Fund structures

India & Singapore perspective

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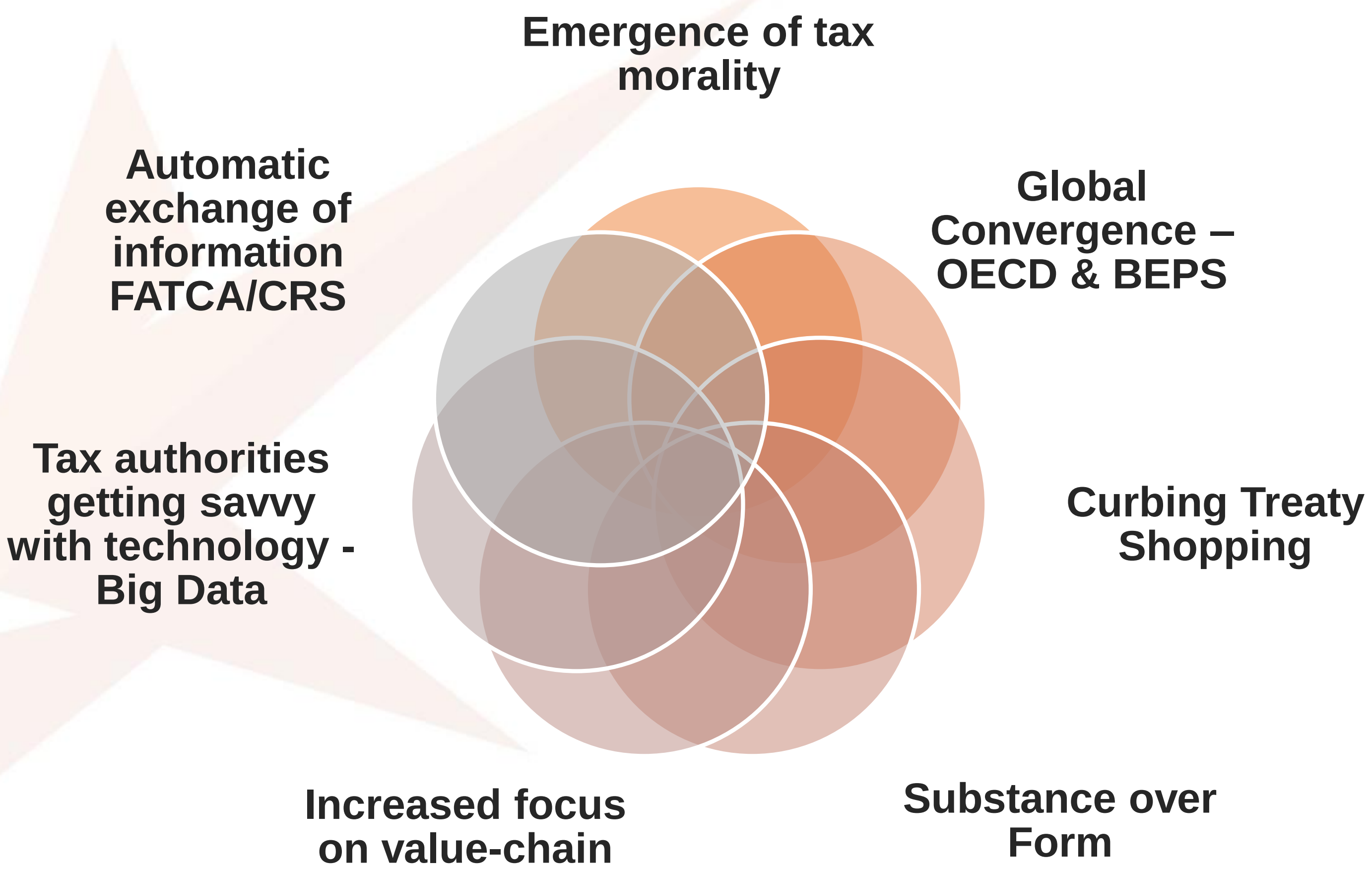
Global trends in tax reforms, MLI and its impact on Tax Treaties

