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China: New Sino-French Tax Treaty

The new Sino-French tax treaty has been signed on November 26th 2013 and is currently being ratified by both countries. This new Sino-French tax treaty is to replace the old tax treaty which was signed by both countries on May 30th, 1984. If this treaty is ratified in 2014, its most realistic date of entry into force would be January 1, 2015. The new Sino-French tax treaty includes new elements of a modern double taxation treaty and has made several important changes to the old tax treaty. Below a brief overview of these important changes :

I. Permanent Establishment ("PE")

1. Building or Construction Site PE

To be consistent with other tax treaties concluded by China, the new tax treaty extends the scope of a Construction Site PE to "construction/building" and "related supervisory activities". In addition, the period to constitute a Building/Construction PE has been extended from 6 to 12 months.

2. Furnishing of Services PE

The required minimal period of furnishing services which amount to a PE has been changed from "6 months within any twelve-month period" to "183 days within any twelve-month period".

In practice, for tax treaty purposes, some tax authorities counted the "6 months" period by counting the presence of the personnel of the other contracting state (ie personnel from France working on the service project in China) for each calendar month, without taking into account the number of days the personnel stayed in China. This is the rationale behind many new tax treaties where the notion of the "183" days is used and replaces the "6 months" period. Thus, the qualification of a permanent establishment is now calculated on a daily basis.

3. Withholding Tax on Dividends

Under the old tax treaty, the withholding tax on dividends was not exceed 10% of the gross amount of the dividend. The new tax treaty stipulates that if the beneficiary owner of the dividends is a company which directly holds at least 25% of the capital of the company paying the dividends, a withholding 5% tax rate will be applied. Otherwise, the withholding tax rate remains 10%.

4. Withholding Tax on Interests

The withholding tax rate on interests has not been changed and remains at 10% in the new tax treaty with the exception for interest income received by certain financial institutions. The new tax treaty contains a longer list of institutions which have been added to the existing exemption list. For instance, in China, the China Development Bank Corporation, the Agricultural Development Bank of China, etc,

and in France, the *Banque Publique* d'Investissement and the *Caisse des Dépôts et* Consignation etc.

In addition, the definition of the term "interest" has also been modified. More specifically, "penalty charges for late repayment" and "payments for and kind received as a consideration for the guarantee or insurance of a debt-claim" are not be regarded as interest under the new tax treaty but rather deemed as "other income" as further stipulated in article 22 of the treaty.

5. Withholding Tax on Capital Gains

Under both the old and new tax treaties, gains from the alienation of shares or other rights of a company whose assets are mainly immovable properties can be taxed by the country where the immovable properties are located. The new tax treaty provides specific rules and criteria to determine whether the assets are mainly immovable properties, i.e. if more than 50% of the assets (directly or indirectly owned) are immovable properties at any time 36 months prior to the alienation.

As for the disposition of shares of other companies the source country has the taxation right if the recipient of the gain owns at least a participation of 25% in the capital of the company. The new tax treaty provides more specific rules on the participation of 25% by taking into account all shares directly or indirectly held at any time 12 months prior to the alienation.

6. Other Income

Under the old tax treaty, the source country generally has the taxation right over "other income" generated from that country. The new tax treaty changed the general rule so that "other income" of a resident of a contracting state shall be taxable only in that state.

7. Methods for the Elimination of Double Taxation

From a French perspective, there is one important change in the method of eliminating double taxation. For instance, the concept of "tax sparing credit" for dividends, interests and royalties received from China have been eliminated in the new tax treaty.

Under the old tax treaty and for royalties, the tax credit was calculated as spared taxes and amounted to 20% of the gross amount of royalties, even though the said royalties were subject to a withholding tax of 10%. This practice has been abandoned in the new tax treaty and only the actual taxes paid in China by the French company are taken into account in order to determine the applicable tax credit in France.

To avoid the negative impact of the new tax treaty, a 24-month transitional period (starting from effective date) has been provided for royalties.

Based on the above, in order to benefit from these measures, it would be interesting to put in place a tax planning. For instance, the said planning can delay the distribution of dividends in order to benefit from the withholding tax rate of 5% based on the new tax treaty. It can also be planned to royalties be paid to the French company within the transitional 24 months period. However, it is highly recommended that such planning be made with the assistance of a tax specialist avoid or mitigate the risks of being challenged by tax authorities.

India: Taxation of Indirect Transfers of Securities within Indian Companies: the term "substantially" clarified

On 20th January 2012, the Supreme Court of India issued the landmark Vodafone decision[1]. This decision pertains to tax regime of indirect transfers of securities of Indian companies, and concluded that transfers, by a non-resident to another non-resident, of shares of a foreign company holding an Indian subsidiary company does not amount to transfer of any capital asset situated in India and that gains arising from the said transaction were not subject to tax in India.

