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Dbriefs

Tax controversy in Asia Pacific: Implications and takeaways (Part 1)

The Dbriefs Corporate Income Tax series

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16 March 2021

Agenda

- New Zealand
- Japan
- India
- China
- Questions and answers

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Polling question 1

What has been your recent experience with the tax office in relation to reviews or audits in Asia Pacific?

- Co-operative / voluntary
- Formal and involving use of statutory powers
- Adversarial and involving search and seizure powers
- A combination of the above

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New Zealand

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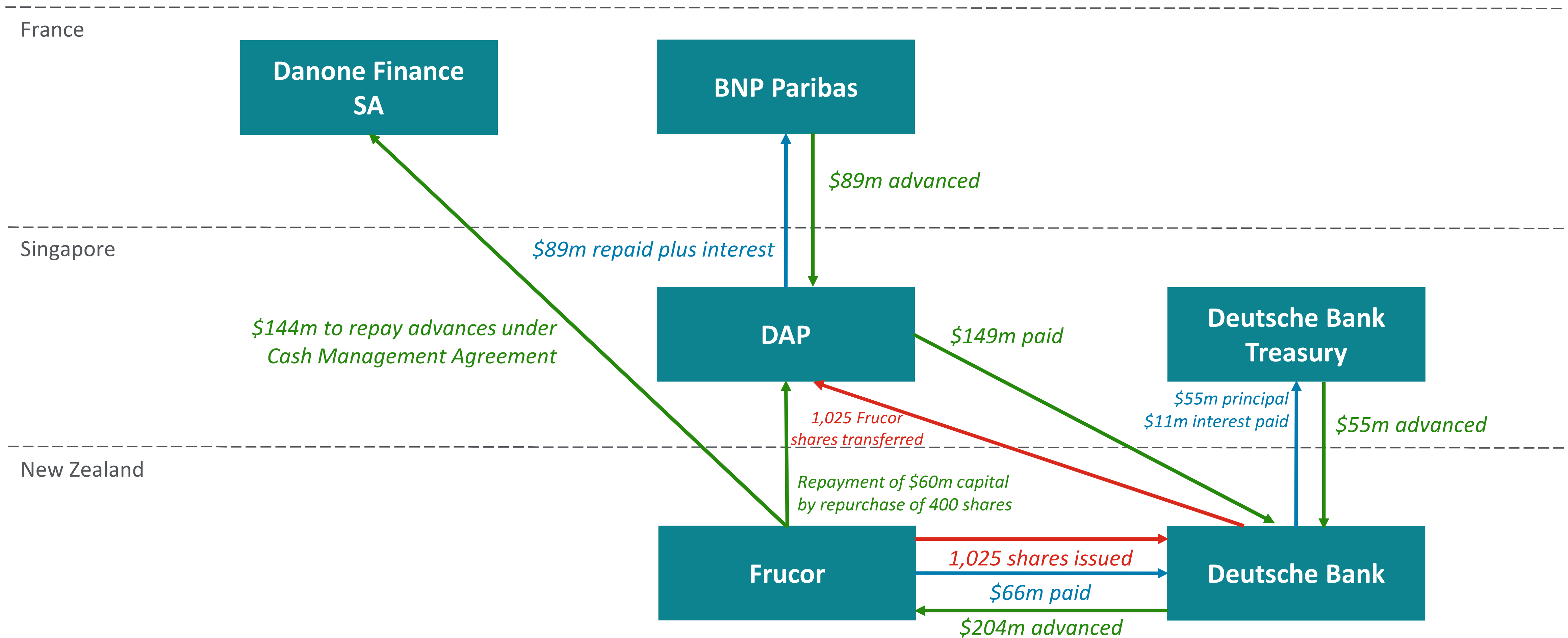
Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited



Steps in Green *– Occurred at commencement of funding arrangement in March-April 2003*

Steps in Blue *– Occurred over the term of the funding arrangement*

Steps in Red *– Occurred at maturity of funding arrangement in March 2008*

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Court of Appeal judgment – Key findings

Financing was a tax avoidance arrangement. Only interest on a net loan of $55m allowed as deduction. No shortfall penalties.

Tax avoidance

- Commercial and economic reality: net loan of $55m, not $204m – ‘real’ exposures
- “Tax efficiency” (contemporaneous evidence)
- Ignore counterfactual – focus on arrangement actually entered into
- Artificiality and contrivance: dressed up subscription for equity as interest-only; tax driven; repackaged and engineered – cannot have been contemplated by Parliament

Counteracting

- Base level allowable deduction?
- Commissioner does not need to consider alternative arrangements
- Tax advantage was the interest deductions that were effectively principal repayments
- Reduced deductible interest from approx. $13m p.a. (6.5% on $204m) to $2.3m p.a. (6.5% on $55m) – punitive?