Global trends in tax reforms



Most of major tax reforms flowing from BEPS project; Trend to continue as project comes of age

BEPS Project – Main pillars

Coherence	Substance	Transparency
Neutralising Hybrid Arrangements (2)	Anti Treaty Abuse (6)	BEPS Data Collection & Analysis (11)
Thin Cap (4)	PE [tax presence] (7)	Disclosure of aggressive tax planning (12)
CFC Rules (3)	TP – Intangibles (8)	TP Documentation (13)
Counter Harmful Tax Practices (5)	TP/Risk and Capital (9)	Effective Dispute Resolution (14)
	TP/ High Risk Transactions (10)	

Commitment by 85+ countries and jurisdictions to implement the project

Tax challenges arising from digital economy (1)

Development of Multilateral Instrument (MLI) for amending bilateral treaties (15)

Treaty eligibility – Recent India tax jurisprudence

Following key parameters have been considered for determining tax treaty eligibility:

- Taxpayer should have a valid TRC;
- Directors should be well qualified to engage in meaningful discussions and take investment decisions;
- Location of the directors while signing the resolution; passport of directors have been scrutinized to ascertain their location;
- Directors of the taxpayer are signatories to SPA;
- Corporate filings with the authorities to ascertain the business activity of the company;
- Payment of consideration for original acquisition of shares to be through proper banking channels
    - Payment should have been done by the taxpayer and not by its holding or group company;
- Similarly, the sale consideration received on transfer of shares by taxpayer should be paid to the taxpayer and not to its holding or group company

Treaty eligibility – Recent India tax jurisprudence

Following key parameters have been considered for determining tax treaty eligibility:

- Management of the taxpayer should independently deliberate on the disposal of funds (e.g. on potential usage of funds for further investments, budgeted expenses)
  - A complete back to back payment may indicate a lack of independent deliberation
- Taxpayer should be the legal and beneficial owner of the shares
  - Such as name of the taxpayer should be mentioned in the share register of the investee company, accounting of shares of the investee company etc.
- In context of investment holding companies, it has been observed that office space and staff is not necessarily a critical factor

POEM Considerations

A person being a company shall be said to be resident in India, if-

- it is an Indian company; or
- its ***place of effective management***, in that year, is in India

Offshore Fund to be a company not engaged in active business outside India as it will earn income only by way of dividend / interest/ capital gains

POEM means

A place where

- key management and commercial decisions
- that are necessary for conduct of the business of an entity as a whole (not of a particular division or geographic unit)
- are, in substance made (essence of decision making rather than form)

POEM implications

- Treaty benefits not available for grandfathered investments
- MAT could apply to sale of unlisted private company shares
- Additional tax of 10% on dividends (over and above DDT paid by Indian companies)
- Share premium could be taxable in hands of Indian portfolio companies [Section 56(2)(viib)]

India-Singapore tax treaty – Current Status

- **Taxation of capital gains**
  - No exemption for shares acquired in an **Indian company** 1 April 2017 onwards
    - Shares acquired upto 31 March 2017 are grandfathered under tax treaty subject to meeting LOB
    - Shares acquired after 1 April 2017 and sold before 31 March 2019 taxable in India at a lower rate (ie 50% of applicable tax rate)
  - However, capital gains on **other securities still exempt**
    - Debt, F&O, CCD, LLP interest
- **Single tier v Double tier structure**
- **Taxation of passive income**
  - Interest @15%
  - Dividend withholding tax rate @ 10% - could it apply to DDT paid by Indian Portfolio companies ??
- **Anti-treaty abuse provisions in Multilateral Instruments (discussed in later slides)**
  - India and Singapore have become signatories to MLI which shall be effective from 1 April 2020 (**Financial Year 2020-21**)
  - Impact for shares acquired before 1 April 2017 !!

