TalkingPoint

INVESTING IN INDIA

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FW moderates a discussion on investing in India between Hiten Kotak, a partner and leader of mergers & acquisition tax, and partners Ganesh Raju and Ashutosh Chaturvedi, at PwC India.

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FW: Can you outline recent policy initiatives undertaken by the Indian government to encourage M&A and investments in India?

Kotak: Prime minister Modi’s government has, over the last couple of years, taken some bold steps in bringing in reforms and liberalising the economy to attract foreign capital to India. Along with this, the thrust has been on ease of doing business in India, labour reforms, stability in tax policy and great focus on revitalising certain important sectors like infrastructure, power, banking and manufacturing. Noteworthy initiatives include opening up sectors such as retail trading, ecommerce, insurance and defence for greater foreign investment and thrust on the Make-in-India initiative. The good part is that along with the reforms, the government has been creating a robust regulatory ecosystem that permits flexibility in structuring transactions with limited restrictive conditions for foreign investment, allowing new financing instruments for equity and debt, permitting put and call options, deferred payout, clarity on tax position, and so on. A framework for setting up REITs and InvITs in India, and the introduction of a new GST law, will help to increase the momentum of M&A and investments in India.

FW: How would you describe investor sentiment based on the government’s efforts to bring stability to tax policy in India?

Kotak: Certain high profile tax litigations and amendments to tax laws with retrospective application and disputes on transfer pricing, have created an atmosphere of uncertainty and scepticism in the minds of investors. This is now a thing of the past and special efforts have been made by the government to provide clarifications on the ambiguities and anomalies on taxation matters to provide a stable and predictable taxation regime. There has been a significant uptick in the number of tax related issues being clarified, institutional mechanisms have been strengthened for faster resolution of tax disputes, compliance has been simplified and advance tax rulings may now be obtained by investors on taxation matters. The government has adopted a listening approach with greater interaction with foreign investors and other stakeholders in determining the tax proposal of the Union budget. Investors now view India’s tax regime with a positive mindset and applaud the government’s efforts in bringing in tax reforms at a good pace.

FW: Are the regulations liberalised to permit foreign debt for acquisitions in India? Does India have thin capitalisation rules and how does transfer pricing impact the same?

Raju: Indian corporates can raise foreign debt for funding acquisitions overseas. Generally speaking, the use of foreign debt for making equity or capital market investments in India is restricted. The debt investment can be structured as a hybrid that would eventually convert into equity to overcome this limitation. Further, foreign investors can subscribe to debentures listed in India and the Indian company can use the debt for financing acquisitions in India. India does not have thin capitalisation rules at the moment, however for tax purpose it is expected that under the proposed General Anti Avoidance Rules (GAAR), the concept of thin capitalisation will be considered in determining the deductibility of interest expenses and characterisation of payouts where an entity is excessively levered. For a group company transaction, transfer pricing rules require the interest to be on an arm’s length basis. Also, BEPS Action Plan 4 proposes certain fixed ratio rules which may be followed by countries to limit an entity’s deduction for interest payout. Being a member of the OECD, India has endorsed the BEPS action plan, including Action 4.

FW: What are some of the preferred jurisdictions to make investment into India, given the recent renegotiations of tax treaties?
Kotak: Tax is only one of the considerations in determining the investment structure. Historically, Mauritius, Singapore, the Netherlands and Cyprus have been considered for making investment into India since the tax treaty took away the taxation rights from India. The Indian government has successfully renegotiated the tax treaty with Mauritius and the principle of source based taxation has now been introduced to provide taxation rights to India. It is likely that tax treaties with Cyprus, Singapore and the Netherlands will be amended post negotiation along similar lines. Mauritius continues to remain a preferred jurisdiction and is now also desirable from a tax perspective for structuring debt investment into India. Singapore is also a popular choice given the well-developed financial markets and related infrastructure; however, a lot would depend on the impact post negotiation of the tax treaty.

FW: How will the Indian M&A landscape change with GAAR and BEPS coming into force?