Shortfall penalties

- Unacceptable tax position: viewed objectively, a tax position fails to meet the standard of being “about as likely as not to be correct”
- Merits of the taxpayer’s arguments were substantial, and the arguments would be considered seriously by a court (Frucor won in the lower court of first instance)

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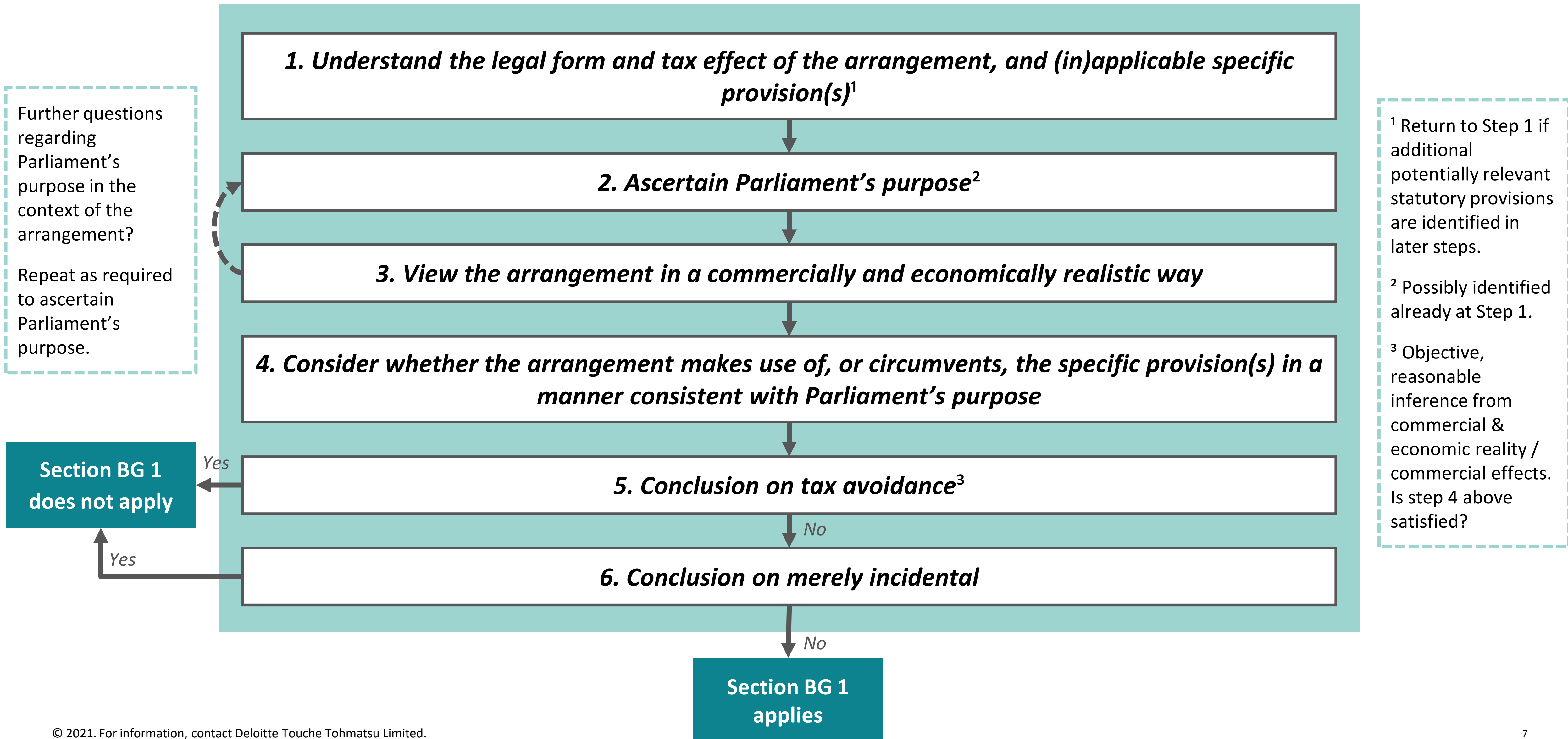
New Zealand Inland Revenue's approach to the tax avoidance inquiry



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Japan

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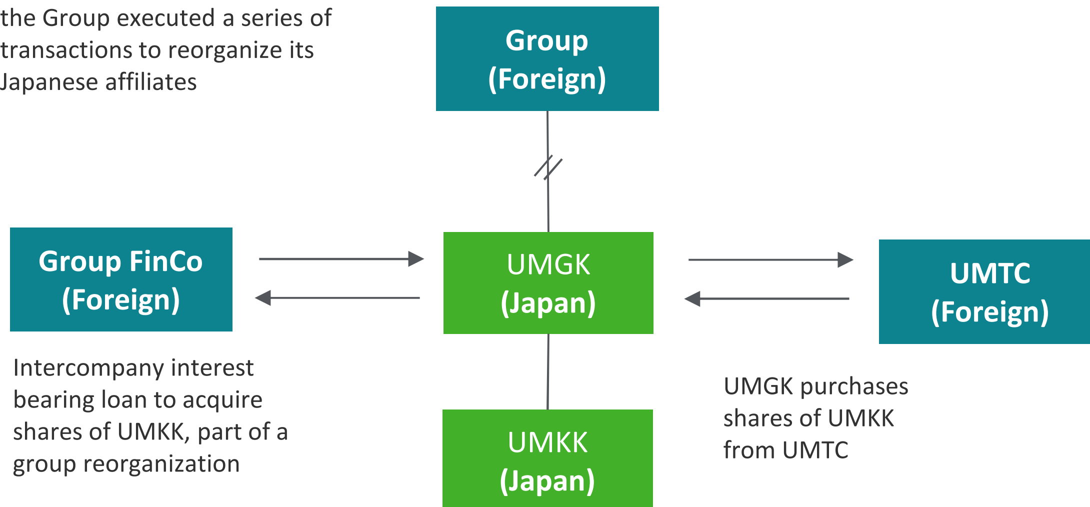
Japan

