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India | Tax & Regulatory | For internal circulation only | 25 July 2016

Global Business Tax Alert
Sharp Insights

The Central Board of Direct Taxes ('CBDT'), vide Notification No.55/2016 [F.No. 142/26/2015-TPL]/SO 2226 (E), dated June 28, 2016, has notified Income-tax (19th Amendment), Rules, 2016 (Indirect transfer rules') prescribing the manner of determination of fair market value in certain cases and reporting requirement for Indian concern.

Issue no: GBTA/36/2016

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Background

- The Supreme Court of India in the case of Vodafone International Holding BV (Vodafone) held that the gains arising from sale of shares by a foreign company to another foreign company should not be taxable in India since the situs of such shares is outside India.
- The Finance Act, 2012 brought in a retrospective amendment in the Income-tax Act, 1961 ("the Act") which provided that any share of or interest in a foreign company shall be deemed to be an asset situated in India, if, it derived its value substantially from the assets located in India. Accordingly, indirect transfers of Indian assets were brought under the Indian tax net. However, there was still an ambiguity on the interpretation of the term 'substantial value'.

- The Finance Act, 2015 made additional amendments to indirect transfer provisions to provide a criteria for determining as to when it would be deemed that share or interest in a foreign company shall be deemed to be deriving value substantially from India (threshold of INR 100 million and the limit of 50% of the value of all assets owned by the company or the entity) as also providing relief for exemptions to small shareholders and relief for specified transfers and business structuring. A reporting obligation was also imposed on the Indian concern (whose shares are indirectly transferred). The provisions for manner of determination of valuation of assets including the provision for manner of determination of income were introduced subject to rules to be prescribed by Government.
- The Central Board of Direct Taxes ('CBDT') has now issued rules providing for a valuation mechanism, determination of proportionate income taxable in India, forms for reporting compliance and details of documents to be maintained by the Indian concern in respect of indirect transfer transactions.
- These rules have come into force from 28 June 2016.

Indirect transfer rules- Salient features

1. Computation of FMV of tangible and intangible assets[1] of **an Indian_company or entity** held directly or indirectly by a foreign company or entity on the specified date

Particulars	Computation of FMV
Shares of Indian Company Listed on a Recognised Stock Exchange	Observable price[2] of the share on the stock exchange on the specified date. Where share is listed on more than one recognised stock exchange, Observable Price is the price on the recognised stock exchange[3] which records the highest volume of trading in the share during the period considered for determining the price.
Shares (of a company listed on Recognized Stock exchange) confer any right of	FMV = (A + B) / C A = Market capitalisation of the company based on observable price of its listed shares B = Book value of liabilities[5] of the company on the

management or control[4]	specified date C = Total number of outstanding shares
Shares of Indian Company not listed on any recognised stock exchange	FMV as determined by the merchant banker or accountant (in accordance with any internationally accepted valuation methodology for valuation of shares on arm's length basis) plus the liability considered in such determination
Interest in a partnership firm, or an Association of Persons (AoP)	**1:** To determine the value of firm or AOP as on the specified date in accordance with any internationally accepted valuation methodology by a Merchant Banker or an accountant Plus Liability, if any, considered in such determination **2:** Value determined in step1 above is allocated among partners or members in following proportion: a) First to the extent of capital contribution amount; b) Residual [remaining post part (a) allocation] shall be distributedin accordance with the agreement in the event of dissolution of the firm or AOP for distribution of assets or Profit sharing ratio, in absence of an agreement FMV of the interest of a partner/member in the firm/AOP = (a) + (b)
Asset other than those mentioned above	Price it would fetch in the open market as determined by a report from a merchant banker or an accountant[6] plus the liability considered in such determination

