



BEPS and its impact on Mergers & Acquisitions



Agenda

Background

BEPS action plan

Implications for business

- Financing
- Holding and repatriation
- Intellectual property

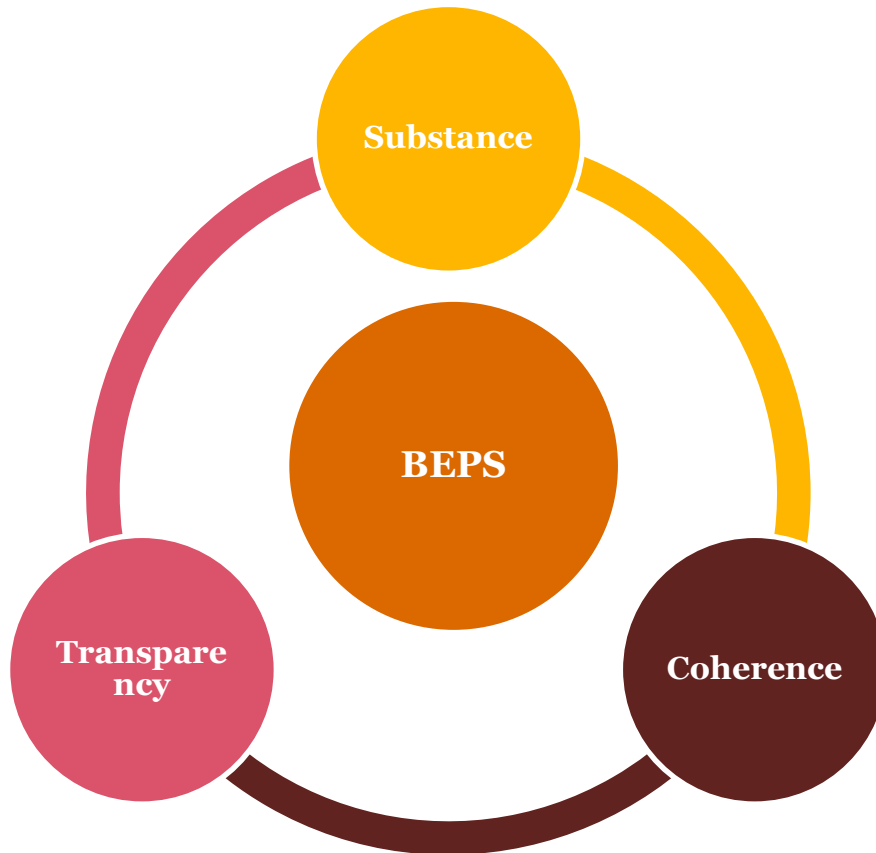
Operating Structure Simplification



BEPS- Background







Substance, Coherence and Transparency



- Substance actions seek to align taxing rights with relevant value-adding activity
- Coherence actions aim to remove gaps and 'black holes' between jurisdictions
- Transparency actions look to provide significant additional disclosure

BEPS action points

Action 1 Digital Economy	Action 2 Hybrid Mismatch Arrangements	Action 3 CFC Rules	Action 4 Interest Deductions	Action 5 Harmful Tax Practices
Action 6 Preventing Tax Treaty Abuse	Action 7 Avoidance of PE Status	Action 8 TP / Aspects of Intangibles	Action 9 TP / Risks & Capital	Action 10 TP / High-Risk Transactions
Action 11 Measuring and Monitoring BEPS	Action 12 Mandatory Disclosure Rules	Action 13 TP Documentation	Action 14 Dispute Resolution	Action 15 Multilateral Instrument

	Coherence
	Substance
	Transparency
	Horizontal work

The changing landscape

Then

- Limited public and political attention on corporate tax
- Wide use of planning structures taking advantage of mismatches in tax laws in different countries
- Uncoordinated efforts by tax authorities and governments

Now

- Huge media, NGO and political interest
- Greater caution from clients on use of aggressive planning structures
- Governments cooperating to reduce mismatches in laws
- Tax authorities working together and sharing information

The future

- Continued pressure on multinationals to be good corporate citizens
- Transparency on corporate taxes through CbCR and local transparency measures
- Tax planning to be aligned with commercial models and substance?
- Ongoing cooperation and information sharing between tax authorities and governments

BEPS- Implications for Business



BEPS: Adoption in India and Impact on MnA

Action Plan	Corresponding amendments in the Income Tax Act	Impact on MnA
Action Plan 4 Interest Deductions	Introduction of section 94B (restriction of interest deductibility)	<ul style="list-style-type: none"> • Financing structures & debt equity ratio
Action Plan 5 and 6 Harmful Tax Practices & Treaty Abuse	Amendments to DTAA's (eg: Mauritius, Singapore & Cyprus)	<ul style="list-style-type: none"> • Use of SPVs for acquisition and repatriation
Action Plan 8 TP aspects of Intangibles		<ul style="list-style-type: none"> • IP – location for registration and royalty
Action Plan 13 TP Documentation	Country by Country Reporting (CbCR)	<ul style="list-style-type: none"> • Operating structures
Action Plan 5, 6, 7	Place of Effective Management (PoEM)	

GAAR to have an over-arching effect on all areas

Financing

Implications of fundamental and far-reaching reforms



Financing

Implications of fundamental and far-reaching reforms



Interest deductibility and Hybrids

- OECD seeks best practice rules on base erosion and profit shifting via interest expense and similar payments, particularly among related parties
- Three proposals put forward, although no overall conclusion reached yet
 - Group-wide interest allocation
 - Fixed ratio rule
 - Combined approach
- Arm's length and withholding tax approaches rejected
- Any rule adopted should deal with all forms of debt, payments equivalent to interest, and expenses related to financing
- OECD has recommended domestic rules to neutralise the following results arising from hybrid mismatch arrangements:
 - Deduction with no taxable inclusion (D/Ni)
 - Double deduction (DD)

Financing

Implications of fundamental and far-reaching reforms



Interest deductibility

Fixed ratio test

- Allow a net interest deduction up to a fixed net interest/tax EBITDA ratio
- Fixed ratio between 10%-30%
- Currently used in a number of countries: Germany / India based on taxable EBITDA, US based on adjusted taxable income. Perceived that ratios are too high

Group-wide interest allocation

- Higher Group's net interest/EBITDA ratio may apply as escape from fixed net interest/EBITDA ratio
- Similar proposal in the Obama Administration's annual budget
- Similar rules operate in Australia, Germany and New Zealand as a carve-out from a 'fixed ratio' test

Combined approach

An initial fixed ratio rule with a carve out to use an allocation basis where groups exceed the ratio or vice versa.

