South African revenue service has indicated that 'lack of commercial substance' broadly refers to situations where the quantum of tax benefit is disproportionately higher than the expenditure incurred.

8. The GAAR provisions identify specific scenarios where an arrangement is deemed to lack commercial substance. The following are particularly relevant in the context of cross-border holding structures:

    - An arrangement is deemed to lack commercial substance if the place of residence of an entity is not backed by any substantial commercial purpose.

    - An arrangement is deemed to lack commercial substance if it involves an accommodating party. An accommodating party includes an entity whose participation in the arrangement is, in whole or part, to obtain a tax benefit.

9. It is hoped that that the 2013 Budget will provide additional clarity, guidance and certainty with

respect to the scope and application of GAAR.

B. Limitation of Benefits (LoB) clause under Singapore tax treaty

1. The capital gains tax benefit available under the Singapore tax treaty may be denied if the Singapore resident does not satisfy conditions laid down under the LoB clause in the treaty.

2. As per the LoB clause (contained in Article 3 of the Singapore treaty protocol), a Singapore resident will be entitled to the capital gains tax exemption on sale of Indian securities only if the following criteria is satisfied:

   - *Purpose not to be primarily tax driven* (Article 3.1 of Singapore treaty protocol): The affairs of the Singapore entity are not arranged with the primary purpose of taking benefit of the capital gains tax relief.

   - *The Singapore resident is not a shell or conduit* (Article 3.2-3.4 of Singapore treaty protocol): A shell / conduit entity is one with negligible or nil business operations or with no real and continuous business activities carried out in Singapore.

     A Singapore resident is deemed not to be a shell or conduit if its annual operational expenditure in Singapore is at least SGD 200,000 per year in the two years preceding the transfer of shares giving rise to capital gains.

3. Article 3.1 of the Singapore treaty protocol is a broad anti-avoidance provision within the treaty itself. A Singapore entity will not be entitled to the capital gains tax relief if its affairs are arranged with the primary purpose of taking benefit of such relief. If this is the case, the benefit may be denied even if the Singapore entity is considered to have commercial substance under the GAAR provisions or incurs annual operational expenditure of SGD 200,000.

4. It is therefore imperative that the business rationale and strategic reasons for investing from Singapore are properly reflected in Board resolutions, disclosures, agreements, and other documents.

5. The Singapore treaty protocol also clarifies that the capital gains tax exemption shall be applicable only to the extent a similar exemption continues to be available under the Mauritius tax treaty. Therefore, if, pursuant to treaty renegotiation, the exemption is not available under the Mauritius treaty, the same would not be available under the Singapore treaty as well.

C. Wide Permanent Establishment (PE) clause

1. An investor from Singapore may in certain cases be subject to tax in India if it has a PE in India. Under Article 5 of the Singapore tax treaty, a PE may be constituted if the Singapore resident has a fixed base or branch office in India. A PE may also be constituted if services are provided by

employees or other personnel of the Singapore entity who spend more than 90 days in India (or 30 days if services are provided to a related enterprise). A dependent agent of the Singapore entity in India will also be treated as a PE.

2. A dependent agent is distinct from an independent agent like a broker or a commission agent who is not contractually or financially tied to a specific principal.

3. Under the Singapore tax treaty, a dependent agent is one who habitually exercises an authority to conclude contracts or maintain stock of goods on behalf of the foreign enterprise.

4. The agency PE clause in the Singapore treaty however presents an additional challenge. A PE may be constituted even if a person habitually 'secures orders', wholly or almost wholly for the foreign enterprise or its affiliates.

5. The expression, 'securing orders' expands the scope of the agency PE clause beyond the conventional notion of agency. The clause is wider than the agency PE clause in most tax treaties signed by India.

6. While there is no definition of this expression in the Singapore treaty, an ordinary interpretation would suggest that it may extend to activities other than actual execution of contracts. Literally read, it may potentially extend to other activities such as sourcing of deals and negotiation of contracts.

7. Under the US tax treaty, the expression, 'securing orders' has been clarified through an exchange of diplomatic letters between the two countries. It is stated that a person shall be considered to habitually secure orders in a Contracting State, wholly or almost for an enterprise, only if :

   - such person frequently accepts orders for goods or merchandise on behalf of the enterprise;

   - substantially all of such person's sales related activities in the Contracting State consist of activities for the enterprise;

   - such person habitually represents to persons offering to buy goods or merchandise that acceptance of an order by such person constitutes the agreement of the enterprise to supply goods or merchandise under the terms and conditions specified in the order; and

   - The enterprise takes actions that give purchasers the basis for a reasonable belief that such person has authority to bind the enterprise.

8. Although provided in the context of the US tax treaty, this clarification may also provide guidance as to the meaning of the expression, 'securing orders' under the Singapore treaty.

9. It is necessary to ensure that the Indian advisory company is not caught within the expanded scope of

PE under the Singapore treaty and additional language and clarification has to be inserted in relevant board resolutions, communication from the fund to the portfolio company, investment advisory agreement and other relevant documentation.

D. Tax relief in Singapore

1. Singapore generally does not impose a tax on capital gains. However, in certain circumstances gains from the sale of shares may be treated as trading income taxable at the rate of 17%.

2. The characterization of gains as trading income depends on factors such as the frequency and volume of transactions.

3. The Singapore tax authorities issued a Circular in May 2012 clarifying that gains from the sale of shares would be treated as capital gains (rather than trading income) if the seller holds at least 20% ordinary shares in the company for a continuous period of 24 months prior to the share transfer. This safe harbor is available till May 31, 2017.

4. Singapore based fund managers may avail of a concessionary tax rate of 10% (rather than 17%) on management fees. For entitlement to the lower tax rate, specific criteria have to be fulfilled including employment of at least 3 professionals in Singapore and other considerations as prescribed by the Monetary Authority of Singapore. Special tax exemptions are available to offshore and onshore funds (and investors) that are managed from Singapore.

While all fund and investment structures have to generally gear up in light of GAAR, Singapore based structures have to specifically factor and address risks arising on account of the LoB and expanded PE clauses.

We acknowledge that this note has been issued by us for the purpose of general information and should not be construed as legal opinion. It may not be relied upon by any other person for any purpose, nor is it to be quoted or referred to in any public document or shown to, or filed with any government authority, agency or other official body without our consent. We are relying upon relevant provisions of the Indian laws, and the regulations thereunder, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could have an effect on the validity of our comments and conclusions. We disavow any obligation to update this note or advise you of any changes in this note in the event of changes in applicable laws or facts, or if additional or newly discovered information is brought to our attention after the date of this note. Our note is based on certain understandings, and if the facts are different from our understandings, it could have material impact on our comments and conclusions. Our note is only with respect to the Indian law, as we are not qualified to opine on laws of jurisdictions other than those of India.