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Dbriefs

Evolution of regulations impacting inbound/outbound investments in China, India, and Vietnam

The Dbriefs M&A Tax series

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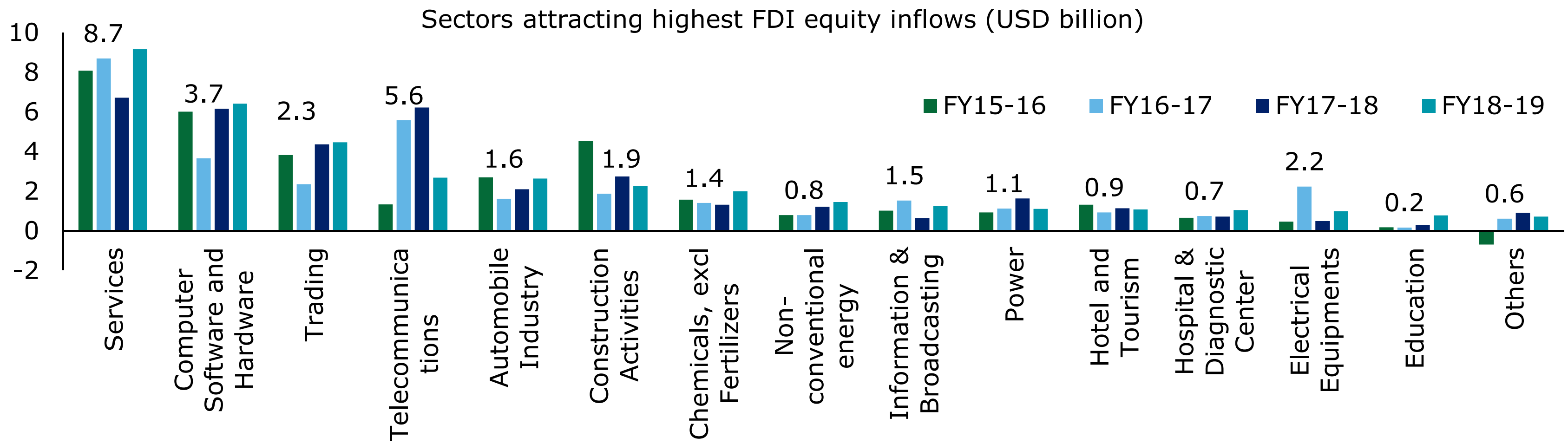
Agenda

- Base Erosion and Profit Sharing (BEPS)
- Multilateral Instrument (MLI)
- Free trade agreement
- Foreign investment laws in China
- Illustrative case studies
- Questions and answers

India

Foreign investments

Sectors attracting highest FDI



- Some marquee cross-border deals
  - Bharti Airtel received approval for sale of 20% stake in its Direct-to-Home (DTH) arm to an America based private equity firm, Warburg Pincus, for around USD 350 million
  - Idea's appeal for 100% FDI was approved by Department of Telecommunication (DoT) followed by its Indian merger with Vodafone making Vodafone Idea the largest telecom operator in India
  - Walmart acquired 77% stake in Flipkart for a consideration of USD 16 billion

Sources: Department of Industrial Policy & Promotion, CEIC and Deloitte analysis

Corporate tax regime – key developments

- Redrafting of direct tax laws – to be introduced
- Relaxation from angel tax provisions to start-ups
- Buy-back tax extended to listed companies
- Increase in surcharge rate up to 37%
- Corporate tax rate of 25% for certain domestic companies
- Minimum public shareholding announced to 35% in listed companies
- Local sourcing norms to be eased for FDI in single-brand retail

Base Erosion and Profit Shifting – implementation status in India

Digital economy – equalization levy introduced - Action Plan 1

Limit on interest deduction (thin capitalization) - Action Plan 4

Harmful tax practices – concessional tax regime for royalty on patents - Action Plan 5

Prevent treaty abuse – general anti-avoidance rules effective - Action Plan 6

Artificial avoidance of PE – scope of business connection widened - Action Plan 7

BEPS - causes

- Existence of loopholes, gaps or mismatches
- Inadequacy of current treaty provisions
- Ineffectiveness or lack of anti-abuse measures

BEPS – major contributors

- Digital transactions
- Permanent establishments
- Hybrid instruments
- Treaty abuse
- Transfer pricing
- Inadequate disclosures

