

Treasury Challenges for Corporates

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Speakers

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- Based in Hong Kong, Philippe Jaccard heads the Asia Pacific business responsible for structuring liquidity solutions for Citi's institutional clients with US\$100 billion in direct deposits. Philippe joined Citi 10 years ago in Singapore where he led Citi's Treasury and Trade Services business. Prior to that, he was Asia Pacific Assistant Treasurer for Cargill, a large producer and marketer of agricultural and industrial commodities. He started his career with Cargill in the wintry city of Minneapolis and holds an MBA in Finance from the University of Chicago

Gourang Shah



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Steve Towers



- Steve Towers is a senior international tax partner with Deloitte, with 28 years' experience in international tax planning for multinational corporations (MNCs). He has worked in Deloitte offices in Europe, US and Asia Pacific and is currently based in Singapore. Steve has substantial experience in advising MNCs on corporate structuring and restructuring, mergers and acquisitions, hybrid instruments, transfer pricing, use of double tax treaties, permanent establishment issues, and supply chain transformations
- Steve has Bachelor of Economics and Bachelor of Laws degrees from the Australian National University and a Master of Laws (first class honours) degree from the University of Sydney, and is a Member of the Institute of Chartered Accountants in Australia. He has been listed in "The World's Leading Tax Advisors" (Euromoney) since 1997
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Albert Einstein's Quote on Taxes

The hardest thing in the world to understand is the taxes.

[On filing for tax returns]

This is too difficult for a mathematician. It takes a philosopher.

Subsidiary Funding and Taxes

Treasury Objective

- Subsidiary Capital Structure
 - Prefer debt over equity to maximize interest expense deduction
 - Flexibility for debt waiver, debt for equity swaps, or recapitalization
- Inter-company Funding
 - High interest rate for countries with higher tax rate

Tax Considerations

- Thin Capitalization Rules
 - Maximum debt over equity ratio for any legal entity in a country
- Transfer Pricing
 - Arms length interest rates between two related parties
- Double Tax Treaties
 - Implication on reducing withholding taxes
- US Taxes on Global Income
 - CFC/Sub-part F rules
- Tax implications of debt waiver, debt for equity swaps, or recapitalization vary by countries

Repatriation (From Foreign Subsidiaries) and Taxes

Treasury Objective

- Dividends
 - Permanently repatriate subsidiary profits to the holding companies
 - Timing decision based on tax deferral principle—parent companies not taxed on foreign sourced income until they actually receive a dividend
- Long-term Upstream Inter-company Loan
 - Need to have a strategy to unwind due to temporary nature of repatriation
 - Homeland Investment Act
 - Potential Capex or acquisition from profitable subsidiary

Tax Considerations

- Withholding Taxes
 - Withholding/distribution taxes on dividends
- Double Tax Treaties
 - Location of holding company
 - Implication on reducing withholding taxes
- Tax Havens
 - Holding companies in low tax jurisdiction could be classified as tax haven and resulting implications
- US Taxes on Global Income
 - CFC/Sub-part F rules
 - US shareholder taxed on overseas income of the firm when earned rather than deferral until receive dividend

Cash Management and Taxes

Treasury Objective

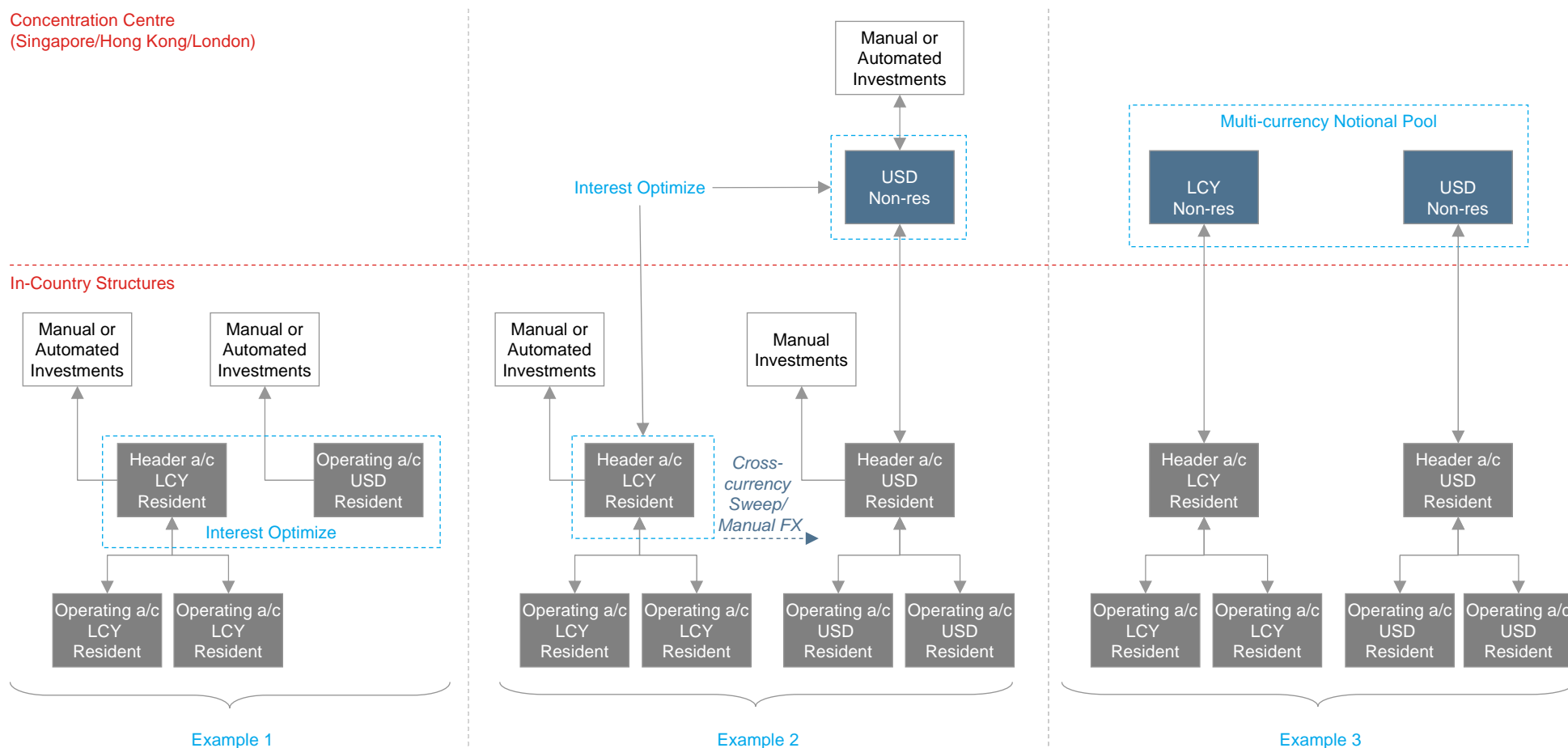
- Cash Pooling
 - Lend surplus funds from one subsidiary to subsidiary with deficit position
 - Agglomerate and control funds from all countries (where regulations allow) and business units
 - Concentrate funds in a low tax jurisdiction
- Investments
 - Concentrate funds in major financial centers where there are more investment options
 - Invest centrally to maximize interest yield