In the wake of this decision, the Finance Act, 2012 had amended Section 9 of the Income Tax Act, 1961 ("ITA"), so that the income deemed to be accruing or arising to non-residents directly or indirectly through the transfer of a capital asset situated in India is to be taxed in India retroactively from 1 April 1962. Thus, this legislative measure negated the decision of the Supreme Court of India.

Explanation 5 to section 9(1)(i) of the ITA (also inserted by the Finance Act, 2012) specifies that, for the purpose of this section, a capital asset will be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

The provisions being hastily introduced as a reaction to the Vodafone decision, the meaning, scope and extent of the word "substantially" were not clarified in the letter of the law.

In this context, a recent judgment from the Delhi High Court in the case of DIT v. Copal Research Limited and Ors. (W.P. 2033/2013 – 14 August 2014) has brought some much needed clarity on the meaning of the word "substantially".

According to the High Court, Explanation 5 has been included in order to clarify the situation and must be read restrictively. The expression "substantially" should be interpreted to mean "principally", "mainly" or at least "majority". Thus, the High Court held that, having that in mind, gains arising from sale of shares of a company incorporated overseas, which derives less than 50% of its value from assets situated in India would not be taxable under section 9(1)(i) of the ITA.

To interpret the term "substantially" and set this 50% threshold, the Delhi High Court relied on several sources:

[1] Vodafone International Holdings B.V v. Union of India & Anr (civil appeal No. 733 of 2012)

(i) the object of Section 9 of the ITA itself which is to tax income having nexus with India irrespective of whether the same was reflected in a sale of an asset situated outside India but not to include income which has no territorial nexus with India; and

(ii) international sources (such as the OECD Model Tax Convention on Income and Capital as well as the UN Model Tax Convention) and domestic sources (the Shome Committee Report and the Direct Tax Code, 2010) where the term "substantially" was considered to be a threshold of 50% of the total value derived from assets of the company or entity.

This decision provides much-needed clarity to foreign investors whose trust was shaken by the actions undertaken by the then government to counter the Vodafone decision. It will be interesting though to see how the Explanation 5 is interpreted by other courts and whether the government will overrule this decision with the Direct Tax Code, which is currently being drafted (released for public comment) and which provides for a threshold of 20%.

Japan - Squeezing out Minority Shareholders, Easy as Pie?

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Keeping minority shareholders in the share capital of a publicly traded company following a successful tender offer can often be a source of difficulties in a take-private context. Minority shareholders can be a nuisance, at the very least they can prevent the target company and its majority shareholder from making use of the flexible management and company law tools available to those who have acquired full control. Compliance, corporate governance and the management of conflicts of interests between a parent company, its subsidiaries and the latter's directors appointed upon the nomination of the former but owing fiduciary duties to the latter require greater attention. Lawyers have been very creative over the years to devise means of getting rid of minority shareholders, the validity of these eviction schemes being sometimes questionable from a legal standpoint. A number of alternatives are available to effect a squeeze out in addition to a direct purchase of their shares from the minority holders (making sure that step does not in itself trigger the obligation to launch a tender offer), namely share-for-share exchanges, including through the - so far - largely theoretical triangular mergers, transactions in which the minority shareholders receive shares of the acquirer or its parent company in exchange for their own shares; cash-out mergers and cash-for-share exchanges, in which shares are exchanged for cash; and the use of so-called "wholly callable shares" ("*zenbu shutoku joukoutsuki shurui kabushiki*") which option has so far proved to be the most effective in terms of outcome and the most tax efficient. Under this scheme, the shares of common stock of the target company are first converted into wholly callable shares that can be called/redeemed by the issuer. Having been re-characterized as callable shares following the approval of at least two-thirds of the target company's shareholders at a shareholders' general meeting, the shares are then redeemed by the target company. Compensation is not paid in cash but in

kind, using another class of shares as consideration. The exchange ratio is set in such a manner that minority shareholders can only receive a stock split/fractional share instead of whole shares. Cash is paid to the minority shareholders in lieu of the fractional shares (in the process, a court needs to approve the cash consideration paid to them for the fractional shares). Dissenting minority shareholders have the right to challenge the share valuation before the court within 20 days of the decision of the aforesaid shareholders' meeting (Companies Act, Article 172) subject to certain conditions. There are therefore possible pitfalls to bear in mind when resorting to wholly callable shares as disruption of the process may cost time and money (e.g. in the event of the challenge of the appraisal initiated by shareholders "supported" by the courts). These potential fair market value and share appraisal method-related issues are illustrated by two notable cases, the Rex Holdings case and the Cybird Holdings case, both in an MBO context.