Adoption of MLI – implementation status in India

Article 4: dual resident entities	• Residential status determined by mutual agreement
Article 5: elimination of double taxation	• India has adopted "credit method"
Article 6: preamble of a DTAA	• Preamble of DTAA modified to provide that treaty should not provide avenues for double non-taxation
Article 7: prevention of treaty abuse	• "Principal purpose test" adopted + LOB provisions to be adopted
Article 9: capital gains	• Gains on transfer of shares - Taxable in jurisdiction where shares & immovable property is situated
Article 16: MAP	• Competent authority to implement bilateral notification

New treaties signed/amended by India with China, Iran, Hong Kong, are in line with MLI provisions

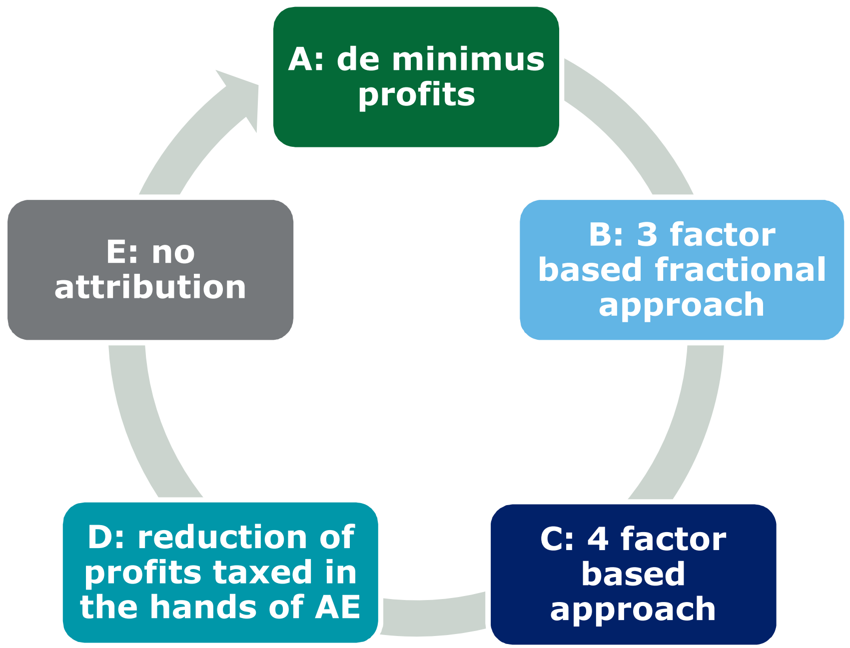
Attribution of income to permanent establishment in India

Draft report for public consultation – 18 April 2019

- "**Profits derived from India**" to be higher of
  - Revenue from India X Global EBIDTA margin or
  - 2% of revenue from India

- **No attribution** where
  - Sales < INR 1 million
  - AE remunerated on arm's length basis

- Profits earned by AE in India chargeable to tax **to be reduced**

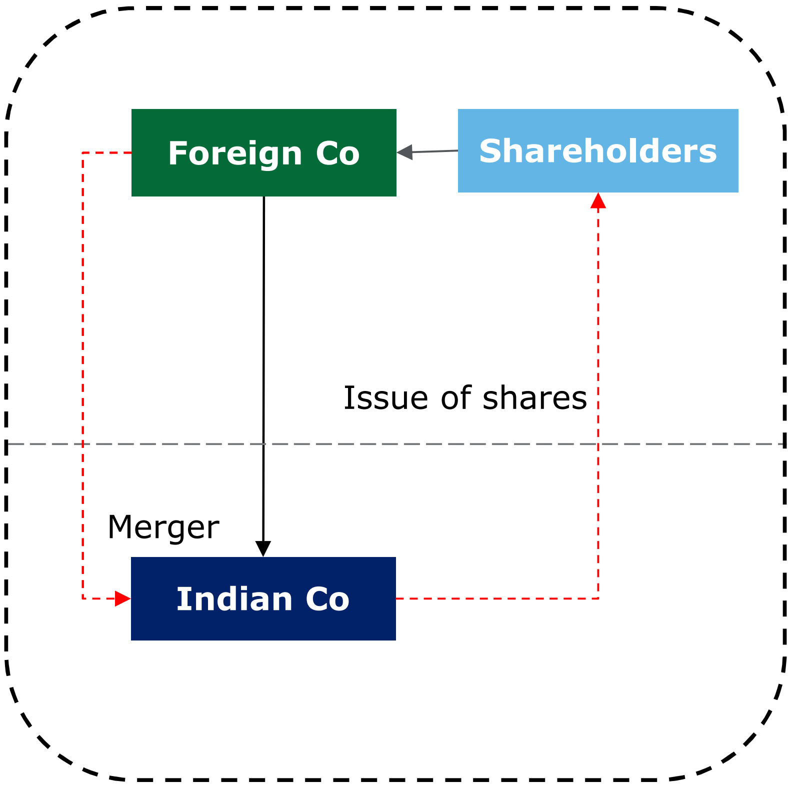


- Equal weights to **sales, employees (manpower and wages) and assets** to determine profits attributable to Indian PE