Tax Considerations

- Interest Deduction
 - Interest expense in non-tax paying (deficit) entity whereas interest income in high tax paying entity (group taxes help neutralize)
- Transfer Pricing
 - Arms length interest rates for pooling funds
- Tax Havens
 - Low tax jurisdiction could be classified as tax haven and resulting implications
- US Taxes on Global Income
 - CFC/Sub-part F rules
 - Foreign tax credits
- Double Tax Treaties
 - Withholding taxes on interest for cross-border fund movement
- Other Taxes
 - Business Taxes on interest in countries such as China

Asia Liquidity Structures for MNCs

Concentration Centre
(Singapore/Hong Kong/London)



- **Example 1:** Possible structure for countries which restricts transferability of both LCY and USD e.g. Bangladesh, China, India, Korea, Macau, Sri Lanka, Thailand, Vietnam
- **Example 2:** Possible structure for countries where LCY is restricted, but USD is freely transferable e.g. Indonesia, Malaysia, Philippines, Taiwan
- **Example 3:** Possible structure for countries where both LCY and USD are freely transferable e.g. Australia, Hong Kong, Japan, New Zealand, Singapore

China Cash Pooling Structure

Multiple entities in China for a typical MNC.

The Need

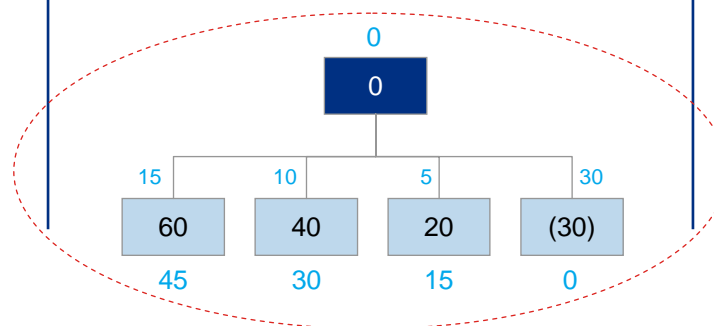
- Manage funds through a centralized arrangement at the group level and extend facility to cash poor entities using its internal funding
- Minimize tax cost
- Real-time visibility of cash position including end of day account balances and transaction details
- Direct link between Citi and client ERP for account posting
- Minimize business tax resulting from movement of funds to header account (zero balance arrangement)
- Unable to systematically limit subsidiaries' borrowing in a cash pool structure

The Solution

- A “sub-limit control” cash pooling structure for the group’s head office to control borrowing limits for specific subsidiaries
- A tax efficient (rule-based) structure and sweep of “exact” amounts to cover overdrafts within a structure
- Interface for daily cash pooling related account posting

The Benefits

- Improved internal borrowing process through improved efficiency
- Centrally manage entities’ funds at group level
- Cost saving from reduce bank agency fees and business taxes
- Improved access to group liquidity; average account balance greatly reduced with much more financial efficiency



Attacks on Treaty Shopping in Asia

Background

Indonesia

- Unilateral termination of Indonesia/Mauritius treaty
- Indofood case
- “Beneficial ownership” ruling
- Disposal of shares through SPV

India

- Vodafone case
- Capital gains exemption under India/Mauritius treaty: E*Trade case
- Treaty override

Korea

- Private equity gains—Lone Star

China

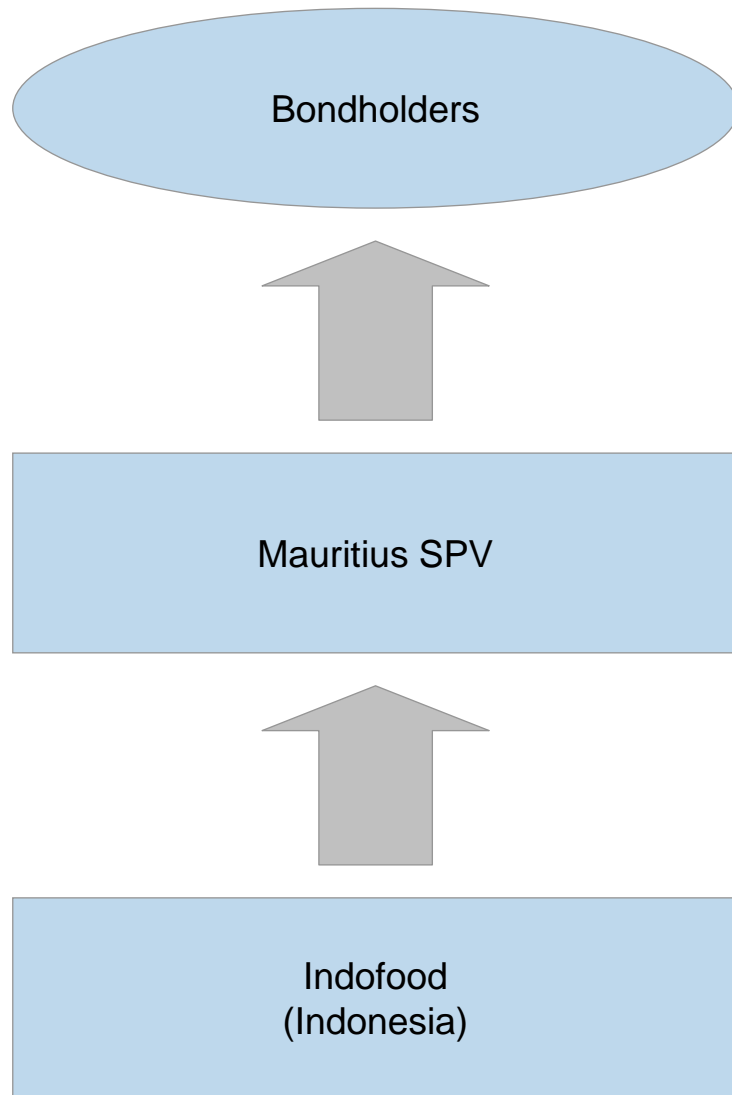
- Chongqing and Xinjiang cases

Attacks on Treaty Shopping in Asia—Background

Asia Pacific

- Greater tax authority challenges to treaty claims
- “Beneficial ownership” rule
 - Not defined in most treaties
 - Article 3(2)
 - Domestic meaning?
 - Context otherwise requires?
 - Common law countries: The term, “beneficial owner”, would exclude a legal owner who is trustee for another
 - OECD Commentary: “The term ‘beneficial ownership’ is not used in a narrow technical sense ...”
- General anti-tax avoidance rule (GAAR)
- Substance over form approach: Disregard interposed entities, especially for capital gains exemption