India-Singapore tax treaty – MLI clause

- **ARTCILE 29A – PREVENTION OF TREATY ABSUSE**

  Notwithstanding any provisions of this Agreement, a benefit under this Agreement shall not be granted in respect of an item of income or capital <u>if it is reasonable to conclude</u>, having regard to all relevant facts and circumstances, <u>that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit</u>, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Agreement.

- **Essential to satisfy PPT under MLI regime to obtain tax treaty benefit :**
  - Treaty benefits not available if PPT test not satisfied – grandfathering benefits lost
  - Existing Singapore funds with feeder/ pooling vehicles outside Singapore could face challenges on the eligibility of the India-Singapore tax treaty benefits under MLI & GAAR
  - Essential to establish 'commercial rationale' coupled with economic realities

Singapore's VCC framework is a significant development for investment fund industry and could be a game-changer for FDI in India

Singapore Variable Capital Company

Singapore Variable Capital Company (VCC) – Journey so far

23 March 2017

Consultation paper for the framework for the VCC was published

10 September 2018
MAS issues response to the feedback received on the Consultation Paper

1 October 2018
VCC Bill passed in Parliament

31 October 2018
MAS announces tax framework for the VCC

Subsidiary legislation awaited

Pilot programme : MAS recently completed a pilot programme for selected fund managers and service providers who are seeking to launch their new investment funds as VCCs on the day that the VCC framework is launched.

VCC – Concept

Covers both traditional and alternative assets strategies

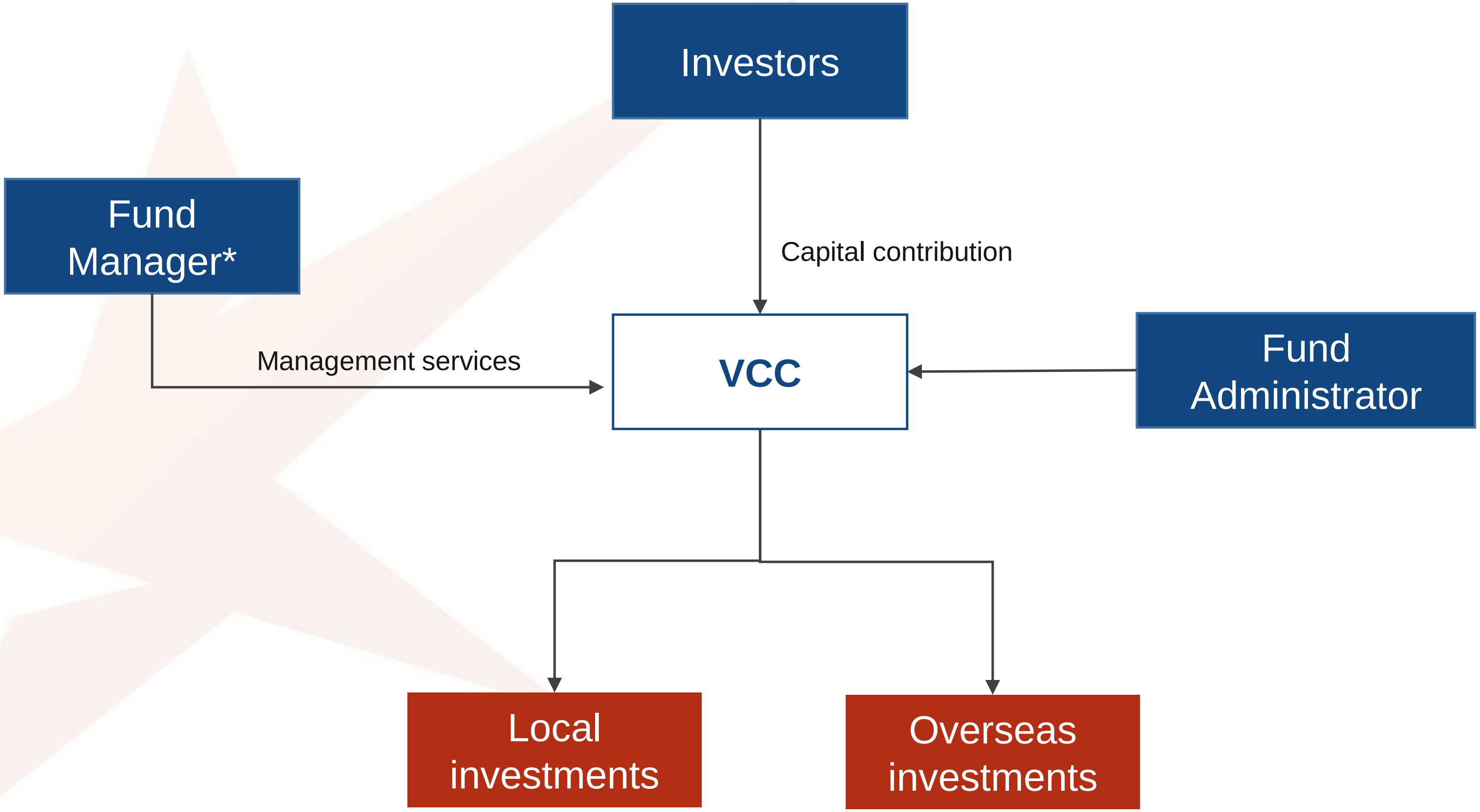
Can be open-ended or close-end fund entity