Kotak: The BEPS proposal and GAAR will need to be factored into M&A planning and execution with careful consideration, under all phases of the deal process comprising historical diligence of the target’s position, funding and acquisition structuring, compliance and reporting, and the operation and maintenance of structures. Reporting requirements such as Country by Country Reporting (CbCR) are already part of the current tax law. The focus will need to be on the effective substance proposed under a commercial arrangement. Transactions or arrangements designed solely to avail tax benefits, such as treaty shopping or tax mismatches on cross-border financing arrangements, are likely to be challenged. With BEPS and GAAR coming into force, we will, more likely than not, witness a change in the way businesses operate and how tax authorities will look at business transactions. Having said that, the government is conscious that the new provision can be enforced only after there are detailed rules providing clarity and certainty – a mechanism for eliminating double taxation and machinery for improving the efficiency of dispute resolution.

FW: What are the key due diligence issues faced when conducting M&A in India? What advice can you offer to buyers on this process?

Chaturvedi: Financial, tax, commercial, legal, technical and environmental diligence carried out by a professional adviser can provide vital insights to an investor before concluding a deal in India. Typically, buyers need to understand the historical trends of earnings and cash flows, off-balance sheet liabilities, tax contingencies and effective tax rate going forward and approvals requirements under licences or contracts. In specific situations the technical and environmental diligence assessments are vital to understand the target’s situation on key aspects. The impact of conversion from Indian GAAP to the buyer’s accounting standards is also important, although India is now gradually moving toward a GAAP that is more aligned with IFRS. For each diligence finding, it becomes imperative to determine the quantum of exposure to the extent possible and acquirers should build appropriate safeguards to protect their interest. An appropriate transaction structure and strong deal documentation can suitably ring fence against historical liabilities.

FW: Could you provide some broad insights to dealmakers for structuring investments into India?

Raju: There are a host of regulations that need to be factored while structuring India M&A and a well thought-out structure can provide significant benefits in terms of ownership, optimisation of income flows including tax thereon, and eventual exit. New entity forms like an LLP and investment structures such as alternate investment funds for pooling capital provide more flexibility to dealmakers. The mode of investment and the intermediary jurisdiction
to hold the investments should also be considered and periodically reviewed to align with the changes in law. Needless to mention, it is increasingly important to ensure that there is substance and commercial rationale in the overall acquisition structure which will be maintained during the lifetime of the investment.

FW: Does the antitrust and fair trade regulator pose any significant challenges to timelines when conducting M&A in India?

Chaturvedi: The experience with the regulator so far is very positive, and the Competition Commission in India has allowed transactions to proceed with certain safeguards where necessary. The overall timelines to get approval is 210 days and in most cases the decision has been communicated well within this timeframe. The Competition Commission has recently expanded the list of exemptions to transactions that do not require its approval. Further, electronic filing and pre-consultation and confidentiality provisions have ensured flexibility, greater clarity and certainty for consummation of M&A transactions.

FW: Does India allow pass-through status to foreign investors on pooling of funds for investments in start-ups or any specific sectors?

Chaturvedi: A tax pass-through is available for investments made by specified alternate investment funds, excluding hedge funds. Such funds can invest in any sector including start-ups, early stage ventures or other socially or economically desirable sectors. A tax pass-through status has also been accorded for certain income streams of REITs and InvITs. Foreign investment is permissible in alternate investment funds, REITs and InvITs.

FW: What do you think is the key differentiator that makes India an attractive investment destination? What are your expectations for Indian M&A, both domestic and outbound, over the coming months?

Kotak: India is a large economy, a market that is growing at a robust pace which cannot be ignored by anyone in today’s global context. Enterprises seeking growth, talent and new markets are very keen to make and increase their investments in India. Numerous policy initiatives including programmes like ‘Make in India’, ‘Skill India’, ‘Digital India’, ‘Smart Cities’, as well as the policies for financial inclusion and use of technology for distribution of subsidies and the delivery of last-mile services, have been instrumental in accelerating the pace of economic growth. The government’s commitment to providing a stable, predictable, non-adversarial taxation regime and to introduce reforms like the goods and service tax, make India an attractive investment destination. The buoyancy in economic activity will further increase M&A activity, both inbound and outbound.