- In case of **digital models, weights to be assigned to users** in addition to the above three factors

Illustrative case study 1 – cross-border mergers

Inbound merger

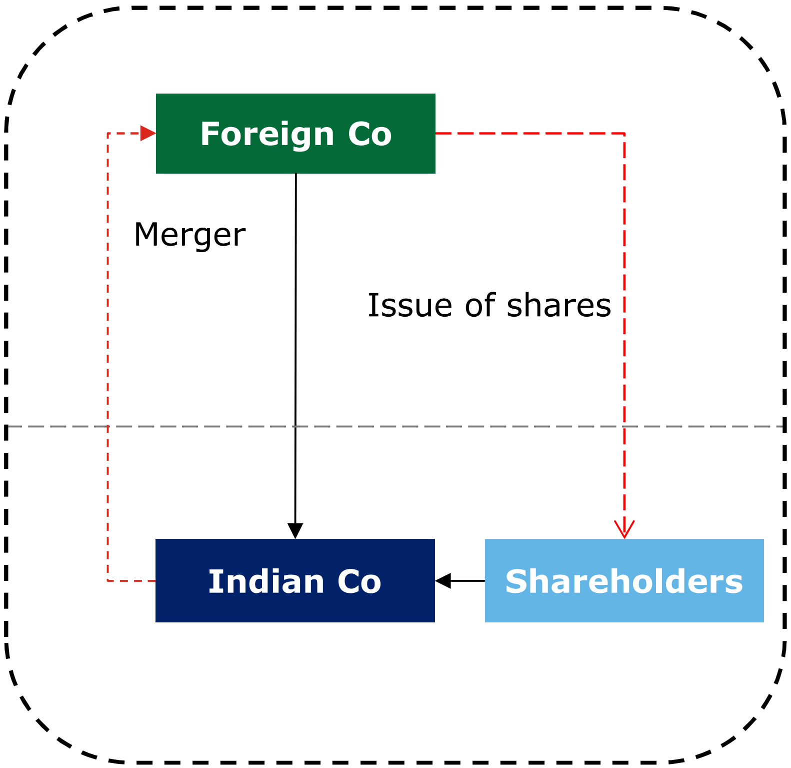


Inbound merger

- **Broad mechanics**
  - Foreign Co to merge into Indian Co
  - Indian Co to issue its shares to shareholders of Foreign Co
  - Pursuant to merger, Foreign Co to transfer all its assets and liabilities to Indian Co
- **Key considerations**
  - Merger to be tax neutral (subject to satisfaction of certain conditions)
  - Compliance with exchange control regulations
    - Sectoral caps/reporting obligations
    - Subsidiary/JV outside India of Foreign Co
    - Borrowings/guarantee of Foreign Co
    - Asset/security of Foreign Co not permitted to be acquired/held by Indian company