Can be set-up as a standalone fund or an umbrella fund with multiple sub-funds that may have different investment objectives, investors as well as assets and liabilities

Is governed by Variable Capital Companies Act and Securities and Futures Act

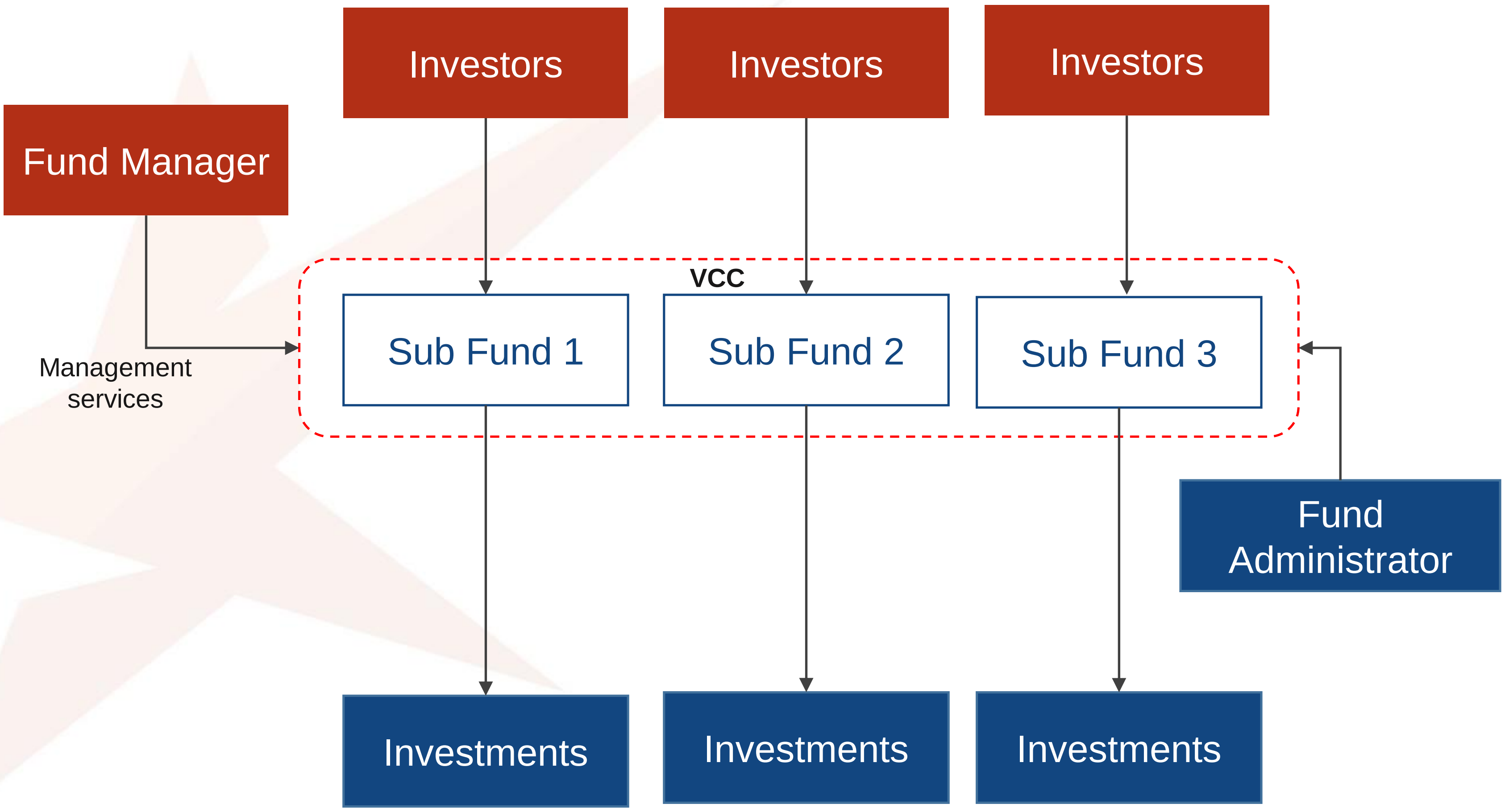
Regulated by both MAS and ACRA

VCC Fund structure – Standalone Fund



*Singapore based licensed or regulated fund manager (unless exempted under the regulations)
Single family office, private real estate funds, REIT managers, Business Trust managers not eligible for VCC structure