Financing

Implications of fundamental and far-reaching reforms



Introduction of section 94B

	<i>Interest</i>	Applicable only if interest payable > INR 10mn
<ul style="list-style-type: none">• Only Non-resident AE's covered• Impact on Bank borrowings	<i>AE / Guarantee given by AE</i>	
	<i>Quantum of Disallowance</i>	Lower of <ul style="list-style-type: none">• Total interest in excess of 30% of the EBIDTA• Interest paid or payable to the AE
Upto 8 years from the end of the year in which the excess interest was first computed	<i>Carry Forward</i>	

Financing

Implications of fundamental and far-reaching reforms



Introduction of section 94B

Manner of Computation of disallowance under section 94B

<i>Particulars</i>		<i>Amount</i>
<i>EBITDA of the company</i>		100
<i>30% of EBITDA</i>	A	30
<i>Interest paid</i>		
<i>Associated Enterprise (AE)</i>	B	10
<i>Non-associated Enterprise</i>		60
<i>Total Interest</i>	C	70

<i>Interest amount disallowed for interest paid to the AE under 94B is lower of:</i>	
<i>-Total interest amount in excess of 30% of EBITDA (C – A)</i>	40
<i>-Interest paid or payable to the AE</i>	10
<i>Therefore, the amount of interest paid to the AE disallowed:</i>	10

Financing

Implications of fundamental and far-reaching reforms



Secondary Adjustment (section 92CE)

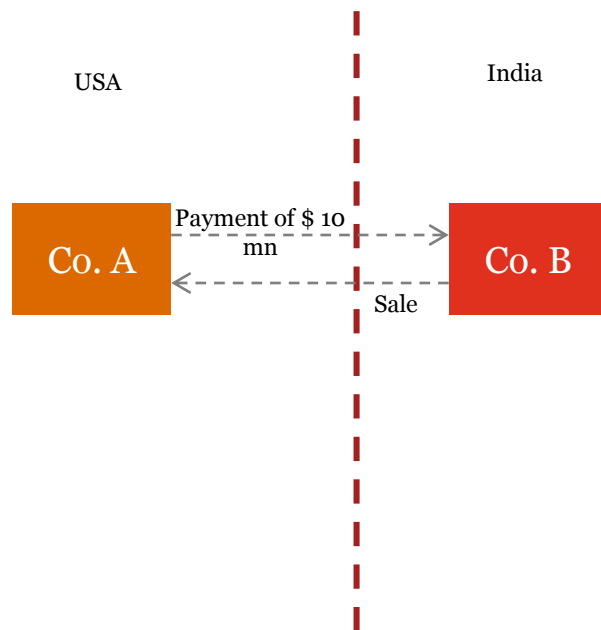
- In the case of the following “Primary Adjustments” a “Secondary Adjustment” will be required to be made:
 - voluntary adjustment in return of income; or
 - acceptance of adjustment proposed by AO; or
 - determination in an APA; or
 - adoption of safe harbour rule; or
 - resolution under Mutual Agreement Procedure
- The Secondary Adjustment would be deemed as advance to AE if such amount is not received within prescribed time limit and interest would be applicable in a manner to be prescribed
- No Secondary Adjustment if Primary Adjustment does not exceed INR 10 million

Financing

Implications of fundamental and far-reaching reforms



Secondary Adjustment



- Co. A in USA and Co. B in India are Associated Enterprises
- Co. B sells goods to Co. A at \$ 10 mn and Co. A paid the said amount to Co. B
- However, an adjustment was made in Co. B's assessment - to state that the goods were only worth \$ 8 mn
- The excess \$ 2 mn received by Co. B will be a secondary adjustment and will be treated as a deemed loan

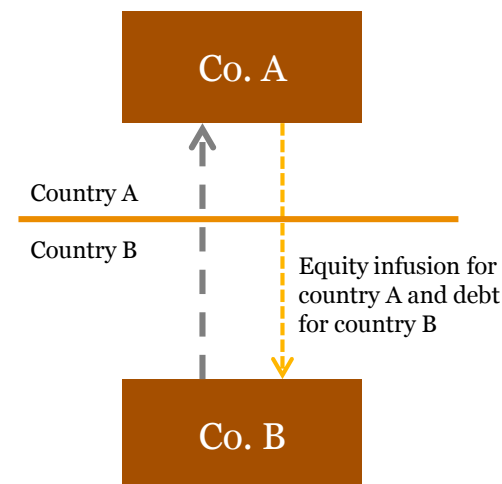
Financing

Implications of fundamental and far-reaching reforms



Deduction with no taxable inclusion

- Co. B, a resident of country B is funded by Co. A located in country A
- The instrument issued against the funding is considered as equity in country A but debt in country B
- Payments made under the instrument are deductible interest expense in country B and tax exempt dividends in country A for tax purposes