Illustrative case study 2 – cross-border mergers

Outbound merger

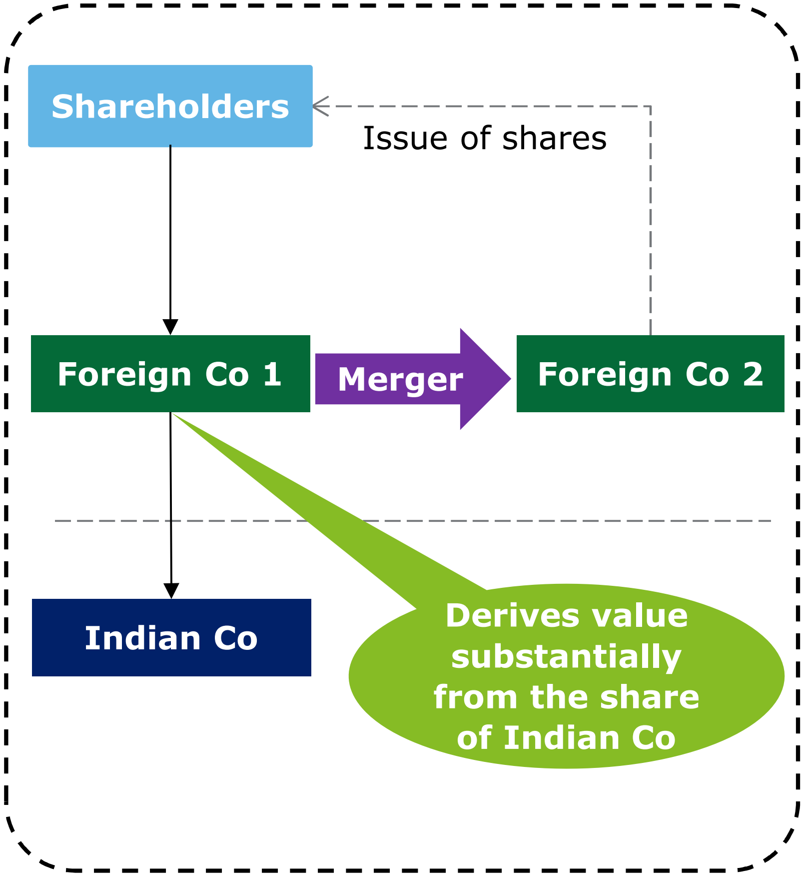


Outbound merger

- **Broad mechanics**
  - Indian Co to merge into Foreign Co
  - Foreign Co to issue its shares to shareholders of Indian Co
  - Pursuant to merger, Indian Co to transfer all its assets and liabilities to Foreign Co
- **Key considerations**
  - Non-tax neutral merger (tax implications in hands of Indian Co + shareholders)
  - Compliance with exchange control regulations
    - Reporting obligations
    - Transfer of borrowings/guarantee of Indian company as per NCLT scheme - NOC to be obtained from lenders
    - Asset/liability of Indian Co not permitted to be acquired/held by Foreign Co

Illustrative case study 3 – indirect transfer implications

Overseas merger



Overseas merger

- **Broad mechanics**
  - Foreign Co 1 to merge into Foreign Co 2
  - Foreign Co 2 to issue its shares to the shareholders of Foreign Co 1
  - Pursuant to merger, Foreign Co 1 to transfer all its assets and liabilities (including shares of Indian Co) to Foreign Co 2
  - Foreign Co 1 derives its value substantially from shares of Indian Co
- **Key considerations**
  - No indirect transfer implications for Foreign Co 1 (subject to certain conditions)
    - Tax implications in hands of shareholders of Foreign Co 1, subject to treaty benefits
    - Tax losses of Indian Co should not lapse provided 51% shareholders of Foreign Co 1 continue to be shareholders of Foreign Co 2
    - Compliance with exchange control regulations

Free Trade Agreements (FTAs)

Key features, benefits, and conditions

- **Premium FTAs between India and other countries**
  - APTA and ASEAN Agreement are premium FTAs entered by India
  - APTA is designed to liberalize and expand trade in goods progressively in Economic and Social Commission for Asia and Pacific (ESCAP) region. APTA includes countries such as India, Bangladesh, Republic of Korea, Sri-Lanka, Mongolia, and China
  - AFTA is a trade bloc agreement supporting local trade and manufacturing in all ASEAN countries. AFTA includes countries such as Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam
- **Benefits under FTA**
  - India allows import of goods by providing concession of 5-100% from import duty. The concessional rate reduction is applicable only if goods are originated from countries listed in FTAs
  - In general, the goods should accompany a certificate of origin along with goods imported in India. Certificate of origin is treated as the primary documents to avail benefit under FTAs
- **Key considerations tested time and again include**
  - Adherence to rules of origin
  - Determination of Regional Value Content (RVC)
  - Local country’s (importing country) requirement

Polling question 1

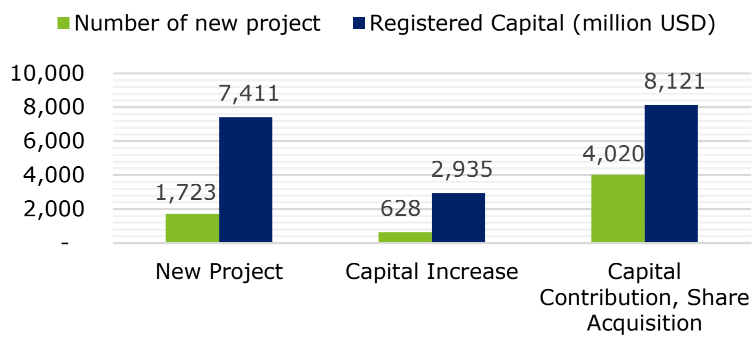
Do you believe the adoption of MLI will substantially reduce situations of treaty abuse?