Universal Music Case

Case overview

- Intercompany loan made to Japanese Subsidiary (GK) to acquire shares of another related Japanese group company (KK)
- Tax Authority assessment disallowed deducted interest payments, alleging the principal purpose of the loan transaction was to reduce the Japanese tax liability



Court decisions

- Tokyo District Court and the High Court have decided in favour of the Taxpayer (27 June 2019 and 24 June 2020, respectively)
- The final decision is pending at the Supreme Court

Ruling

- Holding in favor of the Taxpayer, both Courts concluded:
  - Intercompany loan was an economically rational transaction with legitimate (non-tax) business purposes, carried out as part of group reorganization that included the Taxpayer
  - The decision was based largely on the non-tax business objectives presented by the Taxpayer to support the economic reasonableness of the loan and positions taken on its returns claiming the interest deductions

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India

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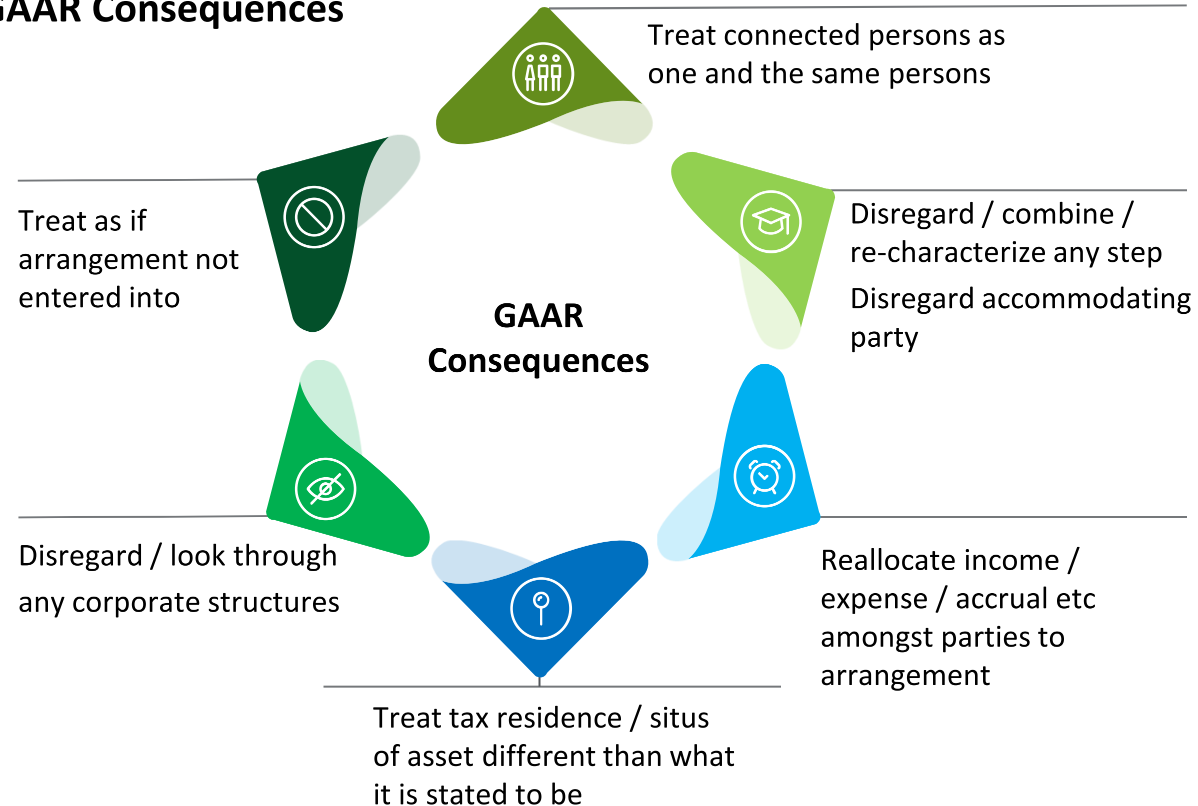
General Anti Avoidance Rules (GAAR) in India

GAAR – A set of rules designed to empower revenue authorities with the right to scrutinize tax transactions which they believe are structured solely to avoid taxes; main purpose of which is to obtain tax benefit