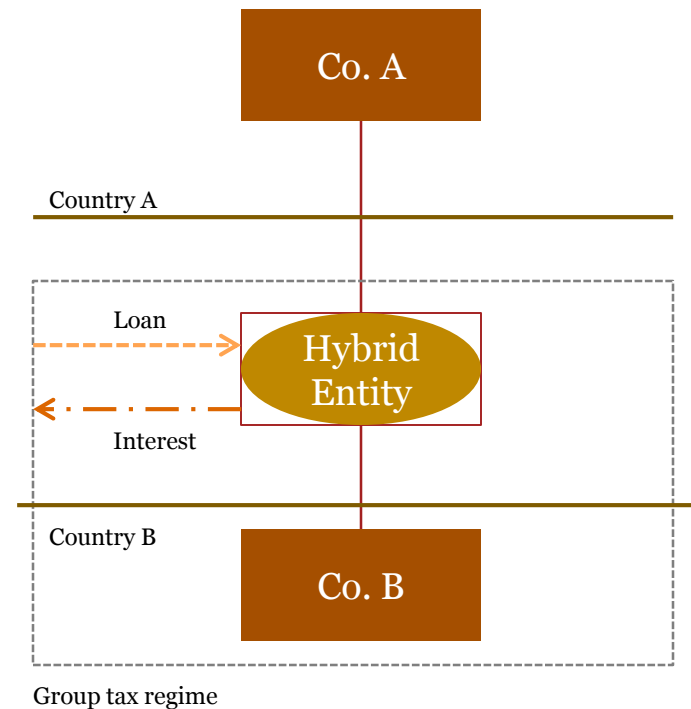
Financing

Implications of fundamental and far-reaching reforms



Double Deduction

- Co. A located in country A holds almost entire equity in Hybrid Entity
- Hybrid Entity borrows funds to invest in equity of operating Co. B located in country B
- Thus, Co. A holds equity of Co. B indirectly through the Hybrid Entity
- Hybrid Entity and Co. B are located in such jurisdictions which enjoy a group tax regime thereby enabling Co. B to claim deduction of interest paid by Hybrid Entity against its own profits
- In country A, Hybrid Entity will be considered as a pass through entity thereby entitling Co. A also to claim deduction of interest paid



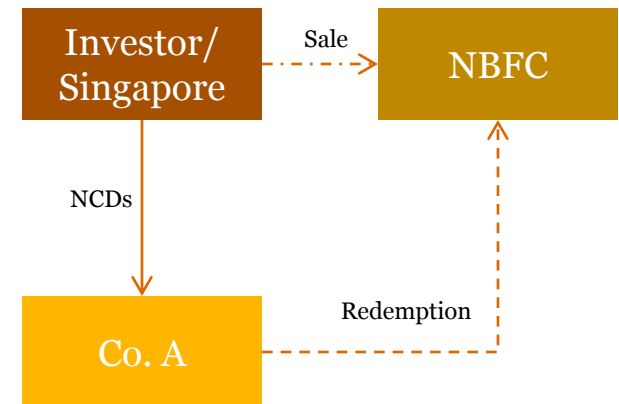
Financing

Implications of fundamental and far-reaching reforms



NCD Structure

- An investor invests funds by way of Non Convertible Debentures (NCDs) in Co. A engaged in real estate sector
- Terms of the NCDs are as follows:
 - Term- 48 months
 - Interest- Moratorium period for first three years – interest accrues only in year 4
 - Redemption- at significant premium
- Investor sells the NCDs to the NBFC just before the redemption date



Will the sale of NCDs to the NBFC just before redemption be considered as a way to mitigate tax?

Financing

Implications of fundamental and far-reaching reforms



What should you be doing now?

- Model the impact of the interest deductibility proposals on funding and cash management arrangements
 - Factor into key business decisions, e.g. corporate acquisitions, long term contracts
- Review impact of hybrid mismatch rules on current financing arrangements and consider feasibility of potential alternatives
 - Structures likely to be rendered ineffective include those with entities which are disregarded (check the box) for US tax purposes
- Review of existing protocols for transfer pricing of internal debt
 - How are policies applied in practice?
- Consider wider strategic review of group's financing and treasury policies
- Timing
 - Weigh up benefits of taking action now against waiting for proposals to be finalised/changes to be introduced