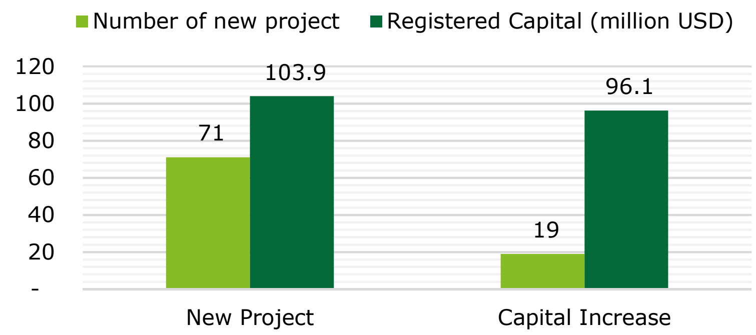
- Yes
- No
- Maybe

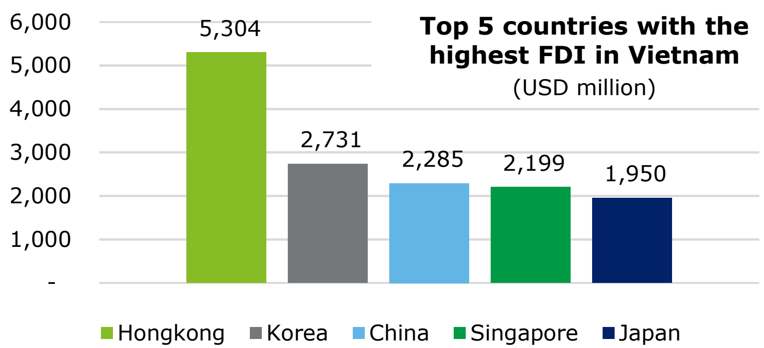
Vietnam investment landscape in 2019

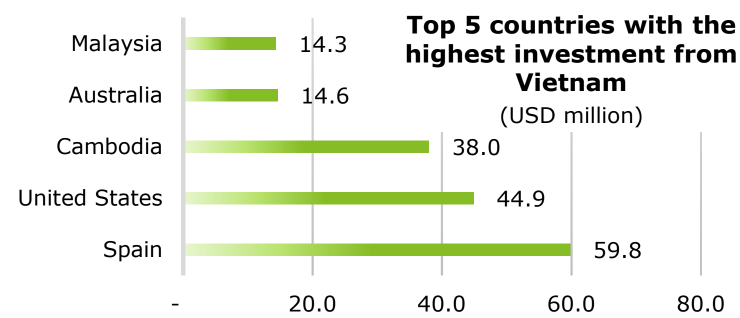
Inbound and outbound investment in Vietnam