Indonesia—Indofood Case



- Principles attributable to both external and internal financing
- Indofood prefers to redeem: Could refinance at favorable rates
- Mauritius treaty terminated
- If SPV could become Dutch tax resident and benefit from Dutch treaty, then no redemption
- Indofood: Even if SPV Dutch tax resident, no treaty benefit because not “beneficial owner”

Indonesia—Indofood: Some Findings of Fact

- No spread or margin in financing subsidiary
- Must pay-on interest receivable from parent: In fact, funds bypassed financing subsidiary
- Only obliged to pay noteholders out of proceeds receivable from parent

“... though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.”
(OECD Commentary)

Indonesia—Indofood: Impact

- Unilateral termination of Indonesia/Mauritius treaty
- “Beneficial Ownership” = “International Fiscal Meaning”?
- Public bond market has adapted
- UK tax authority
 - Guidance issued for cases where no tax benefit
 - OECD guidance “conduits” endorsed
- Indofood not specifically used by other tax authorities/courts, however, presume increasing focus on “beneficial ownership”

Indonesia—“Beneficial Ownership” Ruling

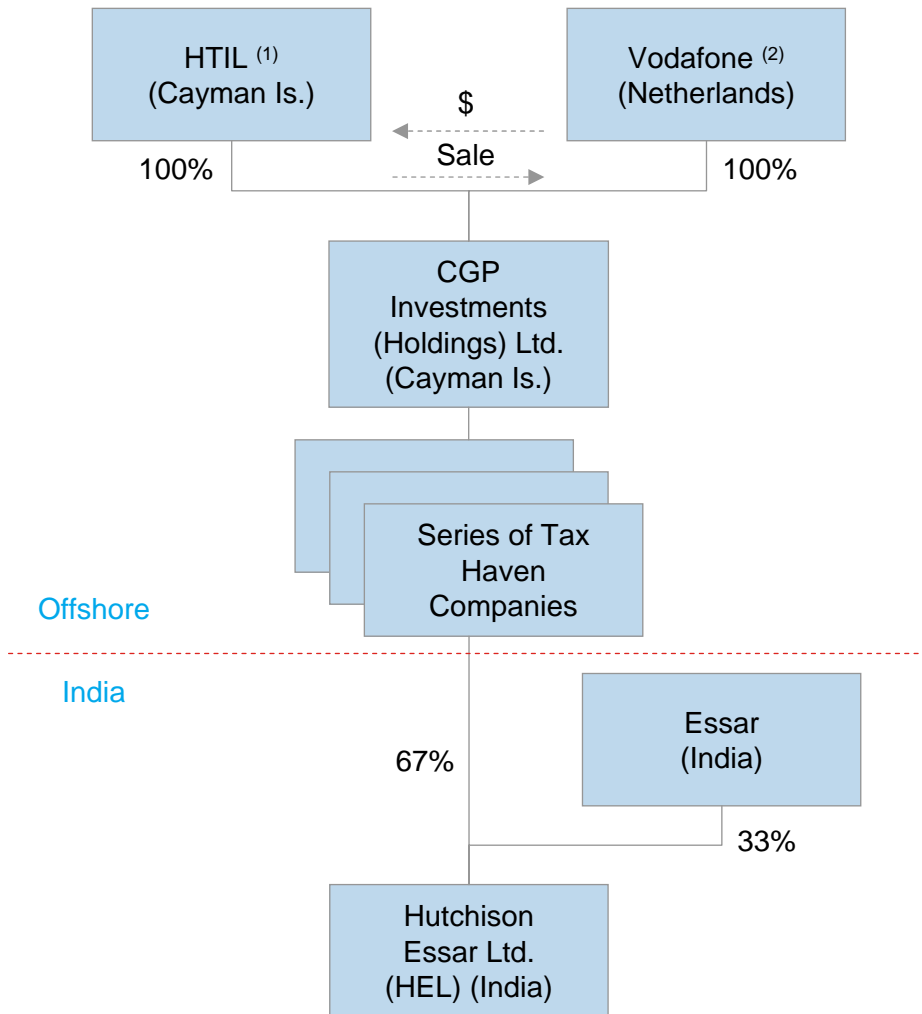
Circular issued by Director General of Taxation on August 22, 2008

- New definition of “beneficial owner” for tax treaty purposes
 - A beneficial owner is the actual owner of dividend, interest or royalty income, and the person entitled to directly enjoy the benefits of such income
- For the domestic taxpayer to withhold at a lower treaty rate, it must be certain that
 - The non-resident recipient of the income is a resident of the other Contracting State, as evidenced by a valid certificate of domicile; and
 - The non-resident is the actual owner of the income and the one entitled to directly enjoy the benefits of the income as mentioned in the treaty
- Unless both requirements are met, the domestic taxpayer must withhold tax at 20%

Indonesia—Disposal of Shares Through SPV

- Transaction value of shares in a foreign company domiciled in a tax haven country that acts merely as a SPV and holds shares of an unlisted Indonesian company, subject to final effective tax of 5% (20% tax rate x 25% deemed gain) on disposal
- Not specified how to determine whether a country is a tax haven
- Not apply if an applicable tax treaty gives the resident country of the seller an exclusive right of taxation
- Payable regardless of whether the gain is actually realized
- Obligation on purchaser to withhold tax if the purchaser is a tax resident of Indonesia
- If purchaser is a non-resident, the Indonesian company must account for the tax even if the transaction takes place abroad and may not be disclosed to the Indonesian company (as there is no change in the company's shareholders)

India—Vodafone (1)