Holding and repatriation

Taking treaty relief for granted could be a thing of the past



Holding and repatriation

Taking treaty relief for granted could be a thing of the past



Treaty abuse

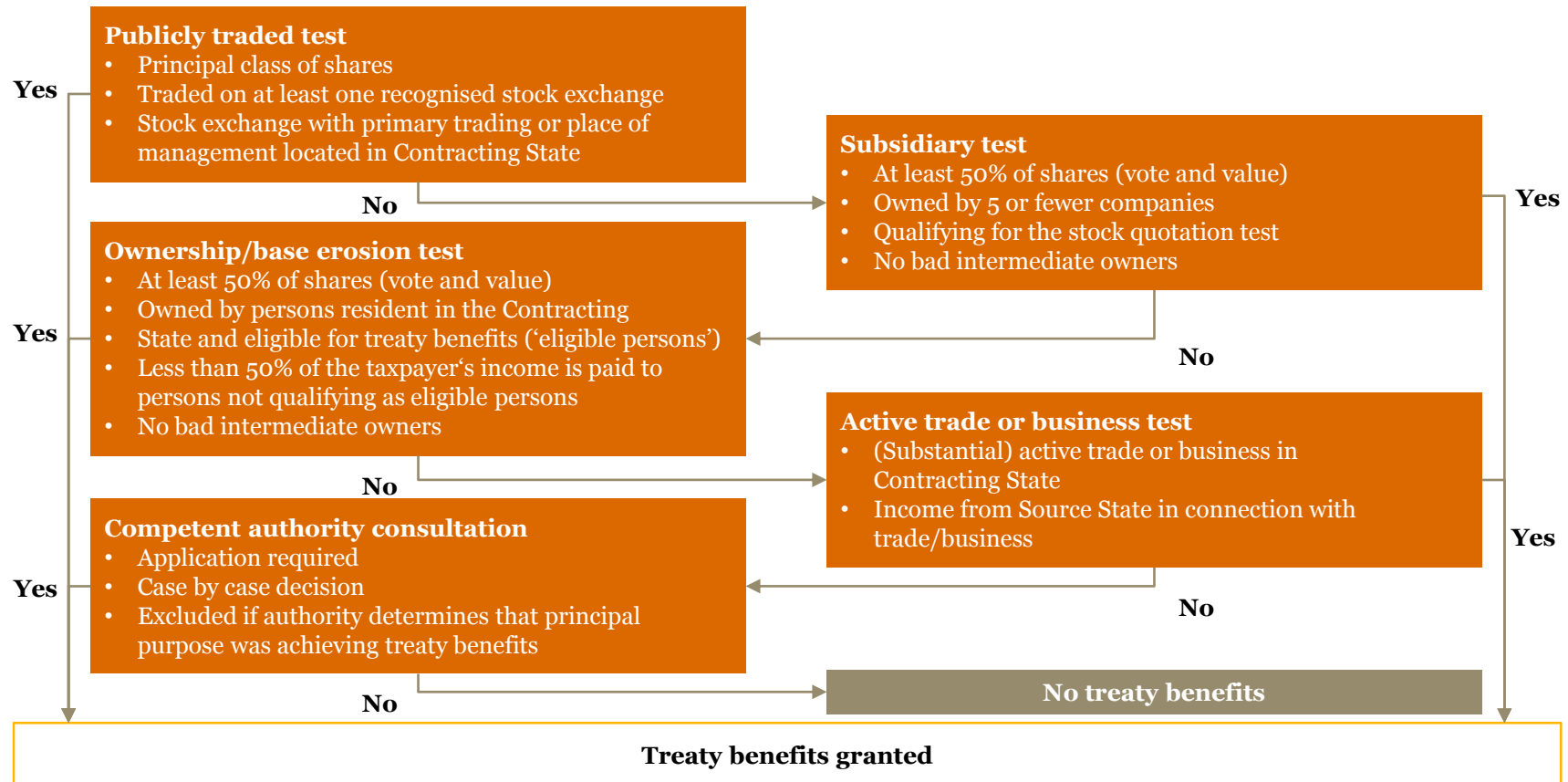
- Minimum protection
 - Limitation on benefits (LoB) and principal purpose test (PPT); PPT alone; or LoB and anti-conduit financing rules
- Further work
 - Non-CIV funds; pension funds
- Potential issues with LoB
 - Complexity, not publicly owned/traded, intermediate holding companies, no active trade or business, compatibility with EU law
 - We expect that the US, Japan and India will seek to retain the LoB
- Potential issues with PPT
 - Subjectivity, uncertainty
- Tax authorities refocussing on treaty access, even under existing rules (e.g. beneficial ownership)

Holding and repatriation

Taking treaty relief for granted could be a thing of the past



Treaty abuse – LoB (excluding derivative benefits test)



Holding and repatriation

Taking treaty relief for granted could be a thing of the past



Snapshot of recent amendments to DTAA's of India with Mauritius, Singapore and Cyprus

Shift from residence-based to source-based taxation

Gradual withdrawal of tax benefits under the India-Mauritius / Singapore Tax Treaty - complete phase out from April 1, 2019*

Prospective application of the Protocol – All investments prior to April 1, 2017 grandfathered

Two-year transition period introduced subject to LOB conditions*

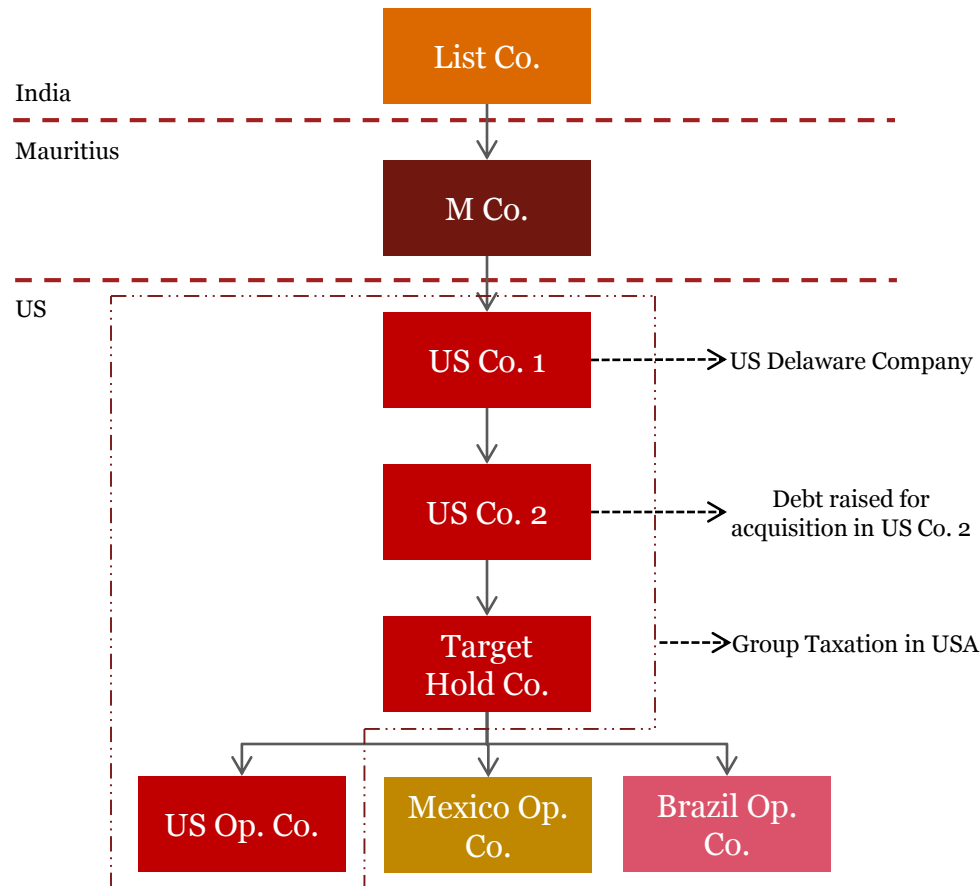
Date of entry into force – April 1, 2017

Holding and repatriation

Taking treaty relief for granted could be a thing of the past



Multi-layered structures



How will you deal with these questions post BEPS?