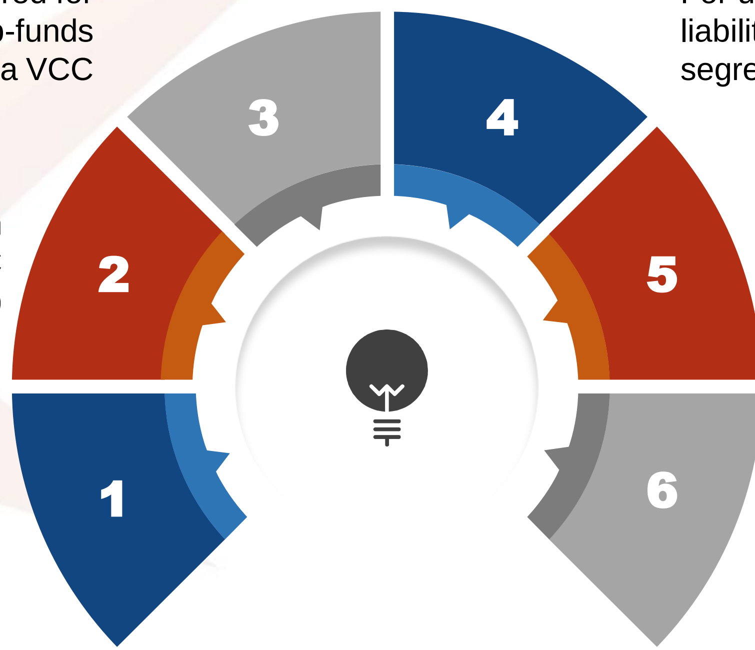
VCC Fund structure – Umbrella Fund



Advantages of VCC structure

Particulars	Limitations in the current framework	Benefits in VCC framework
Confidentiality	Public has access to financial statements and shareholders information and hence no confidentiality	No requirement for financial statements to be made public – Offering privacy to investors
Capital redemption	Redemption of capital requires solvency statement and shareholder's approval	Redemption of capital at fund's net asset value does not require solvency statement and shareholder's approval
Dividend payments	Dividend can be paid only out of profits	Dividends can be paid out of capital and not only profits
Taxation	LP's and Trust does not have eligibility to Tax Treaties	Taxation wise more efficient and benefits under Tax Treaties can be availed
Administration	Administration burden for multiple funds in the current structure	Economies of scale and cost efficiencies due to umbrella fund structure as they can share board of directors, fund manager, custodian, auditor and administrative agent

VCC – Other key aspects



1. Economic conditions (i.e. minimum fund size, business spending) will be applied at umbrella VCC level (and not to each sub-fund)
2. Investment objective condition must be satisfied at the VCC level (and not to each sub-fund)
3. No MAS approval required for addition of new sub-funds under umbrella VCC
4. For umbrella VCC, assets and liabilities of each sub-fund to be segregated
5. VCCs can adopt either SFRS or other recognised accounting standards (i.e. IFRS, US GAAP)
6. Inward re-domiciliation of foreign corporate entities as VCCs permitted, subject to certain conditions