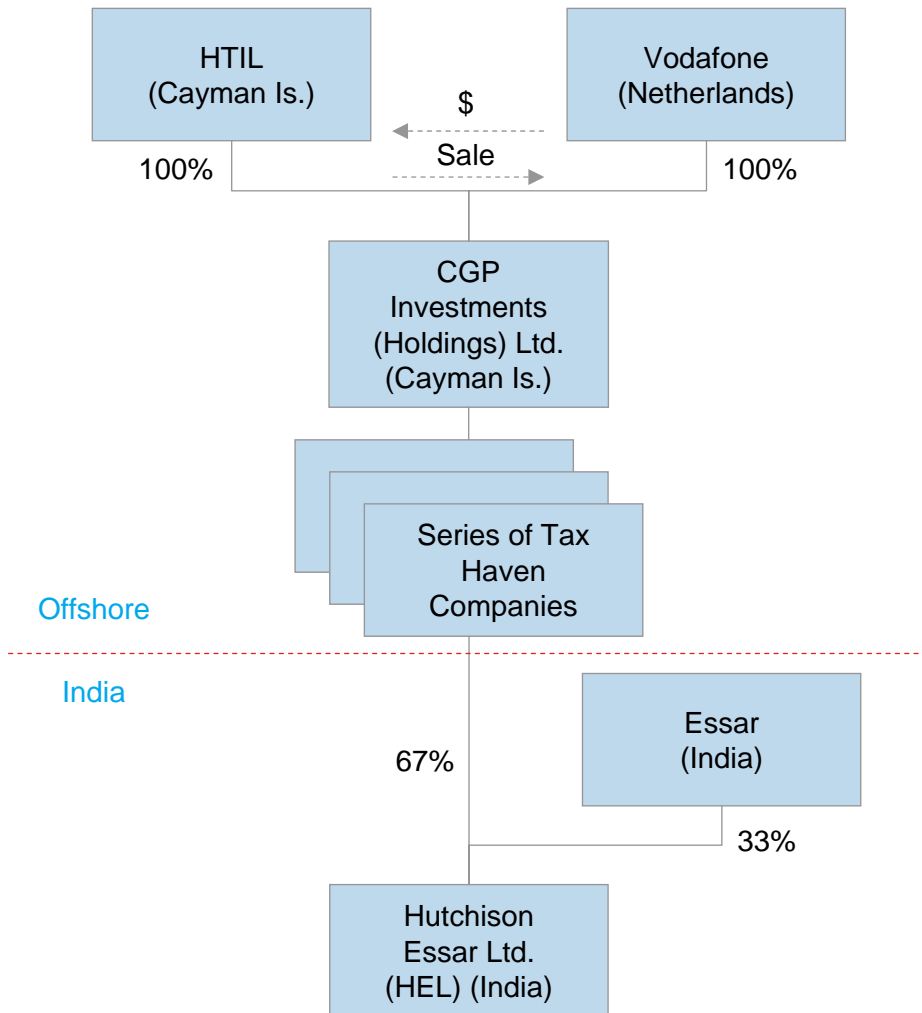


(1) Hutchison Telecommunications International Ltd.

(2) Vodafone International Holdings B.V.

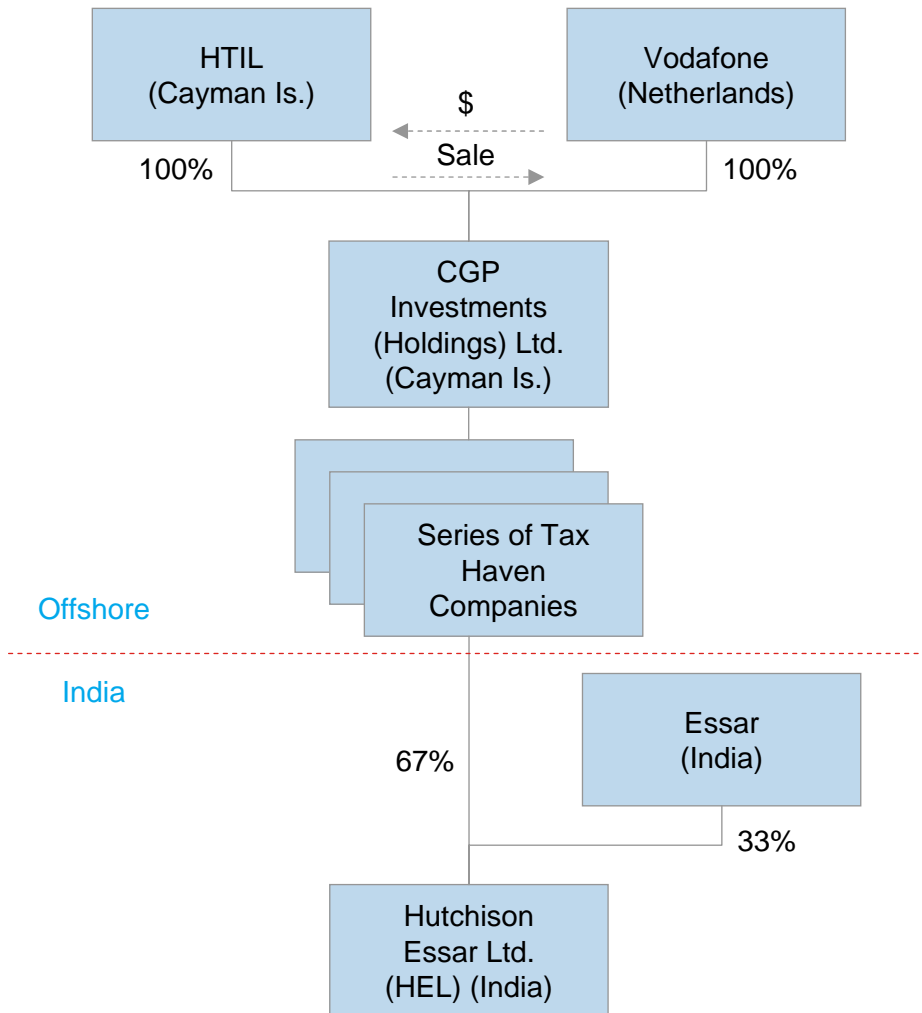
- Complex structure (simplified diagram shown)
- Hutchison Essar Ltd. (HEL) was a JV company of the Hutchison group (Hong Kong) with the Essar group (India)
- HEL obtained Indian mobile phone licence in 1994
- February 11, 2007: Agreement between HTIL and Vodafone for the sale of 100% of the shares in CGP Investments (Holdings) Ltd., subject to compliance with relevant Indian regulatory conditions
- Later in 2007: Conditions satisfied—sale is completed
- Vodafone does not withhold any Indian tax from purchase price paid to HTIL

India—Vodafone (2)



- September 19, 2007: Indian tax authorities issue a Show Cause Notice to Vodafone, requesting Vodafone to show cause as to why it should not be treated as an “assessee in default”; Vodafone was also requested to produce certain documents for adjudication in the matter
- Vodafone seeks (“petitions”) a judicial writ which would annul the Show Cause Notice
- Finance Act 2008: Retrospective amendment of sections 191 and 201 of the Income Tax Act. According to the Notes on Clauses in regard to these amendments, it is stated that each pre-existing provision “leaves room for an interpretation that a person required to deduct tax at source but not deducting the same will not be deemed an assessee in default” and that this was “contrary to legislative intent” and therefore a “clarification” became necessary
- High Court (Bombay): On December 3, 2008, court denies Vodafone’s claim
- January 2009: Vodafone appeals to Supreme Court. Supreme Court dismisses appeal