In June 2014, amendments to the Companies Act introduced a new scheme to squeeze out minority shareholders by facilitating their cashing out. These amendments are expected to come into force by the end of 2015 at the latest. They do not seek to replace the callable share scheme or the other ways to squeeze out minority shareholders, which methods will still be available, but they provide an additional method to gain full control over a target. The new method will be available to shareholders qualifying as a so-called "Special Controlling Shareholder" ("*tokubetsu shihai kabunushi*"). This shareholder is defined as a natural or juristic person controlling not less than 90% of the total voting rights of the target company; in the case of a juristic person, control is achieved either alone or together with its wholly-owned subsidiaries. Under this method, the Special Controlling Shareholder can proceed with a cash squeeze out of the minority shareholders through the exercise of a conditional call option over all of outstanding shares and securities giving access to the share capital (*e.g.*, stock options and warrants) of the target company not yet owned by the Special Controlling Shareholder, excluding treasury shares. The call option is granted automatically by operation of law to the acquirer qualifying as a Special Controlling Shareholder. No contact/negotiation or - due to the statutory nature of the grant - contractual documentation with the minority shareholders is required and there is no prescribed deadline for exercising the option. In order to exercise its option, the Special Controlling Shareholder must first notify the board of directors of the target of its intention to exercise it and provide basic information (*e.g.,* tentative completion date and purchase price) and request the board to accept the call and the proposed terms. Should the board agree thereto, it must inform the minority shareholders at least 20 days before the contemplated share transfer completion date. Oddly enough, the board is required to act on behalf of the minority shareholders to protect their interests (and if need be negotiate accordingly) while the duties of the directors are normally owed to the target company as opposed to a specific group of shareholders. To implement this procedure, which is in principle much lighter than the callable share scheme, there is no need for the acquirer to cause the target to hold a shareholders' meeting to re-characterize the target company's shares, alter the articles of incorporation, etc. or

to get court approval to cash out the minority shareholders. Dissenting shareholders nonetheless still have a number of remedies available to them: they can seek an injunction to thwart the exercise of the call; they can exercise their appraisal rights under article 172 and petition the courts to determine the fair market value of their shares; or they can sue the target company's directors for breach of their fiduciary duties arising from the wrongful approval of the option exercise. The latter remedy in particular and more generally what can be considered as fertile ground for conflicts of interest may act as a deterrent for boards to accept the exercise of the call option although a number of safeguards do exist or should be put into place. In any event, these have been long awaited amendments and although there are pros and cons and potential pitfalls, this new route appears to be a step forward in the right direction. Only time will tell.

Singapore: Labor Law Reform: the Fair Consideration Framework

On September 23rd 2013, the Ministry of Manpower (MOM) announced new rules known as the Fair Consideration Framework (FCF). Effective as of August 1st 2014, the FCF requires employers to consider Singaporeans fairly before hiring Employment Pass (EP) holders. The Key features of the FCF are the followings:

- MOM expects all firms to consider Singaporeans fairly for jobs, based on merit. All firms are strongly encouraged to advertise their job vacancies and must ensure that jobs advertised are open to Singaporeans;

- firms making new EP applications must advertise the job vacancy on a new jobs bank administered by the Singapore Workforce Development Agency (WDA). The advertisement must be open to Singaporeans, run for at least 14 calendar days and comply with the Tripartite Guidelines on Fair Employment Practices (TAFEP). The TAFEP aims to promote the adoption of fair, responsible and progressive employment practices among employers, employees and the general public.

For practical reasons, MOM has decided to exempt the following jobs from the advertising requirement:

- jobs in firms with 25 of fewer employees;
- jobs that pay a fixed monthly salary of S$ 12,000 and above;
- jobs that are necessary for short-term contingencies (i.e. period of employment in Singapore for no more than one month).

At this stage, we can conclude that this new regime is not so constraining as companies are not obliged to interview the possible Singaporean candidates after the opening of their advertisement.

Vietnam: Expanded Foreign Contractor Withholding Tax Regime

The Foreign Contractor Tax (FCT) is the principal mechanism by which Vietnam taxes foreign entities and individuals who do business in or receive income from Vietnam by signing commercial contracts with Vietnamese contracting parties. It is usually withheld from payments made to such foreign entities and individuals by their Vietnamese contracting parties.

Vietnam's Ministry of Finance issued a new Circular on August 6th 2014 which modifies the scope of application of the FCT. This Circular will be effective on October 1st 2014 and extends the foreign contractor withholding tax rules to additional entities such as:

- Foreign entities and individuals distributing or supplying goods in Vietnam under terms whereby the seller bears the risk until the delivery of the goods within Vietnam;
- Foreign entities and individuals who remain owners of the goods being supplied, bear the costs of distribution, marketing and advertising, are responsible for the quality of goods/services, and have the authority to establish the selling price;
- Foreign entities and individuals who conclude contracts in their names via authorized Vietnamese entities or individuals;
- Foreign entities and individuals who exercise their import/export rights and distribution activities in Vietnam, or trade goods for export or sell goods to Vietnamese merchants.

Furthermore, this Circular states that the use of customs bonded warehouse or Inland Container Depot (ICD) port to store goods for international transport, transit, transshipment or for further processing by another Vietnamese company shall not be subject to FCT.

Commercial contracts should be therefore carefully reviewed to determine whether the FCT is applicable or not under Vietnamese regulations and by taking also into consideration the impact of any applicable double taxation avoidance agreement.