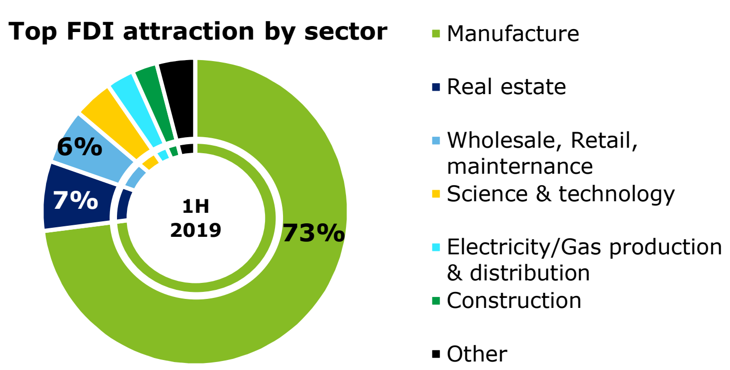
Six months of 2019

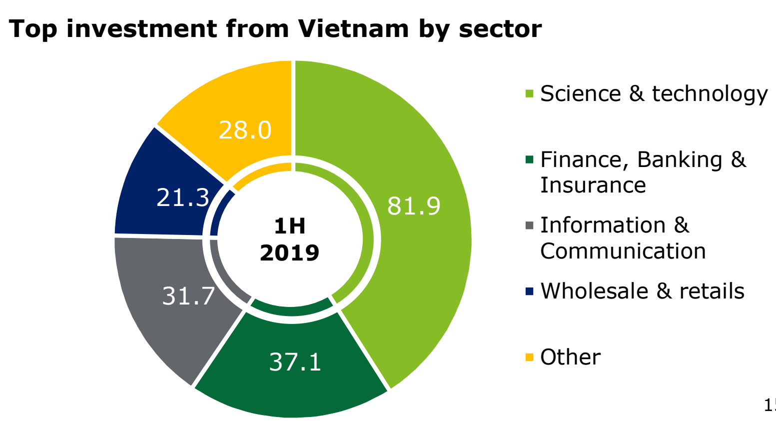




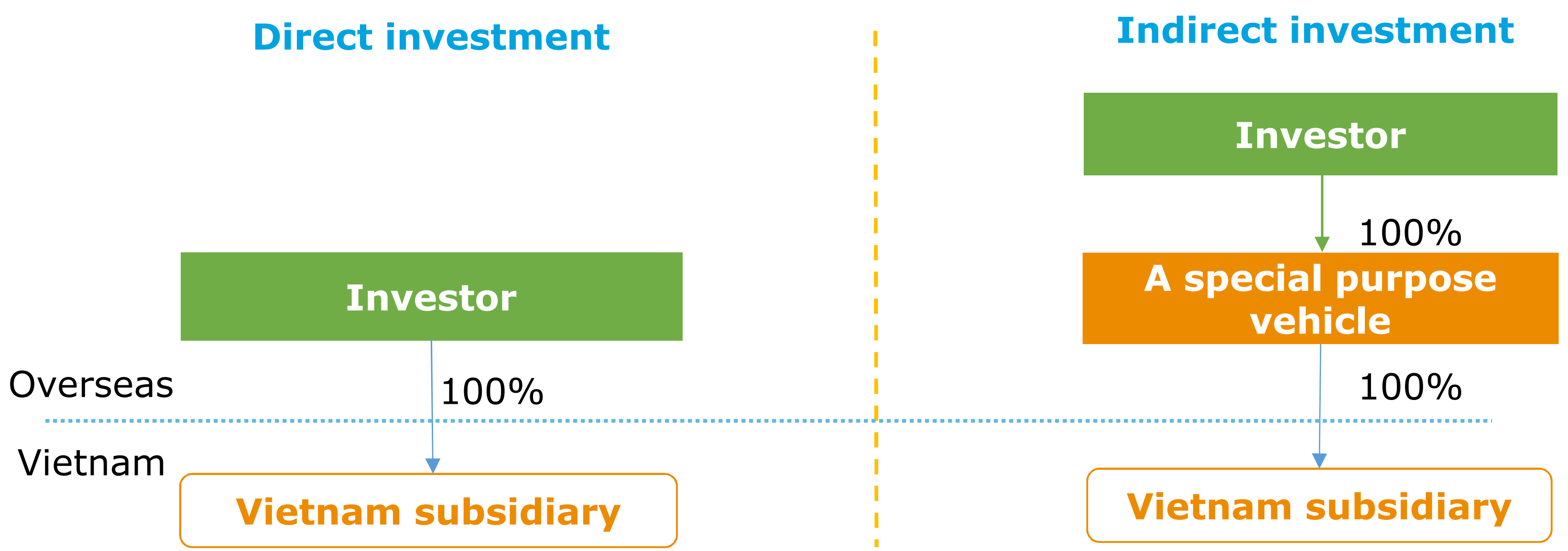








Typical investment structure into Vietnam
Points for considerations

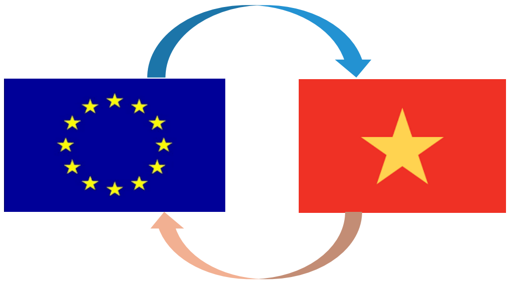


- Location of the investor will impact the utilization of the tax treaty
- Tax implications of divestment

Upcoming changes

Upcoming changes

- **Vietnam – EU Free Trade Agreement**



Providing almost **99% of elimination** of custom duties between the EU and Vietnam

Trade in goods value between EU and Vietnam in 2018 **is EUR55 billion**, expected to be increased up to **20%** in **2020** and **42.7%** in **2025**

Increasing **export to EU** and **import from EU**

- **Proposed changes to the law on investment**

	Existing investors	Potential investors
Change in the determination of a Foreign Invested Enterprise (FIE)	Potentially no impact	To notice the change to properly determine an FIE for appropriate application
Investment approval is required for projects in specific locations (border and coastal areas)	No impact	Investors in certain locations would be subject to additional approval from the Government
Remove various business sectors from the list of conditional business sectors	No impact	New projects in these business sectors would just be subject to general requirements

Vietnam in the era of BEPS

Doing business in Vietnam in the context of BEPS – what to note?

