

WALMART-FLIPKART DEAL

High-stakes tax fight in India can't be ruled out

Despite seeking treaties' cover, no guarantee won't be Vodafone-like scrap

SUMIT JHA
New Delhi, May 7

US-BASED RETAIL giant Walmart is most likely to encounter an aggressive Indian taxman, who could deny it a certificate of withholding tax waiver over the proposed mega deal to purchase a substantial stake in Flipkart from existing investors in the Indian online retailer. Walmart, tax experts said, could try and obtain a

■ Walmart could seek **nil-tax-liability** order from AAR, but even this doesn't guarantee relief

■ Tiger Global arms could seek protection under **grandfathering clause** in New Delhi's 2016-amended treaties with Mauritius/Singapore

■ If SoftBank takes US route, it may **delay deal till August 2019** so that capital gains are long-term and taxed less

nil-tax-liability order from the Authority for Advance Ruling (AAR) before going ahead with

the deal, but even that won't guarantee that the imminent purchase would not precipitate a high-profile Vodafone-like tax fight.

It is also possible that the US major is protected by a commercial indemnity clause, in which case it would be immune to an India tax cost from the deal.

At least one or even both of sellers — Tiger Global and SoftBank — may cite residency in a treaty-protected country to escape/reduce a capital gains tax liability here. (In case of a tax liability, the buyer withholds the tax while the burden is on the seller.)

Continued on Page 2

istered in Mauritius/Singapore and acquired their combined 21% stake in Flipkart before April 1, 2017, they could seek protection under a grandfathering clause in New Delhi's double taxation avoidance agreements with the two countries (the tax waiver is not available to shares purchased post the cut-off date, thanks to amendments to treaties at New Delhi's behest in 2016).

In the case of SoftBank, which purchased its near-21% stake in the online retailer in August last year, a two-year (April 1, 2017, to March 31, 2019) transitional phase when the tax rates will be half India's domestic rates could be available. However, if the Japanese venture capital firm chooses to carry out the stake sale to Walmart via a US-based arm (reports suggest so), the tax relief would not be available to it.

If SoftBank indeed takes the US route for the transaction, then it might delay the deal till August 2019, to be the recipient of long-term, rather than short-term capital gains, which is taxed at a higher rate. Currently, India taxes short-term (held for less than two years) capital gains from unlisted shares at 15%, while similar long-term (over two years) is taxed at 20% with indexation.

Under Section 9 (1)(i) of the Income Tax Act, "all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India or through the transfer of a capital asset situated in India" shall be deemed to accrue or arise in India and is liable for tax. This piece of law was amplified in 2012, after Vodafone episode where the government was caught on then wrong foot, by attempting retrospective taxation (the Supreme Court in January 2012 ruled in the telecom giant's favour, saying it was not liable to pay any tax over the acquisition of assets in India from the Hong Kong-based Hutchison).

As for the Indian tax

authorities, the avenue for tax revenue from the Walmart-Flipkart deal comes from the limitation of benefit clause under the protected tax treaties. An entity claiming residency in Singapore/Mauritius needs to prove "substance" in the claim by passing the motive and expenditure tests. The motive test is to prove that the primary purpose of deal (via the treaty protected country) is not to obtain the tax exemption. The expenditure caveat (investment threshold) is relatively easy to surmount.

"If the shareholders are protected by treaty between their country and India which exempts capital gains tax in India realised from shares other than shares of Indian companies, then even where the foreign company derives more than 50% of value from Indian assets, sale of shares of such foreign company in the hands of such shareholders may be protected by the provisions of the relevant applicable treaty," said Daksha Baxi, partner, Cyril Amarchand Mangaldas.

Some analysts also see Flipkart losing the "tax shield" on account of its accumulated losses owing to the proposed deal.

Under Section 79 of the IT Act, carry-forward and set-off of losses in a closely held company shall be allowed only if there is a continuity in the beneficial owner of the shares carrying not less than 51% of the voting power, on the last day of the year or years in which the loss was incurred. As the proposed transaction involves acquisition of more than 60% of Flipkart, in essence, more than 51% of shareholding shall not be beneficially held by same persons. Loss of the tax shield is something Walmart, as the buyer, has to be worried about and this also makes the case stronger for a delay in sale of stake by SoftBank. In FY16, Flipkart's loss was Rs 5,223 crore and this rose to Rs 8,771 crore in the subsequent year. "Walmart may perhaps decide to claim the continuance of tax shield thereby opening up

litigation at various levels," said Amit Agarwal, partner, Nangia & Co.

Delhi High Court dismisses govt's plea against Voda

"THE TRIBUNAL while deciding the said issue will take into account the defendants' (Vodafone) undertaking to this court that if the Union of India gives its consent, it would agree to consolidation of the two BIPA arbitration proceedings before the India-United Kingdom BIPA Tribunal," the court said.

Quoting Sundaresh Menon, Chief Justice of Singapore on International Arbitration, the HC said that where there is an investment treaty arbitration between a private investor and the state, national courts are divested of their jurisdiction.

It said that investment arbitration disputes are fundamentally different from commercial disputes as the cause of action (whether contractual or not) is grounded on State guarantees and assurances (and are not commercial in nature).

After the tax liability of over Rs 22,000 crore was imposed in 2012, Dutch firm Vodafone International Holdings had initiated the arbitration process under the India-Netherlands BIPA on April 17, 2014.

While the proceedings were pending, two other group firms — Vodafone Group and Vodafone Consolidated Holdings — initiated second arbitration under India-United Kingdom treaty as well on January 24, 2017.

The Centre then moved the HC alleging that the Vodafone Group had abused the process of law by initiating two international arbitrations. The second arbitration was stayed by the HC in August 2017, after the Centre sought an injunction on the ground that the two arbitration claims were based on the same cause of action and they seek identical reliefs, but from two different tribunals constituted under two different investment