Global Tax Update

India

Deloitte Tohmatsu Tax Co.

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1. India-Japan Social Security Agreement ("SSA") to be effective from 1 October 2016

Governments of India and Japan signed the SSA on 16 November 2012 subject to certain pending administrative procedures. The governments have now exchanged 'Note Verbale' and announced that SSA will come into force from 1 October 2016.

SSA is expected to favorably impact Indian and Japanese companies as it would reduce the cost of doing business. Also a significant number of Indian and Japanese nationals will benefit from the SSA. It provides for following benefits:

- Detachment: Exemption is available in respect of specified social security contributions in the host country where home country contributions are continued and a certificate of coverage is obtained.
- Totalization: Period of contribution in both countries (to the extent they do not overlap) shall be added to arrive at the eligible period for determining social security entitlements.
- Export of benefits: Enables portability of benefits across countries.

Effective 1 October 2016:

- Companies with mobile employees from Japan to India and continuing home country contributions will be able to avail exemptions from contributions to India Provident Fund.
- Foreign nationals from Japan who have contributed to India social security would be able to withdraw the provident fund balances upon repatriation.
- Companies with outbound population to Japan need to understand deputation structures that would help leverage on the benefits provided under the SSA. It is to be noted that not all components of social security in Japan are covered under the SSA.

2. Indirect Transfer Tax Rules[1]

The Central Board of Direct Taxes (CBDT) has 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 share transfer transactions.

The 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. These rules have come into force from 28 June 2016. It is recommended that India tax experts are consulted before applying the rules and taking positions. Salient features have been summarized below:

(1) Computation of fair market value ("FMV") of assets[2] of an Indian company or entity held directly or indirectly by a foreign company or entity on the specified date

Shares of Indian company listed on a recognised stock exchange	Observable price[3] 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[4] which records the highest volume of trading in the share during the period considered for determining the price.
Shares discussed above and confer any right of management or control[5]	➢ FMV = (A + B) / C ➢ A = Market capitalization of the company based on observable price of its listed shares ➢ B = Book value of liabilities6 of the company on the specified date ➢ C = Total number of outstanding shares
Shares of Indian company not	FMV as determined by the merchant banker or accountant (in accordance with any internationally accepted valuation methodology for valuation of

1 The Finance Act, 2015 amendments prescribed criteria for determining as to when share or interest in a foreign company shall be deemed to be deriving value substantially from India (i.e. threshold of INR 100 million and the limit of 50% of the value of all assets owned by the company or the entity). A reporting obligation was also imposed on the Indian concern. 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.

2 For determining the fair market value of any asset located in India, being a share of an Indian company or interest in a partnership firm or association of persons, all the assets and business operations of the said company or partnership firm or association of persons shall be taken into account irrespective of whether the assets or business operations are located in India or outside.

3 "observable price" in respect of a share quoted on a stock exchange shall be the higher of the average of the weekly high and low of the closing prices of the shares quoted on the said stock exchange during the six months period preceding the specified date; or the average of the weekly high and low of the closing price of the shares quoted on the said stock exchange during the two weeks preceding the specified date.

4 The terms "merchant banker" and "recognised stock exchange" shall have the meaning as assigned to them in rule 11U.

5 "right of management or control" shall include the right to appoint majority of the directors or to control the management or policy decision exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

6 "book value of the liabilities" means the value of liabilities as shown in the balance-sheet of the company or the entity as the case may be, excluding the paid-up capital in respect of equity shares or members' interest and the general reserves and surplus and security premium related to the paid up capital.

listed on any recognised stock exchange	shares on arm's length basis) plus the liability considered in such determination
Interest in a partnership firm, or an Association of Persons (AOP)	➢ **Step 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. ➢ **Step 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 distributed in 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[7] 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

Transfer of share or interest between unconnected 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
Other cases	➢ FMV of all assets = A + B ➢ A = Market capitalization of the foreign company or entity computed on the basis of observable price of the share on the stock exchange, if shares are listed, else, 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 = Book value of liabilities of the company or the entity on the specified date

(3) Determination of Income attributable to assets in India

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 x B / C

7 The modified definition of the term ‘accountant’ has been introduced to mean an accountant referred to in Explanation to section 288(2) of the ITA. Further, for valuing FMV of assets of a foreign company / entity, the term also includes any valuer (or any of its agencies) recognized by the Government of the country in which the foreign company / entity is registered / incorporated. Certain other eligibility conditions have also been prescribed.

- 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 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.

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

Indian concern whose shares have been indirectly transferred is required to report in 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 has the effect of directly or indirectly transferring the rights of management or control, the information shall be furnished in within 90 days of the transaction.

The Indian concern is required to maintain 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).

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