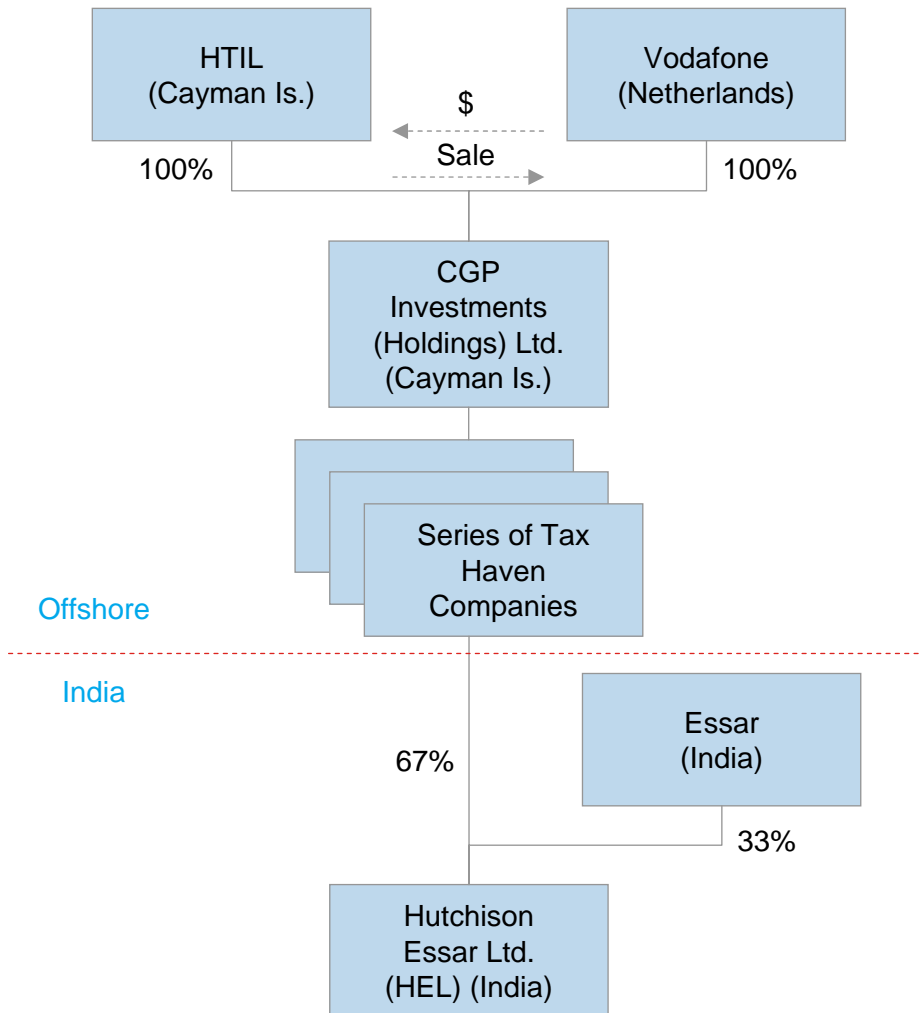
India—Vodafone (3)



Decision of High Court

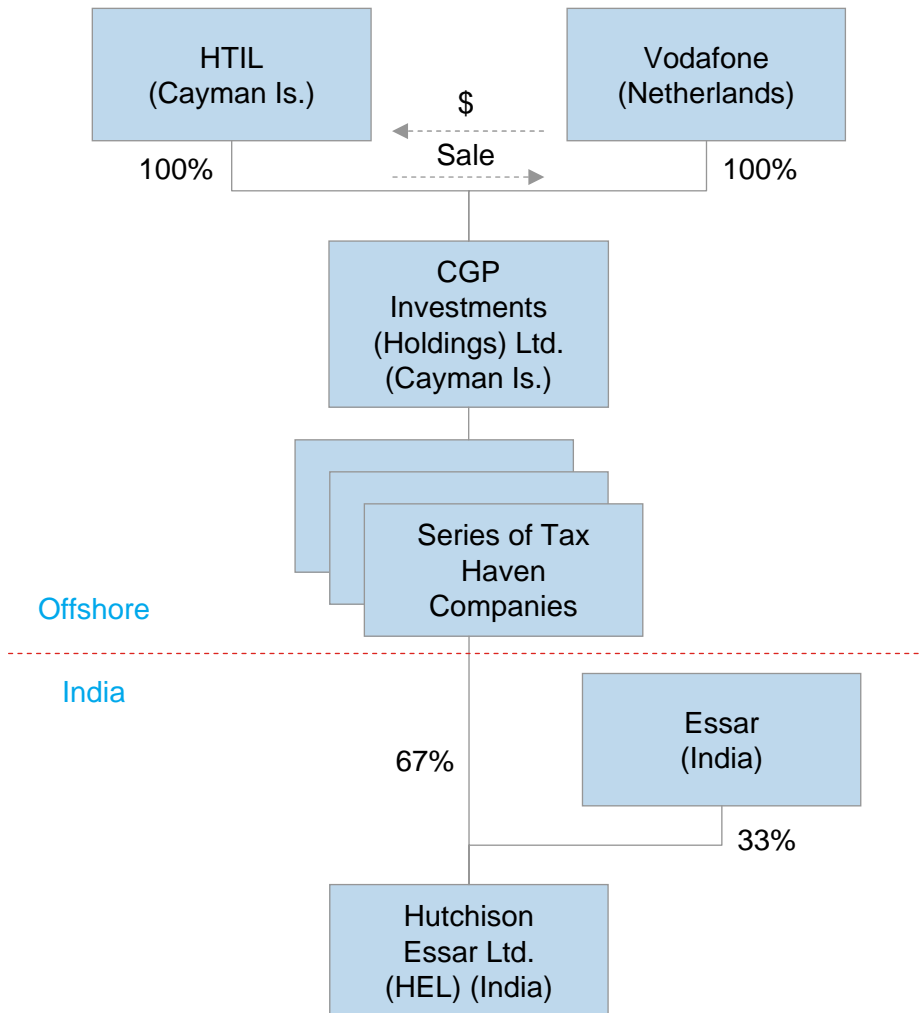
- Decision in favor of tax authorities, for two main reasons
 - The Court agreed that the Show Cause Notice indicates a prima facie case that the transaction gives rise to a tax charge
 - According to the Court, Vodafone has failed to produce certain documents for adjudication in the matter
- Prima facie case that the transaction gives rise to a tax charge: Per the Court “Prima facie, HTIL, by reason of this transaction, has earned income liable for Capital Gains Tax in India as the income was earned towards sole consideration of transfer of its business/economic interests as a group, in favor of [Vodafone]
- ...