GAAR Consequences



GAAR – Guidance

- GAAR applicable from 1 April 2017 onwards
- GAAR to be applied only after obtaining an internal approval from the Commissioner and the Approving Panel
- GAAR to co-exist with any other Specific Anti Avoidance Rules under the Treaty
- GAAR to override tax treaties
- For foreign investors, GAAR would apply only where tax treaty benefit(s) is claimed
- GAAR not applicable if the entity is set up in a tax efficient jurisdiction for non-tax commercial reasons
- GAAR applicable if tax avoidance strategies are not sufficiently addressed by the existing LOB clause in a tax treaty
- GAAR to not interplay with the right of a taxpayer to select or choose the method of implementing a transaction
- GAAR not applicable if an advance ruling is obtained to this effect

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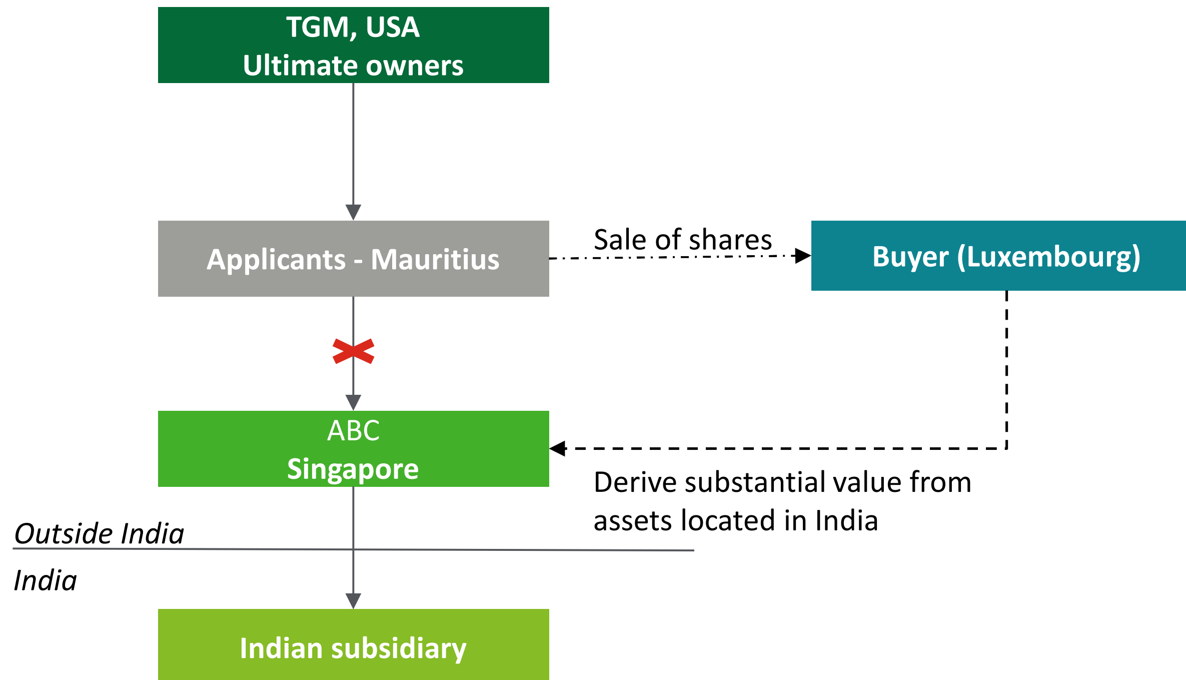
Tiger Global International II Holdings, In re [2020] 116 taxmann.com 878 (AAR – New Delhi)

Holding structure



- The Applicants (Mauritius companies) sold shares in ABC Singapore to buyer in Luxembourg (Buyer)
- The Buyer has acquired the shares as a part of acquiring majority stake in ABC Singapore from several shareholders

Advance ruling question

Whether the gains arising from the sale of shares in ABC Singapore would be chargeable to tax in India under the Indian domestic tax law read with the India-Mauritius tax treaty in the hands of the Applicants?

Ruling

- Transaction was **designed prima facie for avoidance of tax**
  - Primary objective for setting-up the Applicants in Mauritius was to avail tax treaty benefit
- **"Head and brain" of Applicants effectively in US**
  - Key decisions were made in the US
  - Decisions pertaining to investment or sale were taken by the Board of Directors of the Applicants but **real control over key decisions** was exercised in the US
  - US based director on the Board of Applicants was present in all important decisions taken by Applicants
- **Control over Funds** not in Mauritius, but in the US
  - The authority to operate the principal bank account in Mauritius was with the US based director
- **Objective of India Mauritius treaty is to allow benefit on transfer of Indian Company's shares**
  - Any exemption on transfer of shares of company not resident in India was never intended by legislator

