NATIONAL FOREIGN TRADE COUNCIL, INC.

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July 17, 2009

Honorable Mr. Pranab Mukherjee
Finance Minister
Ministry of Finance
North Block
New Delhi

Dear Minister,

The National Foreign Trade Council, organized in 1914, is an association of some 300 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and our members have for many years been substantial investors in many countries. U.S.-based multinational companies in particular have a history of robust investment in India, where our investors have created significant jobs and wealth. We are writing to express our concern about a recent shift in the approach of Indian revenue authorities towards the taxation of cross-border investment that seems at odds with the efforts of the Government of India to liberalize India's foreign investment policies.

NFTC Member Concerns

A number of our members have observed that over the past 24 months the Indian revenue authorities have begun to argue that India is entitled to tax certain capital gains on global mergers and acquisitions taking place outside of India. The particular circumstances where this is argued involve a transfer of shares in a non-Indian company between two non-Indian residents, where some part of the transactional value is attributable to underlying Indian assets. Furthermore, it seems that the revenue authorities are trying to apply this to already completed transactions (e.g., in the Vodafone – Hutchison matter). Thus, the revenue authorities are seeking to recover the tax from non-resident buyers who, they assert, were required to withhold the tax from the consideration paid to sellers -- even if the buyers and sellers have no connection with India. The revenue authorities have sought to support this position with retrospective tax legislation enacted in 2008.

These types of transactions have been commonplace for many years, but have never been subjected to tax in India in the past. Indian tax laws have not been amended in relation to such transactions, so the new approach is based on a novel interpretation of existing provisions.

The new approach is novel not only in relation to long-standing Indian interpretation but also compared to generally accepted norms of international taxation. Very few countries seek to tax transfers of shares in foreign companies merely because the companies have underlying assets in country. Such measures are widely regarded as inappropriate due to their extraterritorial scope. A study of tax regulations in some developed jurisdictions (the UK, USA, France, etc) shows that none of them tax transfers of overseas holding entities merely because the companies have underlying assets in these jurisdictions. Some jurisdictions do have specific and overt legislative provisions to tax such gains in specific circumstances; Indian laws do not contain any such provisions. This departure from international norms could give rise to substantial double taxation of the same gains. By taxing extraterritorial income, multiple governments could claim the right to tax such income with no guarantee that there will be a credit for another country's taxes. We believe that such actions are contrary to existing international tax norms and they create significant barriers to the free flow of capital and investment.

Our members believe that this sudden and significant shift in interpretation of long-standing provisions, coupled with retrospective amendments to tax laws and regulations, creates an appearance of unfairness and is likely to cause continued controversy. It creates an impression among foreign investors that investing in India brings with it a significant risk of tax liabilities arising from unforeseen new interpretations of tax laws and retrospective tax changes. Our members will have limited funds to invest overseas in the next few years, and this new interpretation may cause several of them to reconsider investing in India, looking instead to other countries which have not taken this position and which act in a perceived less arbitrary manner in taxing foreign investors.

We are also concerned that the new approach taken by the revenue authorities to the taxation of cross-border transactions is undermining the efforts of the Government of India to liberalize India's foreign investment policies. Such liberalization has encouraged the inflow of foreign investment to fund infrastructure projects and has created jobs and yielded robust economic growth. However, investors seek stability and certainty in a country's tax regime, and the current approach of the revenue authorities is affecting the confidence of foreign investors.

NFTC Member Recommendations

In the light of the above, NFTC Members urge the Government of India to move swiftly to undertake a policy review of whether taxation of the transactions in question is appropriate. If, following such review, the Government of India remains convinced that these transactions should be taxable in India, our Members believe that the necessary changes should be made to the laws with prospective effect only, rather than through retrospective changes in interpretation of current law or application of withholding tax provisions.

Our members would be very pleased to work with you on this matter.

Yours sincerely,

William A. Reinsch
President

cc:

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