- What is the justification for the multi-layered substance created for acquisition of Target Hold Co.?
- What is the substance of M Co. and US Delaware Co.?
- Will filing of a group tax return by US Co. 1, US Co. 2, Target Hold Co. and US Op. Co. be considered as harmful tax practice?

Holding and repatriation

Taking treaty relief for granted could be a thing of the past



Impact of BEPS on holding and repatriation

- Withholding tax on dividends
 - Proposed treaty changes may restrict or prevent access to reduced rates of WHT
- Non-resident capital gains
 - Proposed treaty changes may remove treaty protection
 - Risk of double taxation
- Alignment of holding and substance
 - Active trade or business requirement in LoB
 - Discrepancies highlighted by country by country reporting
- Repatriation of cash/reserves
 - Returns to shareholders/working capital reduced by additional dividend WHT

Holding and repatriation

Taking treaty relief for granted could be a thing of the past



What should you be doing now?

- Review impact on existing holding structure and cash management/repatriation strategies to identify areas which may be susceptible to challenge under new tests or existing rules
 - Wide anti abuse rules (LoB/PPT)
 - Targeted anti abuse rules
 - More rigorous application of existing rules
- Establish how urgently this needs to be addressed
- Consider alternative methods for returning value to shareholders
 - Holding structure rationalisation
- Consider alternative cross border cash management arrangements
- Retain flexibility

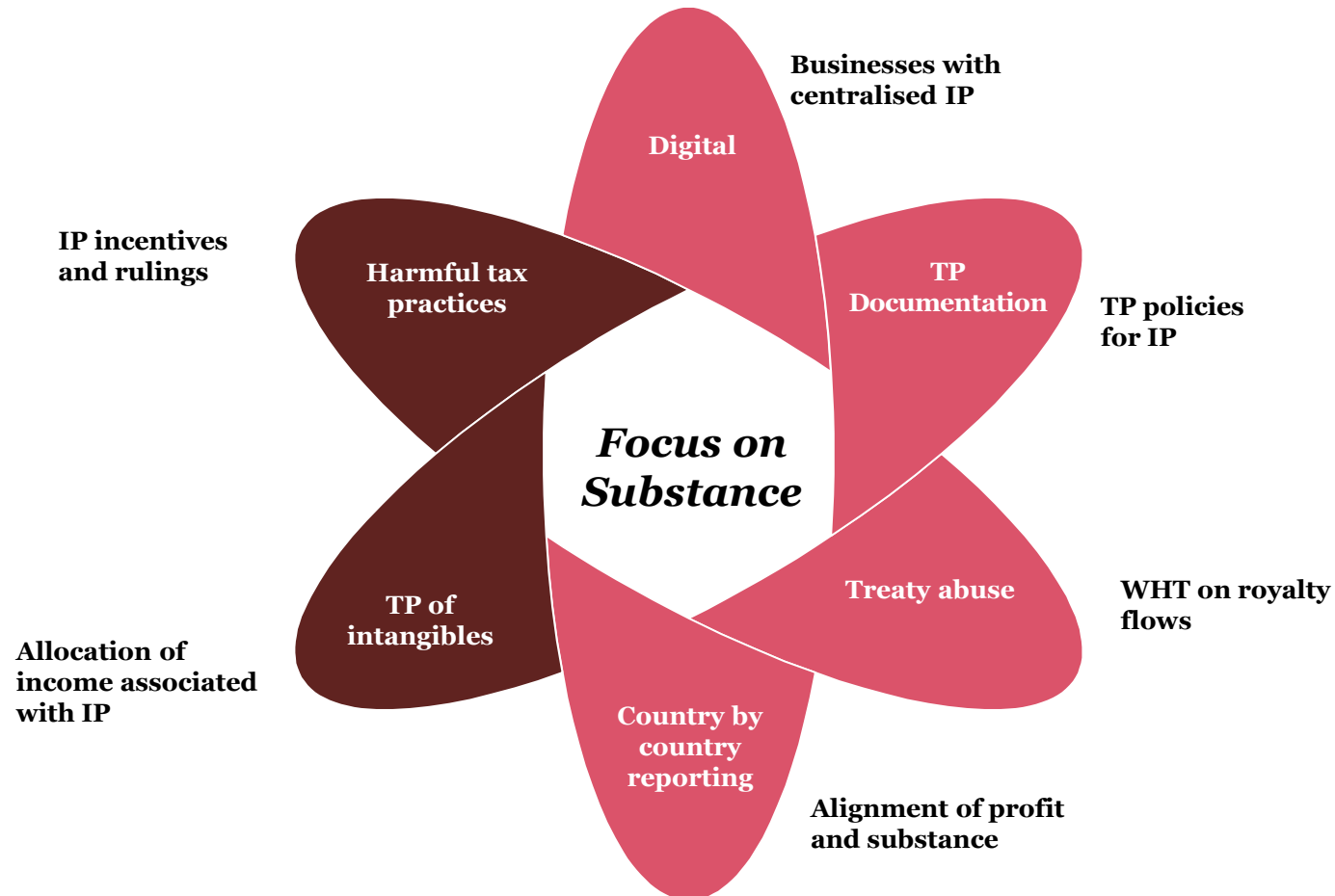
Intellectual property

*Understanding the meaning and importance of
'substance'*



Intellectual property

Understanding the meaning and importance of ‘substance’



Intellectual property

Understanding the meaning and importance of ‘substance’