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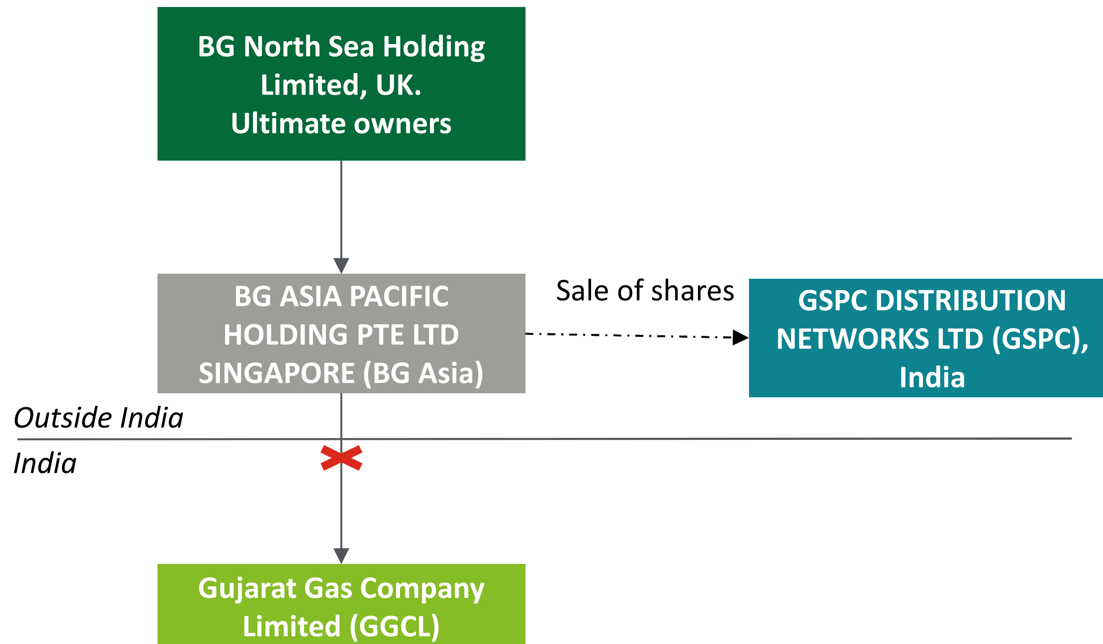
BG Asia Pacific Holding Pte. Limited [2021] 125 taxmann.com 2 (AAR – New Delhi)

Holding structure



- BG Asia (seller) has significant investments in groups companies located in India, Singapore, Egypt, Thailand and Trinidad
- BG Asia proposed to sell shares in GGCL to GSPC (Indian Buyer)
- The proposed transaction was to be undertaken by way of sale under private arrangement and to be completed outside the stock exchange as an "off market' sale transaction.

Advance ruling question

Whether the Applicant/seller is liable to capital gains tax as per provisions of the Act read with the India-Singapore tax treaty?

Ruling

- As per the treaty, gains arising from sale of shares will be taxable only in Singapore, on satisfaction of conditions under the 'Limitation of benefits' (LOB) clause
- AAR held that the affairs of the assessee-company were not arranged with a primary purpose of availing treaty benefits
  - Shares of GGCL were held by BG Asia since 1997, even prior to the introduction of the 2005 protocol in the treaty exempting the capital gains tax
  - Control & management of BG Asia was located in Singapore
  - Decision to divest non-core business interest not limited to India but extended to investments in Brazil and Italy pursuant to bonafide business restructuring,;
- Provisions of the treaty including the LOB clauses have to be strictly interpreted and there is no provision in India-Singapore treaty which states that the benefit of treaty will be denied if a Company is a mere investment holding company
- Relying on SC ruling in *Vodafone* and Andhra Pradesh HC ruling in *Sanofi*, AAR held that holding companies are essential for management of MNC's worldwide business interest and that the activity of such an investment holding company was a bonafide business activity
- The Tax residency certificate issued by the Singapore Tax Authority confirming fulfillment of LOB clause of the treaty in respect of annual expenditure cannot be refuted