BEPS milestone in Vietnam

Jul 2016	**Directive committee on BEPS**	Establishment of directive committee for BEPS by GDT
Feb 2017	**Decree 20 on transfer pricing**	Legal frame adopted various points in BEPS Actions Plan, especially Action 13
Jul 2017	**Became 100th member of IF**	International Vietnam became official 100th member of the inclusive framework
Mar 2018	**First year reports under 3-tier system**	First report With requirements for LF, MF, and CbCR
May 2019	**Seminar on digital economy**	Joint seminar regarding digital economy

- **Tax practice development**
  - **Compliance requirements**
    - LF/MF/CbCR
    - Tight deadline for filing
  - **Substance over Form**
    - Tax authorities have the right to determine "substance" of transactions for imposing tax
  - **Intangibles/royalties/ intra-group services**
    - Severe scrutiny
  - **Interest rate cap**
    - 20% of EBITDA on deductible interest expense
    - Potentially regardless of loans from RP or not
    - Unclear for loss-making

What BEPS-related movements we can expect?

Law on tax administration

- **Tax on "substance over Form"** in all transactions
- 20% EBITDA **interest cap** on all loans
- More **collaboration** with other tax authorities

MLI

- **Ministry of Finance (MOF), Ministry of Foreign Affairs (MFA)** and some other relevant governmental bodies are assigned to **study potential impacts resulting from signing up to the MLI**

Digital economy + digital reporting

- Modernization of tax systems (**big data, analytics etc.**)
- **E-invoices** massive implementation (from 20 November)
- Potential involvement of **commercial banks in tax withholding**

Polling question 2

Which transactions does your Vietnam subsidiary have with foreign related parties?

- Management fee
- Royalty (trademark using fee, production know-how, etc.)
- Technical support service
- Recharge of marketing expenses
- Purchase/sale of goods
- Others

The key points and impacts of the foreign investment law of the people's republic of China

History and trend

The 40 years of history of the reform

1978 Reform and open	1979 Cooperative JV law	1980 Equity JV law	1983 Equity JV regulation	1986 WFOE law	1988 Cooperative JV law
1990 Implementation rule of WFOE law	1993 **PRC Company law**	1995 Implementation rule of JV law	2000 **WTO**	2000～2001 FIL amendment	2005 Foreign acquisition of PRC company regulation
2007 Labor contract law	2008 Unification of tax rates	2008 Anti-monoply law	2011 National security review system	2013 Shanghai FTZ	2015 FIL draft

- Equity joint venture
- Cooperative joint venture
- WFOE

- Only limited liability company form is permitted automatically by law

The key points of FIL

The Foreign Investment Law adopted in March 2019 effective from 1 January 2020

- All current laws regulating foreign investment will be abolished
- 5 years of grace period for reform of current structure
- National treatment for foreign investment
- Foreign investment entry admission based on negative list
- The right of repatriation of lawful income from China to overseas is legally granted
- Enhanced intellectual property protection
- Local authorities shall honor the agreements with foreign invested companies

- **Backgrounds of the adoption of the FIL**
  - Trade negotiations between China and the US
  - Domestic economic policy reform
  - The current out dated system of foreign investment administration

State owned enterprise promotion → State and privately owned economy support

The draft of the Foreign Investment Law (2015)

