ASTREA LEGAL ASSOCIATES LLP

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CROSS BORDER TRANSACTIONS

By: Neha Mishra

Introduction

Cross Border Transaction services means services related to transaction which involve two or more countries. In India there are two Acts which primarily seems to show concern when a person (Indian Resident or foreign Resident) undertakes cross border transactions viz. 1) **Foreign Exchange Management Act, 1999** and 2) **Income Tax Act, 1961.**

Types of Cross Border Transactions

- **Cross-Border Financing:** This term refers to any financing arrangement that crosses national boundaries. Cross border financing could include loans, letters of credit or bankers acceptances, Bank guarantees, depositary receipts etc.
- **Buying or Selling Products & Services:** This term refers to any buying or selling activities of

products or services. Both may have different features with respect to infrastructure, permanent establishment, producing product or services outside the one's jurisdictional area, trading across the borders, bridging between local resources and outside supply etc.

- **Combined research/ shared services:** In present business styles, entities are finding it fancier to have a shared service point. Entities are introducing joint research programs for entire industry as one cartel or chamber of commerce or group of commerce. This type of arrangements of shared service centers are also concern matter in international trade if those shared service centers providing services across the borders scattered in different locations. They are very useful to outsource the routine work in less expensive areas.

Furthermore, the following things may be consider before entering into a Cross-Border Transaction:

- Advance ruling.
- Legal compliances.
- Contract with States.
- Change in Law (An exit route in case of change in 'Laws of the Land').
- Choice between Liaison office set up or Branch office set up or subsidiary incorporation
- Taxation Direct and Indirect.
- Transfer pricing.
- International taxation and applicable foreign laws.
- Corporate tax planning.
- Accounting and financial analysis.
- Currency and Repatriation Issues.

The Indian Scenario

In India, Reform initiative has been taken in the field of investment, trade, financial sector, exchange control simplification of procedure. India provides liberal, attractive and investor friendly environment to investors. The world is looking at India as an attractive destination with strategic incentives and lucrative commercial advantages. As compared to other developed markets, the India is largely under penetrated with a huge potential for growth.

As more and more investments are coming in India the clarity on regulatory and taxation front also strengthened. In India taxation system is under the Department of Revenue, Ministry of Finance. Taxability of income is determined by Indian Income Tax Act, 1961. With the countries with which Indian Government have signed Double taxation avoidance agreement in that cases the taxability shall be determined by Indian Income Tax Act, 1961 read with DTAA. As per **section 90(2) of the Act** an assesse has an option to choose from ACT or DTAA whichever is more beneficial to him.

Foreign companies engaged in business activities in India become liable to Indian Income Tax. According to **Sec. 5 (2) Indian Income Tax Act, 1961 ("ITA")** nonresident companies are taxable in respect of the income received or deemed to be received, accrued or deemed to have been accrued or arisen in India. This definition covers income accruing or arising or and also deemed to have accrued or arisen to a non-resident whether directly or indirectly, through or from any business connection in India**, Sec. 9 ITA**.

The term "Business Connection" involves a relationship between the business of the assessee and some activity in India which contributes directly or indirectly to the earning of profits and gains by the assessee from his business. This is a very broad definition rendering almost any activity of a nonresident entity subject to tax in India. It is however required to be read with **Double Taxation Avoidance Agreements (DTAAs)** entered into by India with respective countries.

The DTAAs aim at restricting the right of a state to levy tax on income received by a nonresident entity from business activities pursued in that state. According to national Indian tax law, the provisions of a DTAA apply if they are beneficial for the foreign entity (“assessee”), Sect. 90 (2) ITA.

Any foreign entity may ask for an advance ruling with respect to any activity/ investment in India before starting such activity. Such advance rulings are precisely applicable to the parties of advance ruling and concerned tax authorities and it helps in limiting the dispute and tax liabilities.

Due Diligence before Cross Border Transactions

The Due diligence checklist before entering into a cross-border transaction is a wide list of several essential elements to be kept in mind by the transacting states/Parties:

I. Legal and Regulatory Measures

- detailed schedule of all ongoing, pending and threatened action, arbitration, audit, examination, investigation, hearing, litigation, claim, suit, administrative proceeding, governmental investigation, or governmental inquiry affecting the Entity, its assets or operations.
- Copies of all correspondence, reports to and filings with all regulators, including but not limited to the Securities & Exchange Commission, state securities authorities, foreign securities authorities, Environmental Protection and the ministry of Commerce.
- Copies of all notices of legal or regulatory violations and

infringements including correspondence, reports, notices, and filings related to any dispute, alleged violation or infringement by the Entity, its agents or employees of any local, state, federal or foreign laws, regulation, order or permit relating to employment violations, unfair labor practices, equal opportunity, bribery, corruption, occupational safety and health, antitrust matters, intellectual property and environmental matters.

- All local, state, federal and foreign approvals, authorizations, certifications, clearances, licenses, permits, registrations and waivers related to the Entity, its operations or assets.
- A detailed schedule of all breaches or defaults that have occurred under agreements to which the Entity is a party, including all agreements which would be affected by the contemplated transaction.
- A list of expenses by the entity under the schemes of corporate social responsibilities during last 3 years along with description of ongoing social programs by the entity.