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China

GAAR development in China and case sharing

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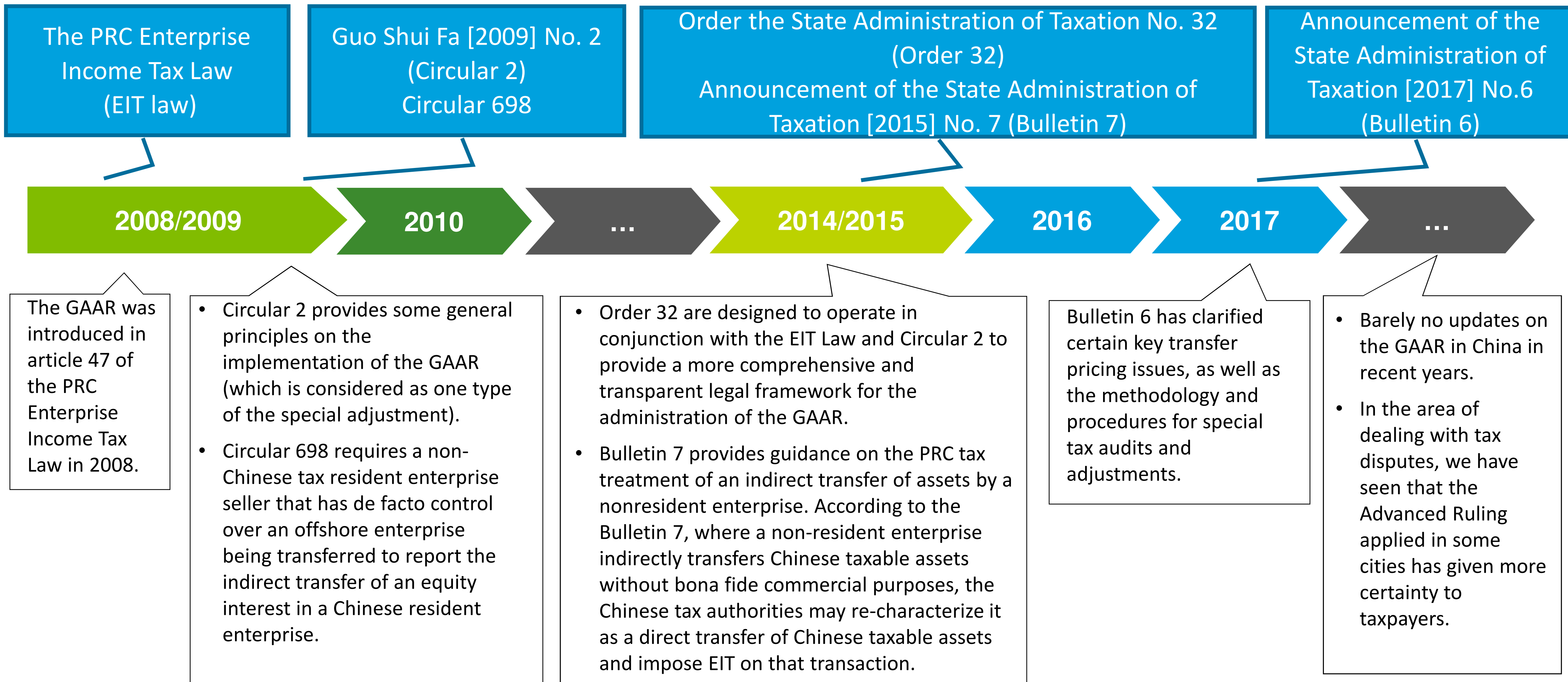
GAAR development in China

Laws and regulations



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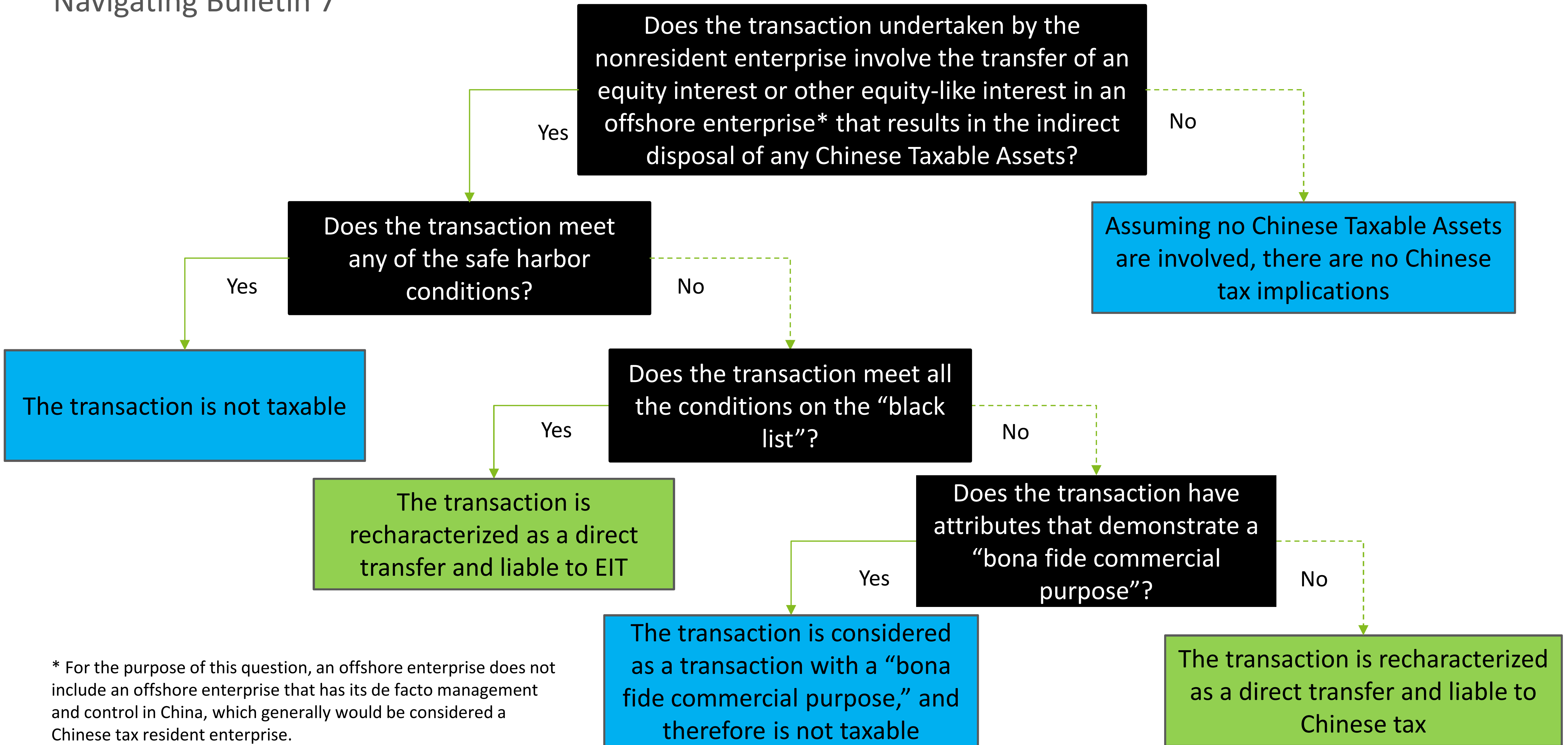
Case Sharing on Bulletin 7