India—Vodafone (4)



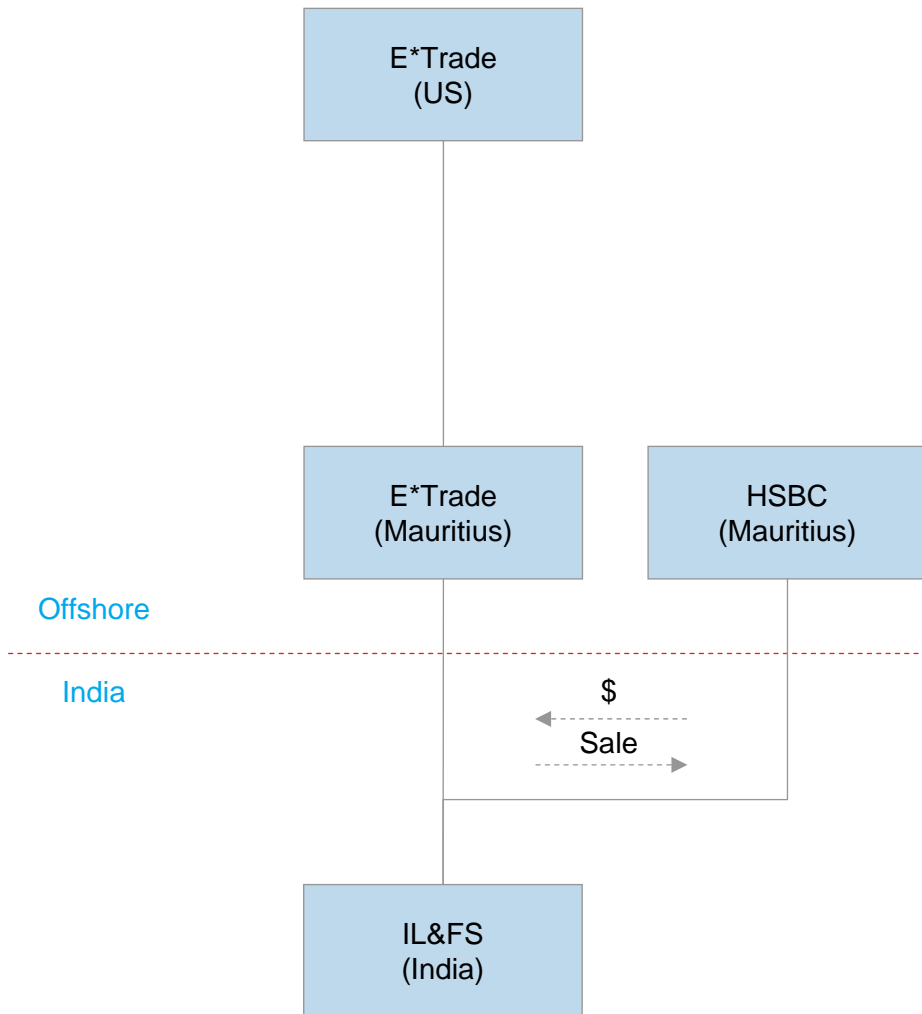
- “The subject matter of the present transaction between [Vodafone] and HTIL is nothing but transfer of interests, tangible and intangible, in Indian companies of the Hutch group in favor of [Vodafone] and not an innocuous acquisition of shares in some Cayman Islands Company, CGP Investments (Holdings) Ltd.
- “Shares in themselves may be an asset but in some cases like the present one, shares may be merely a mode or a vehicle to transfer some other asset(s). In the instant case, the subject matter of transfer as contracted between the parties is not actually the shares of a Cayman Island Company, but the assets (as stated supra) situated in India. The choice of [Vodafone] in selecting a particular mode of transfer of these rights enumerated above will not alter or determine the nature or character of the asset

India—Vodafone (5)



- “Prima facie, apart from the acquisition of controlling interest, [Vodafone] has acquired other interests and intangible rights. [Vodafone] accordingly became a successor in interest in the joint venture between HTIL and the Essar group and became a co-licensee with the Essar group to operate mobile telephony in India. The joint venture by itself confers an enduring benefit to [Vodafone]. Prima facie, [Vodafone] has not only become the successor in interest in that Joint Venture to HTIL, but also has acquired a beneficial interest in the license granted by the Department of Telecommunications in India to its group companies ...”.

India—E*Trade



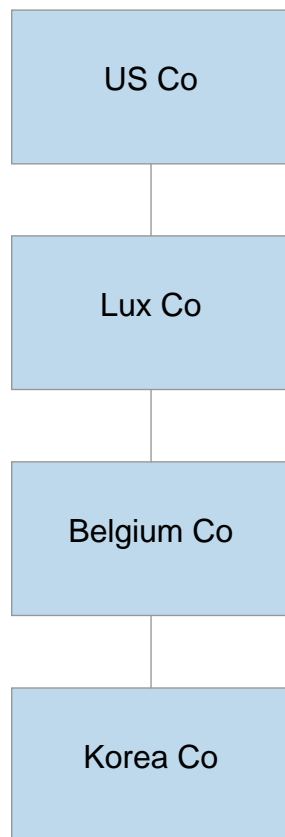
- E*Trade Mauritius sold shares of IL&FS to HSBC Mauritius
- E*Trade Mauritius sought to obtain a certificate from the Indian tax authorities authorizing payment of consideration by HSBC Mauritius without any withholding of tax
- Indian tax authorities refused to grant the certificate
- E*Trade Mauritius filed a writ petition before the Bombay High Court challenging this decision
- The High Court, on the basis of the consent of the parties, directed E*Trade Mauritius to file a revision application before the Director of Income Tax (“DIT”)
- Pursuant to the High Court’s order, the DIT, in his revisional decision confirmed that HSBC Mauritius is required to withhold tax
- The said order is in relation to the issue of withholding tax and not the final assessment

India—New Direct Tax Code (DTC)

- Draft Direct Taxes Code Bill 2009 provides that
 - Neither a double taxation avoidance treaty nor the Code shall have preferential status by reason of its being a treaty or law
 - In the case of a conflict between the provisions of a treaty and the provisions of the Code, the one that is later in time will prevail
- Draft Code would come into force on April 1, 2011 if enacted
 - May override all 75 tax treaties that India has entered into presently!