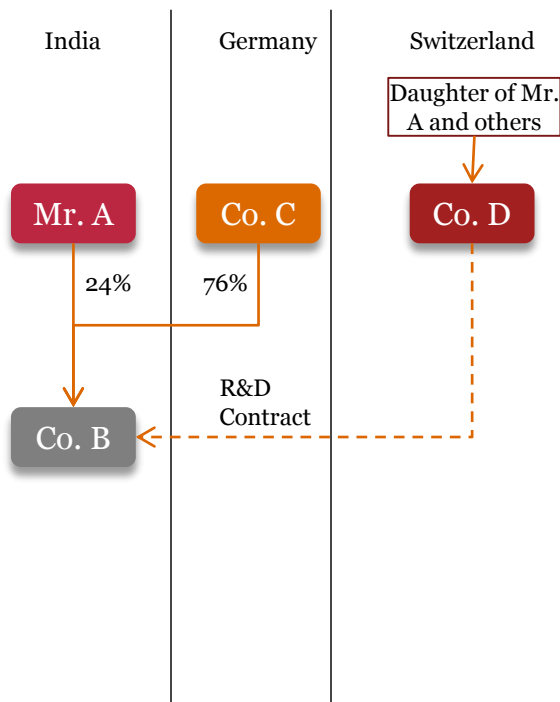
Harmful tax practices

Overview

- Identify and eliminate harmful preferential regimes
- Require spontaneous exchanges of information with respect to preferential regimes- Refreshes list of regimes
- Focus on substantial activity generally viewed as of growing importance and a theme throughout the BEPS papers
- Three potential measures for intangible assets:
 - ‘Value creation’ approach based on given activities
 - ‘Transfer pricing’ approach based on territorial location of significant people functions, legal ownership and bearing of economic risk
 - ‘Nexus’ approach based on alignment of profits with qualifying R&D expenditure

Intellectual property

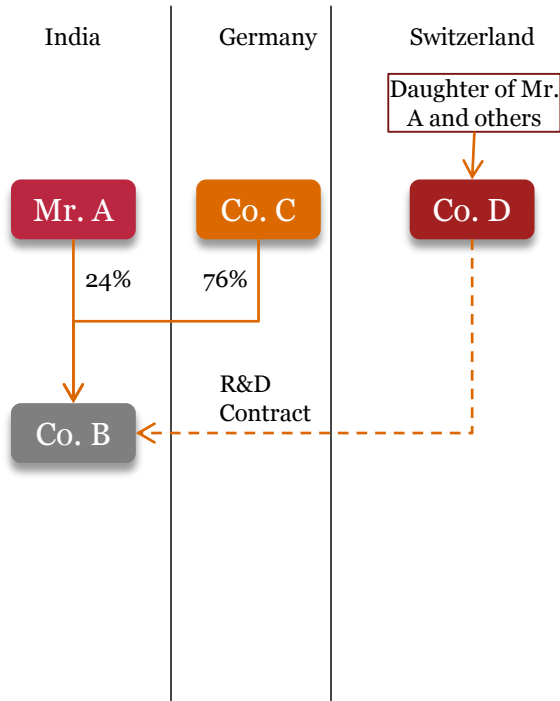
Understanding the meaning and importance of 'substance'



- Mr. A - a Technocrat, resident in India, is engaged in development of specialized product (technical textile)
- He owns 24% equity in Co. B in India and the remaining 76% is held by Co. C, an investment company in Germany
- Co. D in Switzerland held by parties related to Mr. A gives a research and development (R&D) contract to Co. B in India for developing the specialized product
- Co. D registers the IP in Switzerland
- Co. D will set up a manufacturing plant in UAE (subsidiary/branch)
- Co. D will enter into a contract with different clients in India, Africa and Europe for supply of component using IP owned by Co. D
- Clients will insert the component in the final product which will be marketed under the brand name of respective clients

Intellectual property

Understanding the meaning and importance of 'substance'



How will you deal with these questions post BEPS?

- What is the substance behind registration of the IP in Switzerland when substantial work of development of the same is done by Mr. A in India?
- What is the Place of Effective Management of Co. D given the fact that it is in effect managed by Mr. A ?
- How does one establish a nexus between expenditure on R&D and registration of the same in Switzerland?

DEMPE

2010 OECD Guidelines:

9.170: “The economic substance of a transaction ... is determined by examining all of the facts and circumstances, such as the economic and commercial context..., its object and effect from a practical and business point of view, and the conduct of the parties, including the functions performed, assets used and risks assumed”

BEPS - Action Plan 8:

“To the extent that one or more members of the MNE group other than the legal owner performs functions, uses assets, or assumes risks related to the **development, enhancement, maintenance, protection, and exploitation** of the intangible, such associated enterprises must share in the anticipated returns derived from exploitation of the intangible by receiving arm’s length compensation for their functions, assets and risks.”

Considerations for evaluating the existence of economic substance



Is payment of the development cost of an intangible alone sufficient to create the “economic substance” of intangible ownership?



Must one also have control over decision making regarding intangible development?



Is it necessary to pay the cost of development if one has control over decisions?



Can an entity establish the economic substance of intangible ownership if it lacks the personnel or assets to manage the development process and support the economic risk of development?



Are cost sharing arrangements somehow different?

Intellectual Property

Understanding the meaning and importance of ‘substance’



Snapshot of key indicators for identifying Development Center as a Contract R&D service provider with insignificant risks

- * Economically significant functions performed by Foreign Principal – through its employees or AEs
- * Funds / Economically significant assets for research or product development provided by Foreign Principal or its AE – Indian Development Centre remunerated for work performed
- * Foreign Principal or its AE to have complete control of the Indian Development Center and supervise their activities on a regular basis
- * Indian Development Center does not assume economically significant realized risks
- * Presumption that Foreign Principal does not control risks if it is located in a low / no tax jurisdiction
- * Indian Development Center has no ownership right on the development or outcome of the research