Navigating Bulletin 7



* For the purpose of this question, an offshore enterprise does not include an offshore enterprise that has its de facto management and control in China, which generally would be considered a Chinese tax resident enterprise.

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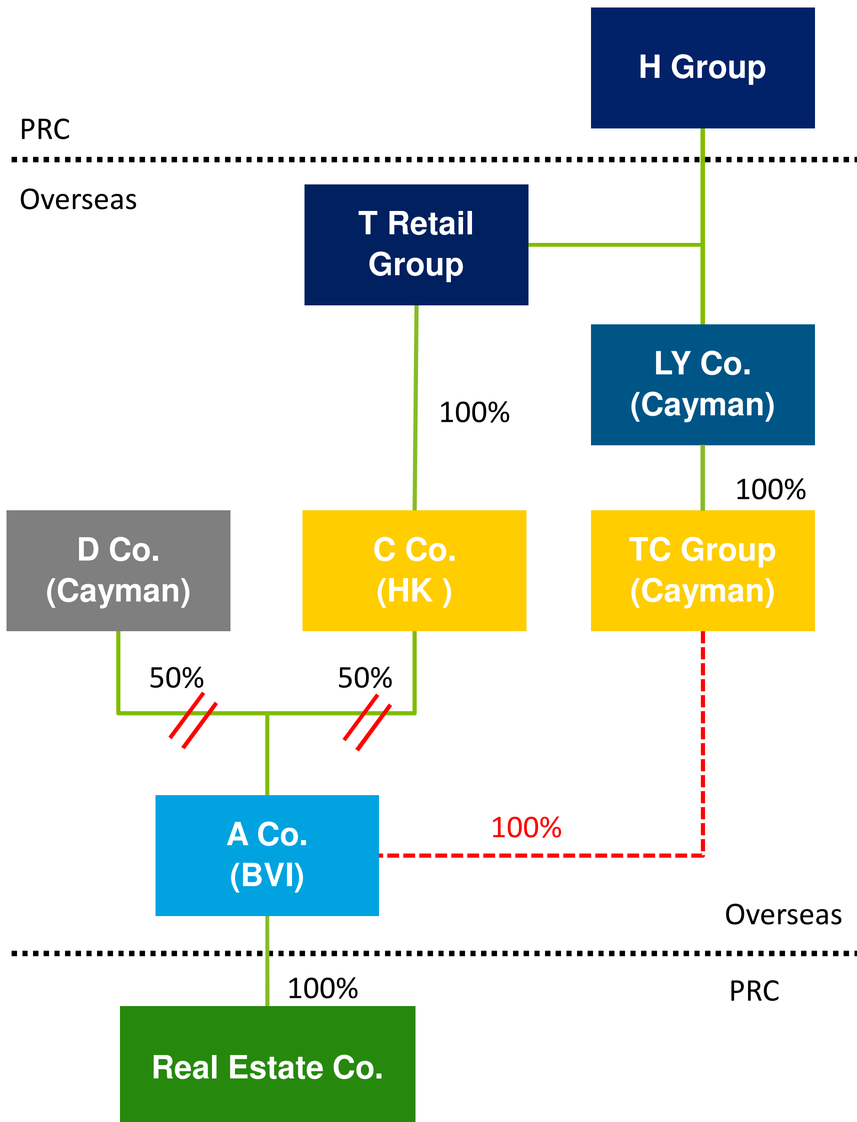
Case Sharing on Bulletin 7