Korea

- Aggressive challenger of perceived treaty shopping
- Application of domestic anti-abuse rules
- Lone Star—Private equity gains

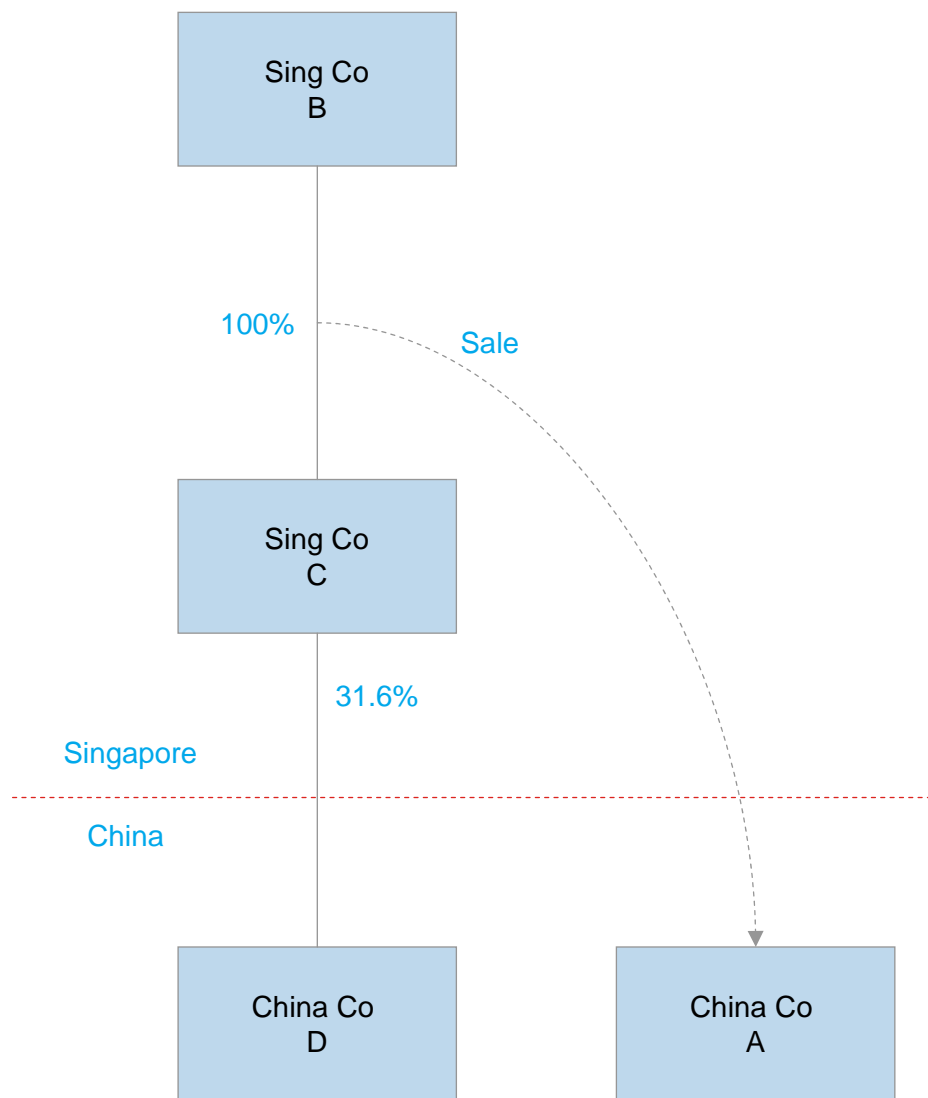


- 2006 Tax Law revisions
 - “Substance over form” rule in international transactions
 - Clarified doctrine applies to tax treaties
 - Special withholding tax procedures
 - Withholding tax on dividends, interest, royalties and capital gains derived by treaty residents in “blacklisted” locations
 - Such treaty residents either obtain upfront ruling from Korean tax authorities, or seek refund of withholding tax
 - Labuan blacklisted

China—Chongqing and Xinjiang Cases: Background

- 2008 China tax reform: General anti-avoidance rule (GAAR) introduced into Enterprise Income Tax Law
- January 2009: State Administration of Taxation (SAT) issues implementation regulations to interpret GAAR
- GAAR applies to these tax avoidance arrangements
 - Abuse of tax incentives
 - Abuse of tax treaties
 - Abuse of a company's legal form
 - Tax avoidance through a tax haven
 - Other arrangements without a bona fide business purpose

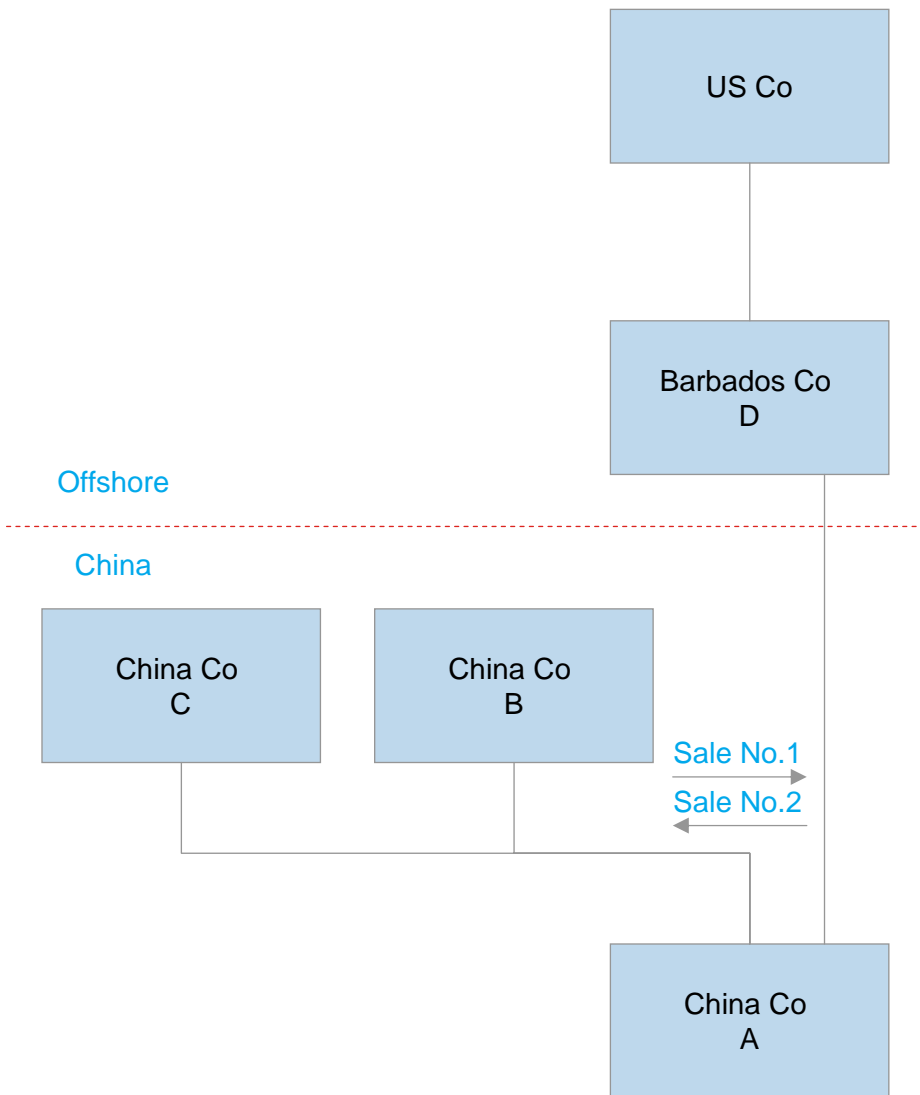
China—Chongqing Case



Chongqing Municipal Taxation Bureau (CMTB)