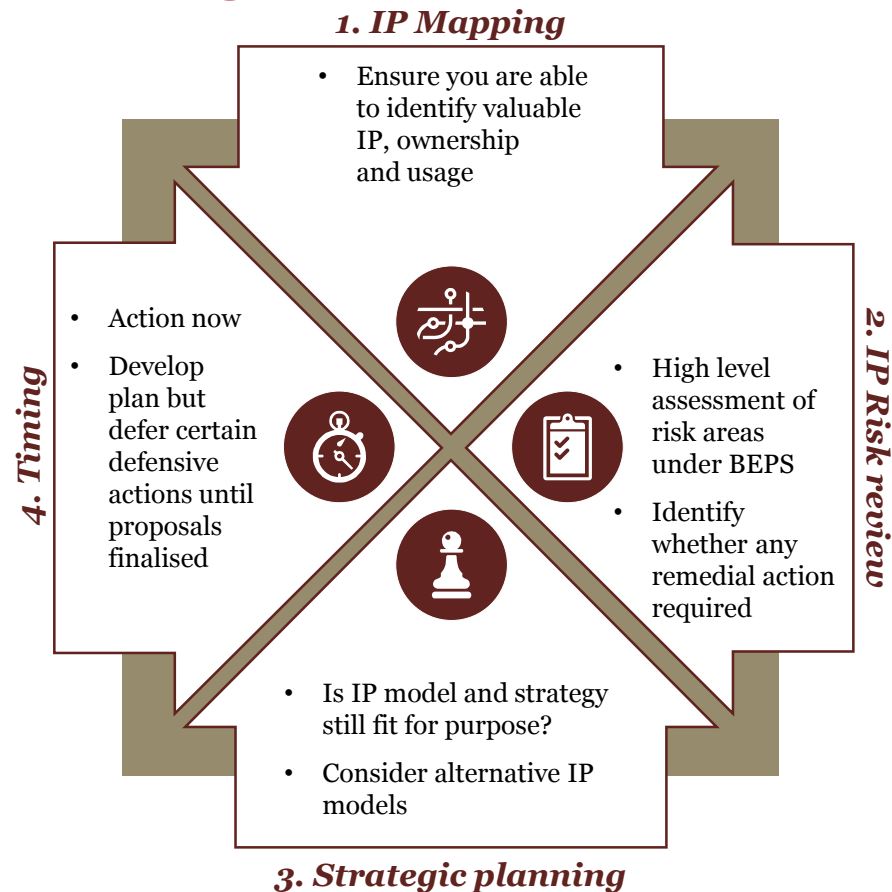
Tax authorities would be guided by the conduct of the parties and not merely by the terms of the Contract

Intellectual property

Understanding the meaning and importance of 'substance'



What should you be doing now



Operating Structures Simplification— the Way forward?



Economic substance in companies - Indicative

Management Company

- Strategic decision making/shareholder functions like management of participations, M&A activity, important asset purchases etc.
- Key management and commercial functions for the group

Operating Company

- Operational and management decisions such as supply chain management, marketing strategy, production decisions etc.

Holding Company

- Shareholder functions relating to the investments held
- Need for local qualified and capable directors

Financing Company

- Making decisions relating to the use of the capital and bearing the risk for the same
- Raising of funds for the Group

No golden rules, guidelines based on our experience

RACI model

Responsible “Doer”

- Individual(s) (Many) who perform an activity or take part in a decision—responsible for action/implementation

Accountable “Buck Stops Here”

- Individual (One!!) who has ultimate decision making and approval authority. Typically the owner of the budget

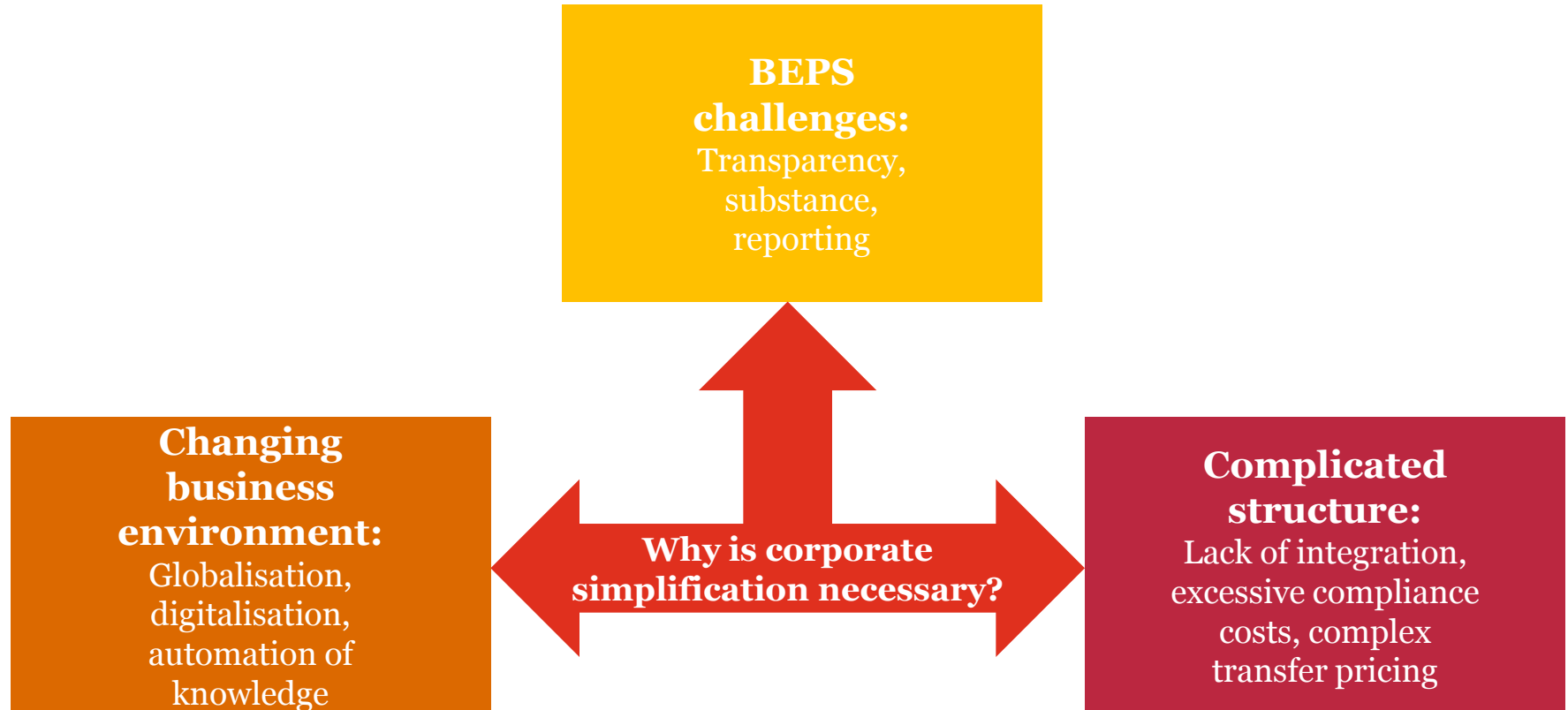
Consulted “In the Loop”