2. Computation of FMV of all the assets **of a foreign company or an entity as on the specified date**

Particulars	**Computation of FMV**
Transfer of share or interest in the foreign company is between persons who are not connected persons;	FMV of all assets = A + B A = Market capitalization of the foreign company or entity computed on the basis of the full value of consideration for transfer of the share or interest; B = Book value of liabilities of the company or the entity as on the specified date as certified by a qualified investment banker or accountant;
In other cases (i.e., where transfer is between connected persons),	**FMV of all assets = A + B**
A. Shares listed on a stock exchange	A = Market capitalization of the foreign company or entity computed on the basis of observable price of the share on the stock exchange ; B = Book value of liabilities of the company or the entity on the specified date
C. Shares not listed on a stock exchange	FMV of all assets = A + B A = FMV of the foreign company or the entity as on the specified date as determined by a merchant banker or accountant as per the internationally accepted valuation methodology B = value of liabilities of the company or the entity if any, considered for the determination of fair market value in A.

3. **Determination of Income attributable to assets in India**
   a. The income from transfer outside India of a share of, or interest in, a company or an entity attributable to assets located in India, shall be determined in accordance with the following formula, namely: -

$$A \times \frac{B}{C}$$

A = Income from the transfer of the share of, or interest in, the company or the entity computed in accordance with the provisions of the Act, as if, such share or interest is located in India;

B = FMV of assets located in India as on the specified date, computed in accordance with the rules ;

C = FMV of all the assets of the company or the entity as on the specified date, computed in accordance with the rules:

Where the transferor fails to provide the information required for the application of the aforesaid formula, the income attributable to the assets located in India shall be determined by Assessing Officer he may deem suitable.

   b. Transferor is required to furnish a report from accountant in the form 3CT along with the return of income certifying the income attributable to assets in India and providing the basis of apportionment of income.

4. **Rule 114DB lays down the information and documents to be furnished by the Indian concern for reporting the indirect transfer under section 285A**

- The Indian concern whose shares have been indirectly transferred is required to report the same in the Form 49D **within 90 days of the end of the financial year** in which any transfer of the share of, or interest in "foreign company or entity" has taken place and where the transaction in respect of the share or the interest has the effect of directly or indirectly transferring the rights of management or control in relation to the Indian concern, the information shall be furnished in the said Form **within 90 days of the transaction**. The notified details will help the tax authority in ascertaining the functional profile of the Indian concern and the factual details in respect of the transaction.
- The Indian concern is required to maintain (alongwith its English translation) the information and documents including details of immediate, intermediate and ultimate holding company, other entities of the group in India, holding structure; transfer contract or agreements; financial and accounting statements of the foreign entity for two years prior to date of transfer; information relating to decision or implementation process, information in respect of the foreign company such as the business operation, personnel, finance and properties of the foreign entity; the asset valuation report and supporting evidence, the details of payment of tax outside India etc. and produce the details before the tax authorities on demand.
- Where there are more than one Indian concerns that are constituent entities of a group, the information may be furnished by any one designated Indian concern to relieve other Indian concern(s).
- The information and documents specified shall be kept and maintained for a period of nine years from the end of relevant fiscal year (April to March) in which the transaction of indirect transfer took place.

Conclusion

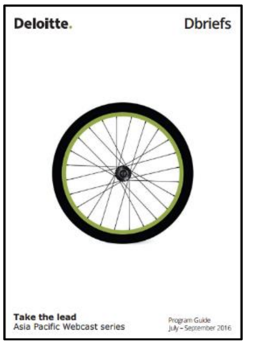
The much awaited rules provide clarity on the manner of determination of fair market value and methodology for computation of income arising from indirect transfers. However, the rules are complex and cast an onerous obligation on the Indian concern for maintaining extensive documentation.

Upcoming Dbriefs – Register

Using the limited liability partnership (LLP) option for tax and regulatory efficiencies

28 July, 11:30 AM – 12:30 PM

The LLP entity was introduced into India in 2008. It has gained more prominence over the last two years, with the number of registered LLPs increasing substantially during that period. This unique form of business entity integrates the features of corporations and partnerships, offering cost efficiency and operational flexibility. The Indian government has promoted the use of LLPs by issuing FAQs and guidance, as well as simplifying the process for setting-up an LLP. Understand the technical and practical implications and opportunities from using an LLP for inbound investment into India.



Register

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