II. Securities & Investments

- A detailed schedule of companies in which the Entity holds an interest of 2% or more.
- Copies of all offering circulars, private placement memoranda, syndication documents, or other securities placement documents, prepared or used by the Entity over the last 3 years.
- Copies of contracts, agreements or engagement letters with investment bankers, finders, business brokers or other financial advisers pursuant to any contemplated financial transaction over the last 3 years.

III. Contracts

- A detailed schedule of all subsidiaries, partnerships, joint ventures and strategic alliances along with copies of all related agreements.

- Copies of all contracts between the Entity and its officers, directors, shareholders and affiliates.
- Copies of all loan agreements, bank financing agreements, lines of credit, promissory notes, guarantees, security agreements, mortgages, indentures, collateral pledges or other contracts with creditors.
- Copies of all contracts related to sales, agency, franchise, dealer, marketing or distribution agreements or arrangements, supplier or vendor agreements.
- Copies of all performance assurance agreements, non-compete agreements by/ for the entity.
- Copies of all licensing agreements, franchise agreements and conditional sales agreements.
- Copies of the Entity's standard quote, purchase order and invoice forms, including standard terms and conditions.
- Copies of any understanding, letters of intent, contracts, agreements, or closing documents related to any acquisition or disposition of corporate shares, companies, divisions, businesses, or other significant assets by the Entity.

IV. Financial

- All annual and quarterly financial statements for the last 3 years for the Entity and all its subsidiaries, if any, along with latest available interim financial information.
- A detailed description of all accounting policies, including depreciation methods. A schedule of any changes in accounting policies, principles or procedures in the last 3 years, including justifications for such changes.
- Details and descriptions of any extraordinary or non-recurring items appearing in the financial statements along with detailed schedule of all deferred income items during last 3 years.
- A detailed schedule of all off-balance sheet transactions

including lease liabilities and credit derivatives.

- A detailed description of the Entity's internal controls. All available entity-wide departmental budgets for the last 3 years.
- Details of all transactions between the entity and its subsidiaries, parents, or other related parties.
- A detailed schedule of long term investments, including shareholding, bonds and debt instruments along with statements of terms and condition related to Investments.
- A detailed schedule of all property, plant and equipment, including acquisition cost, accumulated depreciation and depreciable life.
- A detailed schedule of all contingent liabilities, litigations and suits.
- The latest financial projections and estimates for the Entity and its subsidiaries, including a discussion of assumptions made.
- The latest available capital budget, including a discussion of essential, non-essential and strategic investments.
- A detailed schedule of all cash holdings and short-term investments.
- A detailed aged schedule of accounts receivable by customer and geography along with confirmatory letters from debtors acknowledging their debts as far as possible.
- An analysis of the entity's monthly breakeven cash flow, broken down by fixed and variable cash inflows and outflows.
- A detailed schedule of revenues and cost of sales broken down by customer, geography, and product for the last 3 years.
- A detailed schedule of selling, general and administrative expenses by division, subsidiary and geography for the last 3 years.
- A detailed schedule of all capital expenditures for the last 3 years, including a description of each major expenditure and abandoned projects, if any.

- A detailed schedule of all accounts payable by vendor. A detailed schedule of all outstanding notes payable, bonds, mortgages and other long term debts along with terms and conditions thereof.

V. *Credit Facilities*

- A detailed schedule of all long-term debt facilities, including capitalized leases, guarantees and other contingent obligations, along with copies of all related documents.
- A detailed schedule of all short-term debt facilities, including capitalized leases, guarantees and other contingent obligations, along with copies of all related documents.
- Copies of all correspondence with lenders including consents, notices, waivers of default, and compliance certificates.

VI. *Taxes*

- All local, state, federal and foreign tax returns and filings along with all documents related to compliance with tax laws and regulations for the last 3 years.
- All correspondence with local, state, federal and foreign tax authorities including audits, notices of proposed or final adjustments to the Entity's tax liabilities for the last 3 years.
- Assessment orders from the tax authority received in the past 3 years.
- All agreements, consents, elections, requests, rulings, settlements and waivers made with any local, state, federal or foreign tax authority in the last 3 years.
- All tax opinions received from attorneys, accountants or other specialists for the last 3 years.
- A detailed schedule of all tax liabilities, tax basis of all assets, its accumulated depreciation and the depreciation method used.
- Detailed schedules of all tax carry forwards and carry backs, including their source, their

expiration dates and any limitations on their use.

- A detailed schedule of all tax free transactions not listed on the Entity’s tax returns.
- A description of transfer pricing methodologies and description of advance ruling, if any.
- A detailed schedule of all tax liens against the Entity’s assets.

LAWYERS

Manish Modak

Partner

Email id: manishmodak@astrealegal.com

Expertise: IT, Retail, Due Diligence, Licence and Registration, Transaction, Asset Management, FDI, Risk, Assessment, Election Laws, Corruption and Bribery Laws, Adoption, Legal Strategy.

Parvez Mirza

Sr. Consulatant

Email id: parvez@astrealegal.com

Expertise: Appellate, International Law, Criminal Laws, Muslim Laws, Immigration, Cyber Crime, Identity theft, Mass tort, Mining & Metal.

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EMAIL AT: www.astrealegal.com

QUICK CONTACT: +91 9822720483, +91 020 – 65108782