Indirect equity transfer – contribution in joint venture



Background

- The tax authority noticed a news about the change of name of an international chain shopping mall and so decided to conduct a tax investigation
- C Co. and D Co. transferred their 50% shares of A Co. to TC Group respectively. After the transaction, the TC Group holds 100% share of A Co
- A Co. is a pure holding company and the equity in Real Estate Co. accounts for 90% of its total assets. There are no other investment and financing activities, nor any business activities
- D Co. has paid tax for the equity transfer in China, while C Co. held the opinion that the transaction shall not be taxable in China. The transfer of 50% shares is to complete the capital contribution in joint venture between T Retail Group and H Group, and thus the transaction has bona fide commercial purpose. In addition, C Co. did not receive any cash or had any gains from the transaction
- **View of PRC tax authority**: The tax authority determined that A Co. was a "Shell Company" and there was no bona fide commercial purpose for the transaction. As a result, C Co. were required to pay taxes in China in the year of 2020

Takeaways

- Whether the requirement of capital contribution in joint venture could be considered as a commercial purpose? How to determine whether a transaction has a bona fide commercial purpose?
- Tax filing approach of the counter-party has an impact

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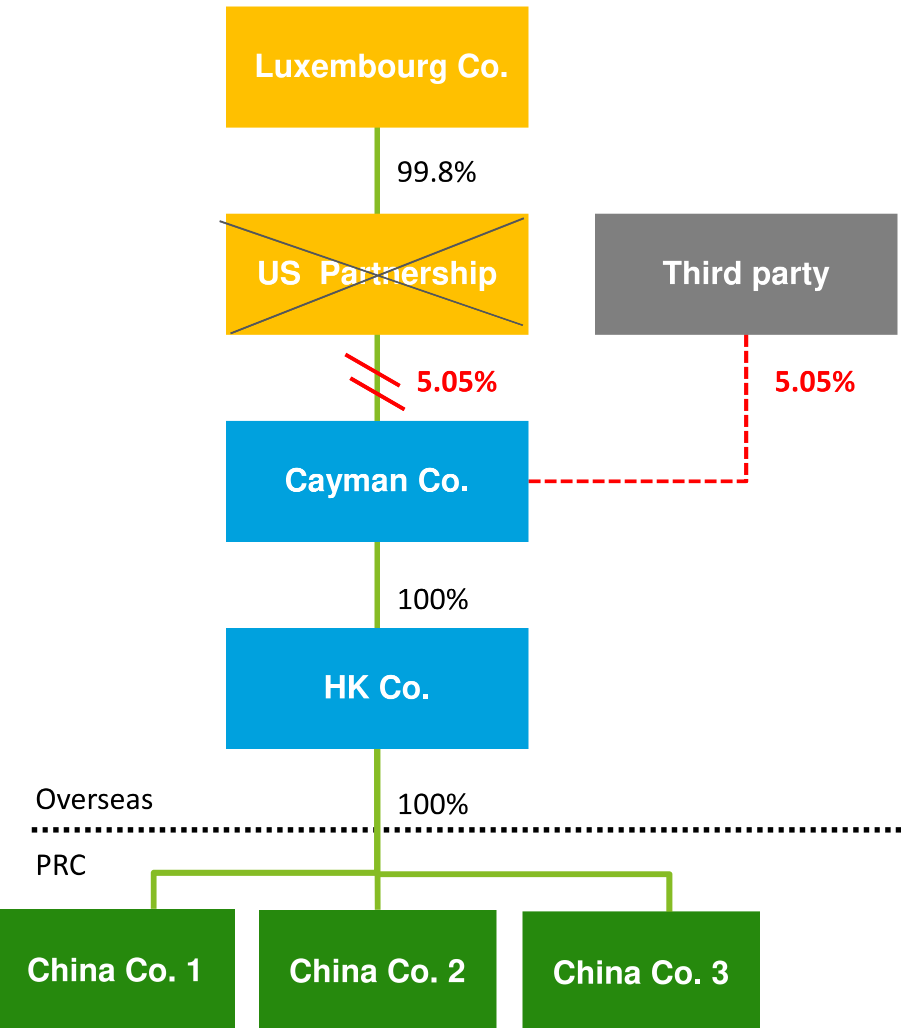
Indirect equity transfer – safe harbor treatment



Background

- US Partnership signed an agreement to transfer 5.05% share of the Cayman Co. to a third party
- US Partnership was not a tax resident in the US and no tax was imposed on this transaction in the US, instead Luxembourg Co. paid tax for this transaction in Luxembourg
- The transferor held the opinion that the transaction could apply safe harbor treatment, i.e., Luxemburg Co. is eligible for DTA exemption if it is direct transfer
- **View of PRC tax authority**: there was no special clause related to flow through entity in the China-Luxemburg DTA, that is to say the income will not be treated as the income of the Luxemburg partners and thus China-Luxemburg DTA is not applicable
- Eventually, the transaction was redefined as indirect transfer of Chinese entity and the US Partnership was required to pay tax in China in 2020

Takeaways

- If a Partnership structure is involved, the safe harbor rules with respect to the DTA exemption may / may not be applicable depending on the tax status of the partnership and the related clauses under the DTA

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Panel discussion

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25 March, 2:00 PM SGT (GMT +8) - Tax controversy in Asia Pacific: Implications and takeaways (Part 2)

7 April, 2:00 PM SGT (GMT +8) - Tax controversy in Asia Pacific: Implications and takeaways (Part 3)

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