Key tax aspects governing VCC structure

1 Treated as a single entity for tax purposes

2 Tax exemption under sections 13R and 13X of the Income Tax Act extended to VCC

3 COR is available subject to VCC establishing that it is controlled and managed from SG

4 Existing GST remission for funds will be extended to VCC

5 10% concessionary tax rate for fund managers subject to successful application

6 Benefit of withholding tax exemption for payment falling under Section 12(6) is extended to VCC

Recent Tax reforms –

Impact on India structures

Reduction in corporate tax rates

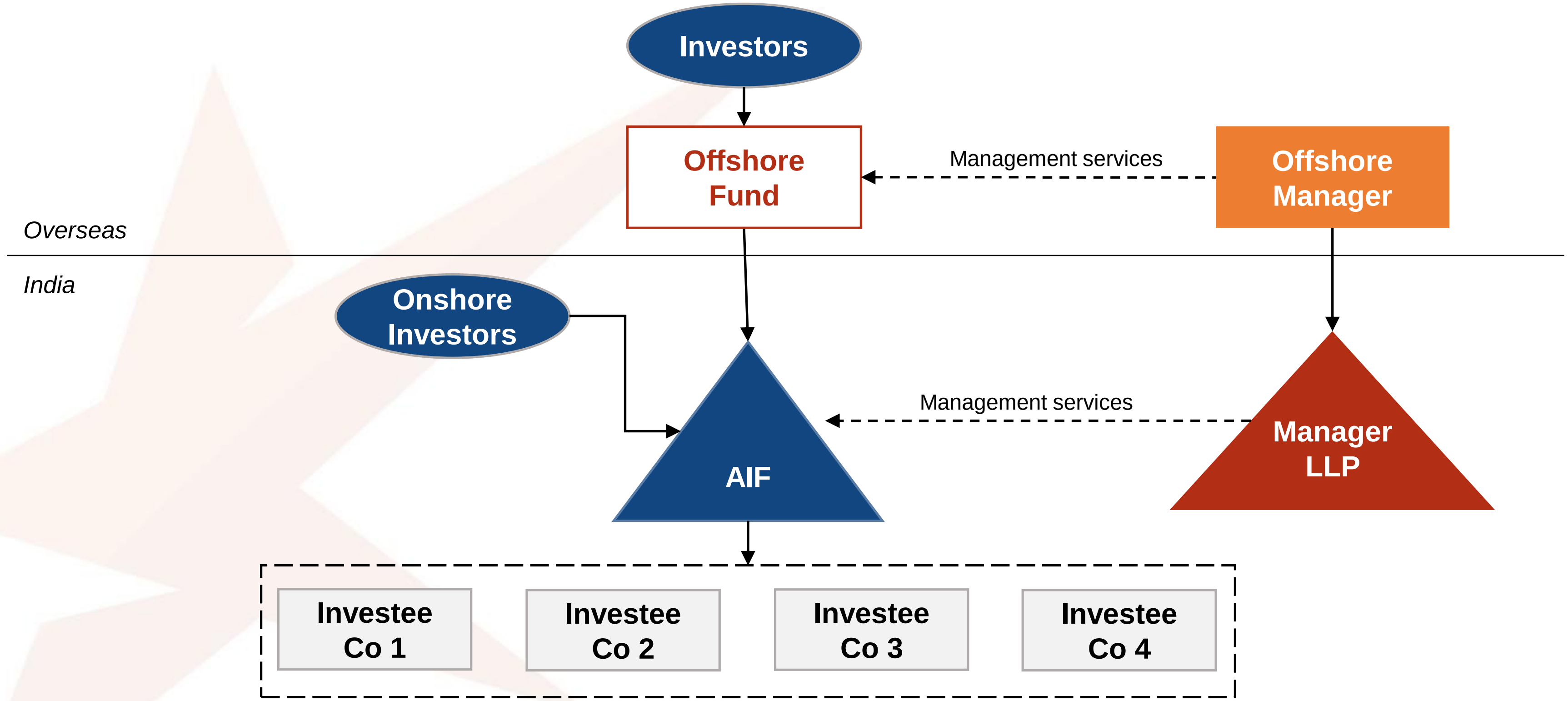
Particulars	Section 115BAA	Section 115BAB
Coverage	• All domestic companies	• New domestic company should be engaged in manufacture or production of article/ thing AND Research or Distribution of article/ thing
Tax Rate	• Headline- 22%; Effective - 25.17%	• Headline- 15%; Effective - 17.16%
Eligibility criterion	• No eligibility criteria	• Company **set-up** and registered on or after 1 October 2019 and has commenced manufacturing on or before 31 March 2023
MAT applicability	• Inapplicable; No MAT credit c/f	• Inapplicable; No MAT credit c/f
Option to be exercised	• **In any year** on or before due date for filing ITR • Not reversible	• **In the first** of the returns filed, before due date for filing ITR • Not reversible
Other restrictions	• No capital and profit linked incentives / deductions • No set off for b/f losses attributable to above deductions • Depreciation rates u/s 32 to be determined may be prescribed	• Same as applicable to section 115BAA • Anti-abuse conditions provided – no splitting or reconstruction, limits on used P&M • Domestic Transfer Pricing to apply

Migration of portfolio companies to new tax regime to be evaluated

Situations warranting restructuring to move to concessional tax regime u/s 115BAA

- Hive-off capital work in progress to WoS
- Companies with undertakings with income taxable at normal rate + those enjoying tax holidays/incentives
  - Hive-off undertakings paying tax under normal provisions to a New Co which opts for Section 115BAA regime
  - Existing Co housing undertakings with normal taxable income to opt for Section 115BAA regime post completion of incentive period and utilization of MAT credit
- Accelerating utilization of MAT credit
  - Faster utilization of MAT credit enables company to move to Section 115BAA – present value benefit
  - Prevents further accumulation of MAT credit once option exercised under Section 115BAA
  - Needless to mention implications under GAAR to be factored for each option

Enhanced surcharge – Adoption of LLP



- **Overall tax efficiency (effective tax rate of 34.94%) - no tax on distribution of profit share**
- **IOCC AIF vs FOCC AIF – Flexibility of alternate financial instruments and investment in sectors without FDI compliance**
- **Permissibility of FDI into LLP (AIF Manager)**
- **Domiciling AIF and Manager in IFSC (GIFT city) – Tax holiday for Manager; no GST on management fees**

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