- November 2008: CMTB posts article on its website, purportedly describing a recent case
- Sing Co B owns 100% of the shares of Sing Co C
- Sing Co C has share capital of \$Sing 100. Its only asset is 31.6% of the equity in China Co D
- Sing Co B sells 100% of the shares in Sing Co C to China Co A, for a price of RMB63.38 million
- CMTB: In substance, Sing Co B sold the 31.6% equity in China Co D. Thus, the sale was subject to Chinese tax on capital gains
- CMTB article suggests that GAAR was the basis for the tax treatment

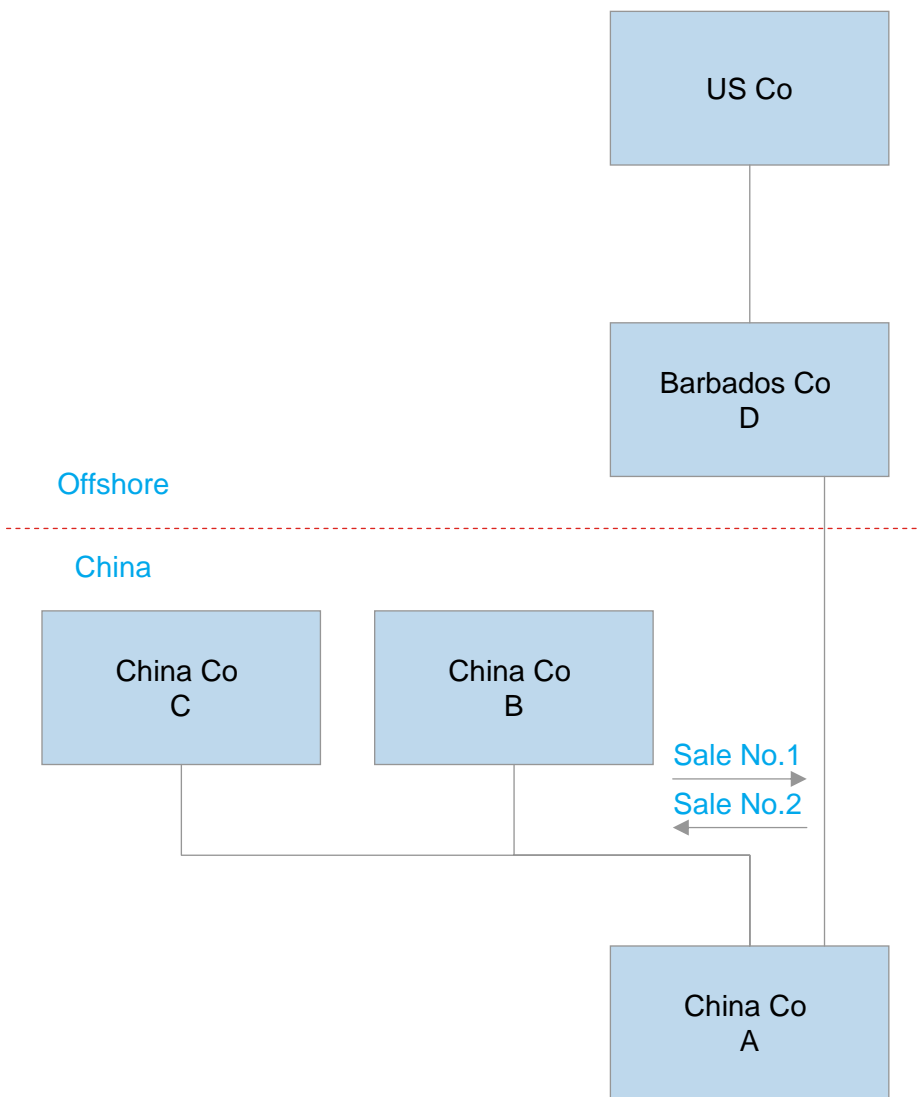
China—Xinjiang Case (1)



SAT Circular 1076 (December 2008)

- SAT Circular 1076 describes a recent case which purportedly occurred in Xinjiang
- May 2006: Barbados Co D incorporated in Barbados by a US group. Its three directors are all resident in the US
- July 2006: Barbados Co D enters into a joint venture agreement with China Co B and China Co C. Those two companies, between them, owned 100% of the shares in China Co A (an operating company in the oil and gas sector)
- July 2006: Under the JV agreement, China Co B sold to Barbados Co D a large portion of its shareholding in China Co A, for a price of \$US34 million
- June 2007: Barbados Co D sold to China Co B the same shares in China Co A, for a price of \$US46 million
- Thus, Barbados Co D derived a capital gain of \$US12 million

China—Xinjiang Case (2)



SAT Circular 1076 (December 2008)

- Barbados Co D claimed exemption from Chinese tax under Art.13 of the China/Barbados treaty, which gives exclusive taxing rights on capital gains from share sales to the residence country
- Definition of “resident” in Art.4 (1): “For the purposes of this Agreement, the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of head office, place of management or any other criterion of a similar nature”
- After an exchange of information with the Barbados tax authorities, the Chinese tax authorities concluded that Barbados Co D did not satisfy the definition of “resident” in Art. 4 (1)—thus, it cannot rely upon the exemption in Art.13

Lessons

- Structures which have no/limited economic substance are dead
- Substance
 - I. **Financial substance:** The financial capacity to bear the relevant risks
 - II. **Managerial substance:** Employees or directors who make the key decisions about assets and risks:
 - Assets: Whether to spend money (and how much) to acquire the asset, how much to spend to maintain the asset, how to best exploit or deploy the asset, etc.
 - Risks: Whether to take on the risk, how to best manage the risk, etc.
 - III. **Operational substance:** Employees or directors who are performing various functions—e.g. procurement, finance, accounting, HR, etc. That is, place as many activities as possible in the tax advantaged company
 - It is easier to place substance in a tax advantaged location, as compared with a tax haven
 - A company with substance, located in a tax haven/tax advantaged location, can continue to be useful in international tax planning

Questions and Answers

Please feel free to engage us and ask questions regarding the treasury related concerns.

Thank you.

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