Evolution of regulations impacting inbound/outbound investments in China, India, and Vietnam
The Dbriefs M&A Tax series
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1 August 2019
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

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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

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Adoption of MLI – implementation status in India

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

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
Inbound merger

Illustrative case study 1 – cross-border mergers

**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**

- **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

- **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 the 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

Top 5 countries with the highest FDI in Vietnam (USD million)

- Hongkong: 5,304
- Korea: 2,731
- China: 2,285
- Singapore: 2,199
- Japan: 1,950

Top FDI attraction by sector

- Manufacture: 73%
- Real estate: 6%
- Wholesale, Retail, maintenance: 7%
- Science & technology: 6%
- Electricity/Gas production & distribution: 21.3%
- Construction: 37.1%
- Other: 31.7%

Top investment from Vietnam by sector

- Science & technology: 81.9%
- Finance, Banking & Insurance: 28.0%
- Information & Communication: 31.7%
- Wholesale & retails: 37.1%
- Other: 21.3%
Points for considerations

Typical investment structure into Vietnam

**Direct investment**
- Investor
  - Overseas: 100%
- Vietnam subsidiary

**Indirect investment**
- Investor
  - 100%
- A special purpose vehicle
  - 100%
- Vietnam subsidiary

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**

<table>
<thead>
<tr>
<th>Change in the determination of a Foreign Invested Enterprise (FIE)</th>
<th>Existing investors</th>
<th>Potential investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Potentially no impact</td>
<td>To notice the change to properly determine an FIE for appropriate application</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investment approval is required for projects in specific locations (border and coastal areas)</th>
<th>Existing investors</th>
<th>Potential investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No impact</td>
<td>Investors in certain locations would be subject to additional approval from the Government</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Remove various business sectors from the list of conditional business sectors</th>
<th>Existing investors</th>
<th>Potential investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No impact</td>
<td>New projects in these business sectors would just be subject to general requirements</td>
</tr>
</tbody>
</table>
Vietnam in the era of BEPS
Doing business in Vietnam in the context of BEPS – what to note?
BEPS milestone in Vietnam

- **Directive committee on BEPS**
  - Jul 2016

- **Decree 20 on transfer pricing**
  - Feb 2017

- **Became 100th member of IF**
  - Jul 2017

- **First year reports under 3-tier system**
  - Mar 2018

- **Seminar on digital economy**
  - May 2019

**Establishment of directive committee for BEPS by GDT**

**Decree 20 on transfer pricing**

**Became 100th member of IF**

**First year reports under 3-tier system**

**Seminar on 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

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

- Equity joint venture
- Cooperative joint venture
- WFOE
- Only limited liability company form is permitted automatically by law
The key points of FIL

- 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 outdated system of foreign investment administration

The Foreign Investment Law (adopted in 2019)

42 Articles

The draft of the Foreign Investment Law (2015)

172 Articles
Impact and challenge

The three laws
The current effective three laws on foreign investment

Registered capital
Total investment
Form of entity
Highest authority organ
Internal organization
Remaining assets after liquidation
Transfer of share
Profit and dividend

Direct
Indirect

25% foreign investment rule
Import tax exemption
JV contract
Governing law
Foreign M&A reporting
Transfer of foreign entity share
Taiwan, Hong Kong, and Macao
Investment company
Reinvestment
Questions and answers
# Glossary

<table>
<thead>
<tr>
<th>Abbreviations</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AFTA</td>
<td>ASEAN Free Trade Area</td>
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<tr>
<td>APTA</td>
<td>Asia Pacific Trade Agreement</td>
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nation</td>
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<tr>
<td>AE</td>
<td>Associated Enterprise</td>
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<tr>
<td>BEPS</td>
<td>Base Erosion and Profit Sharing</td>
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<tr>
<td>DRR</td>
<td>Debenture Redemption Reserve</td>
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<td>DTAA</td>
<td>Double Tax Avoidance Agreement</td>
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<td>EBIDTA</td>
<td>Earnings Before Interest Depreciation Tax and Amortization</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FTAs</td>
<td>Free Trade Agreements</td>
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<td>FY</td>
<td>Financial Year</td>
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<td>INR</td>
<td>Indian Rupee</td>
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<td>JV</td>
<td>Joint Venture</td>
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<td>ODI</td>
<td>Overseas Direct Investment</td>
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<td>PE</td>
<td>Permanent Establishment</td>
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<td>PoEM</td>
<td>Place of Effective Management</td>
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<td>PSU</td>
<td>Public Sector Undertaking</td>
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<td>LOB</td>
<td>Limitation of Benefit</td>
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<td>MAP</td>
<td>Mutual Agreement Procedure</td>
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<td>MAT</td>
<td>Minimum Alternate Tax</td>
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<tr>
<td>MLI</td>
<td>Multilateral Instrument</td>
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<tr>
<td>NOC</td>
<td>No Objection Certificate</td>
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<tr>
<td>NCLT</td>
<td>National Company Law Tribunal</td>
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<td>USD</td>
<td>United States Dollar</td>
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Common Reporting Standard (CRS) compliance: Are you ready for tax authority reviews?

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