- Individual(s) (Many) who need to have input into a decision or action before it occurs

Informed “FYI”

- Individual(s) (Many) who must be informed that a decision or action has taken place

Need for corporate simplification



Simplification of Structures- Drivers and Benefits



Drivers and Benefits

- complex intra-group transactions and transfer pricing structures;
- compliance cost;
- monitoring the effective tax rate- possible disappearance of beneficial tax regimes;
- non-trading and dormant entities;
- implementing a “one face to the client” approach; and
- lowering the PE threshold.

- Substance
- Risk
- Cost
- Transparency
- Reputation

Key Focus Areas- Why Now?



Simplification of Structures- Methods and procedures



1

Simplify Management Model Management Structure Alignment

- Improve speed of decision-making
- Focus management time on core activities and group performance rather than in-country matters
- Improve alignment between management responsibilities and corporate structure
- Reduce duplication of activities by centralising activities
- Systems integration and simplification



2

Integrate your business model: Value chain transformation

- Supply chain rationalisation and savings
- Improve business control
- Substantively reduce intra-group transactions
- Reduce working capital
- Simplify transfer pricing
- Reduce tax risks
- Increase transparency



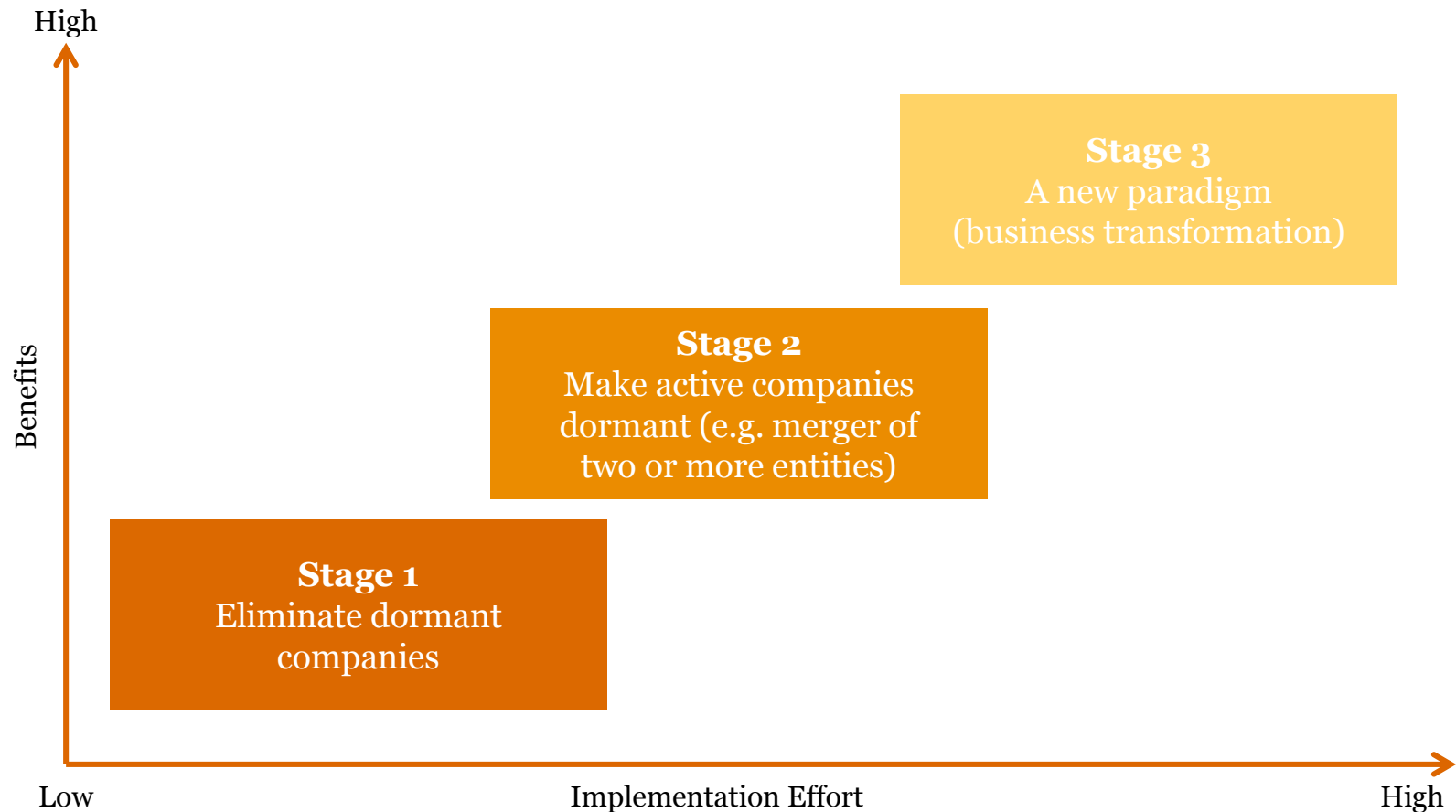
3

Simplify legal entity structure: Single entity structure

- Improve business control and compliance
- Reduce number of entities and related compliance costs
- Reduce statutory reporting and accounting complexity
- Reduce intercompany transactions
- VAT and tax management benefits
- Reduce existing PE risks

Simplification of Structures- Stages

There are three stages by which a company can simplify its entity structure. They require different levels of effort and bring different benefits.



Q&A



Thank you

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