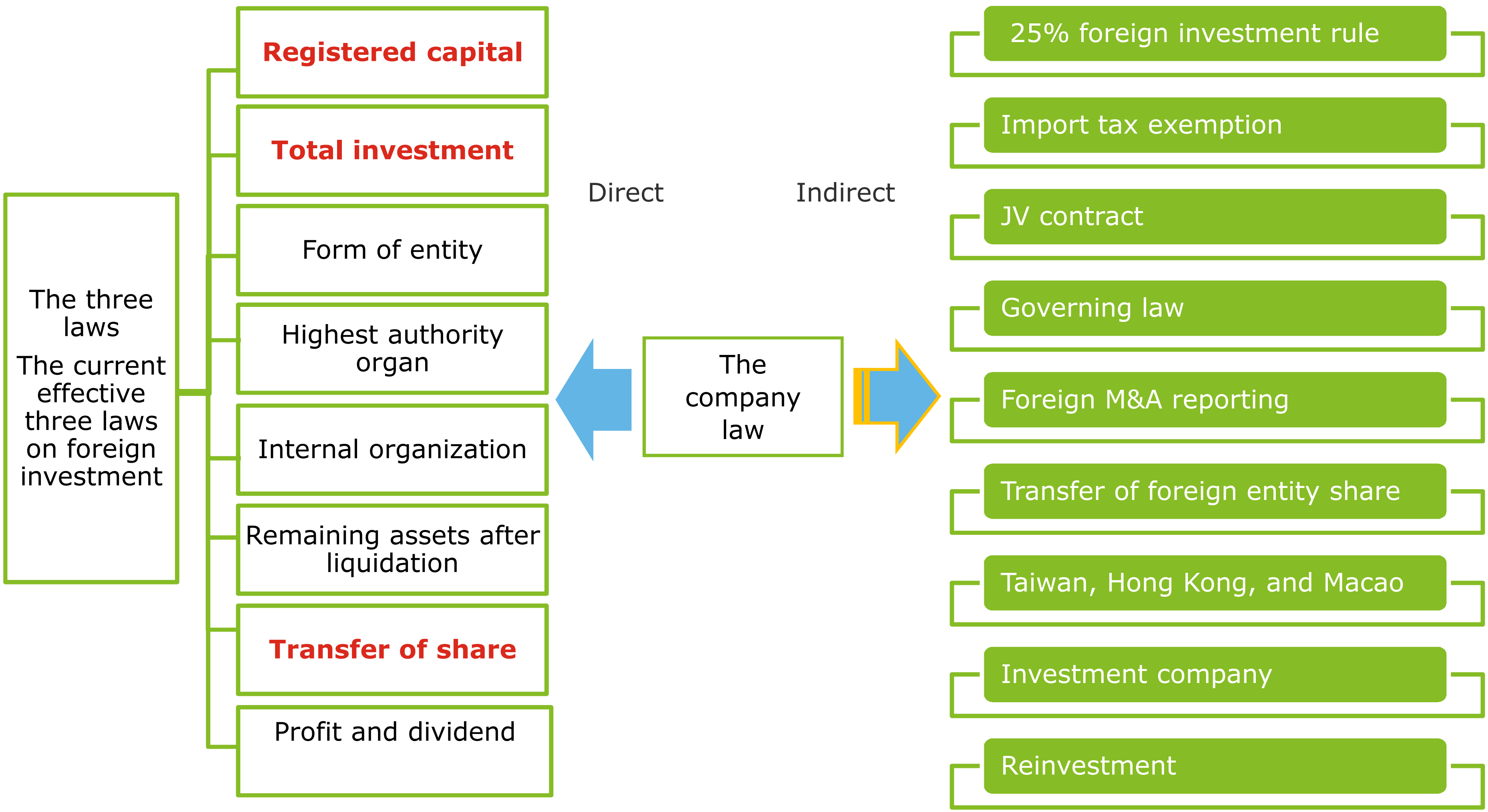
172 Articles

→

The Foreign Investment Law (adopted in 2019)

42 Articles

Impact and challenge



Questions and answers

Glossary

Abbreviations	Full Form
AFTA	ASEAN Free Trade Area
APTA	Asia Pacific Trade Agreement
ASEAN	Association of Southeast Asian Nation
AE	Associated Enterprise
BEPS	Base Erosion and Profit Sharing
DRR	Debenture Redemption Reserve
DTAA	Double Tax Avoidance Agreement
EBIDTA	Earnings Before Interest Depreciation Tax and Amortization
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
FY	Financial Year
INR	Indian Rupee
JV	Joint Venture
ODI	Overseas Direct Investment
PE	Permanent Establishment
PoEM	Place of Effective Management
PSU	Public Sector Undertaking
LOB	Limitation of Benefit
MAP	Mutual Agreement Procedure
MAT	Minimum Alternate Tax
MLI	Multilateral Instrument
NOC	No Objection Certificate
NCLT	National Company Law Tribunal
USD	United States Dollar

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