Offshore transfer of shares: May Vietnam take the "Vodafone Approach"?

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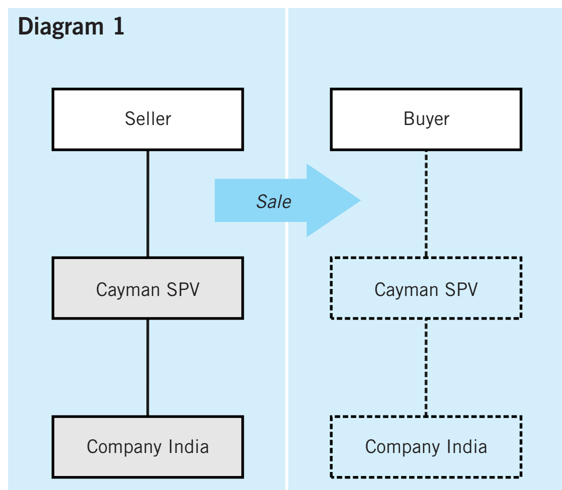
The decision of the Indian Supreme Court in the *Vodafone* case earlier this year (January 23, 2009), with tax regulations on the same issue in Indonesia and China, has woken up the Asian tax community to a significant new tax problem.

The problem relates to the taxation of gains from a transfer of shares in an onshore company by foreign investors, be it shares in an Indian, Chinese, Indonesian, or Vietnamese company. For years, it was assumed that an onshore company in an Asian jurisdiction could be transferred indirectly, i.e. by transferring the foreign holding company of that onshore company. Most often, a foreign Special Purpose Vehicle ("SPV") would be setup just to hold the shares of the onshore company, exactly for that purpose. Such an indirect transfer, it was assumed, does not trigger any local taxes in the country where the onshore company is established because there is no direct transfer in the shares of that onshore company. The shares of the onshore company are transferred, indirectly, by the transfer of the offshore SPV.

Take India as an example. The transfer of shares in an Indian company by a non-resident shareholder would be a taxable gain in India. So, one would prefer not to transfer the shares of the Indian company itself. In the *Vodafone* case, the participation that was being transferred was held by a Cayman Islands holding company. It was this Cayman Islands holding company which was transferred, not the Indian shares.

The Indian tax authorities did not accept that no Indian taxes would apply to this highly publicised transaction and challenged the structure. From their perspective, the buyer had a duty to apply a withholding for income sourced in India. Under section 9 of the Indian Income Tax Act deems that income from the transfer of a capital asset in India is "income arising in India". The purpose of the sale was to transfer the business and economic interests of the Indian company, not the sale of the SPV, the tax authorities argued.



The decision of the High Court of Bombay in the case shocked the international tax community. Indeed, according to the Court the transfer of the Cayman Island holding of the Indian shares could be

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seen as a transfer of Indian tangible and intangible assets for the purposes of the Indian capital gain tax. Indian taxes did apply to the transfer of shares in the foreign holding, more or less as if the Indian shares themselves would have been transferred. The Indian Supreme Court rejected a special plea by the taxpayer on January 23, 2009, upholding the decision of the High Court, although some jurisdictional issues still have to be ruled on.

I. Regional trend?

The *Vodafone* decision is not an isolated incident. Jurisdictions across Asia have taken steps in the same direction recently. In Indonesia, for example, a new regulation was recently issued by tax authorities addressing much the same issue. Decree (258/PMK.03/2008) ("Decree 258") provides that as from January 1, a sale of a "tax haven company" which has as its sole purpose the holding of shares in an unlisted Indonesian company will be taxable in Indonesia. The Decree states that 25 percent of the sale price will be deemed to constitute the taxable capital gain in such situation, which is taxed at 20 percent. Thus, the effective tax rate is five percent on the transfer price of the shares. The Decree only addresses special purpose vehicles which are "tax havens", but does not define the notion. Popular jurisdictions such as the British Virgin Islands and Cayman Islands are definitely targeted. Decree 258 does set out that in case the seller benefits from treaty protection, the taxation will only apply if Indonesia has taxing rights for this gain under such treaty. Interestingly, the treaty with the SPV itself is not mentioned, perhaps because the Indonesian tax authorities will interpret "tax haven" as excluding jurisdictions with which Indonesia has a tax treaty. If Decree 258 applies, the buyer must apply the five percent as a withholding. If the buyer is a non-resident, the Indonesian company which is the subject of the indirect transfer, has the liability to pay the tax.

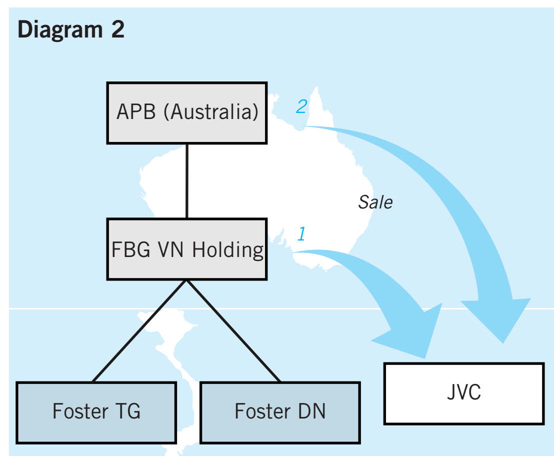
In the P.R.O. China, a similar trend can be seen. There, on January 9, 2009, tax authorities issued a regulation referred to as "Implementation Measures for Special Tax Adjustments ("Circular 2"). This Circular allows tax officials to disregard foreign legal entities that lack substance and which are established in tax haven jurisdictions. Circular 2 can be associated with another new regulation that was issued on February 20, 2009 on tax treaty entitlement. Notice on Issues Relevant to the Implementation of Dividend Provisions in Tax Treaties ("Notice 81") mainly addresses the exemption of withholding tax on dividend distributions by Chinese companies.

II. Rulings on offshore transfer of shares by Vietnam's GDT

The Vietnam GDT is not blind to the existence of tax avoidance techniques. The GDT has acted with determination on what it perceives to be abusive transfer pricing practices, both in terms of regulation and in terms of enforcement. At times official letters are published addressing tax planning devices (such as 8819/BTC-TCT dated July 29, 2008) where one can read between the lines that the tax official seeks to deny the tax planning advantage to the taxpayer. In tax law as well as in audits, questions on substance, business purpose and the "reason" for a transaction are increasingly a factor, so it seems at least to this author.

More importantly, perhaps, Vietnam has already issued several Official Letters which might indicate that tax authorities would indeed in some circumstances treat a sale of the offshore parent as a taxable event in Vietnam as well. Note that the facts of the rulings are usually not published entirely in Vietnam. Therefore, there may be gaps in the facts as we try to analyse the rulings.

A. OL 1719/TCT-PCCS (May 7, 2007) regarding the income from capital assignment



i. Facts

Asia Pacific Breweries (Australia) is the parent company of the FBG Vietnam Holdings Pty Ltd. ("FBG VN Holding"), which owns Foster TG and Foster DN (both located in Vietnam). Vietnam Beer Manufacturer (the "JVC") signed a contract to acquire Foster Tien Giang and Foster Da Nang.

ii. Conclusion of tax authorities

Based on the facts presented, the tax authorities ruled as follows:

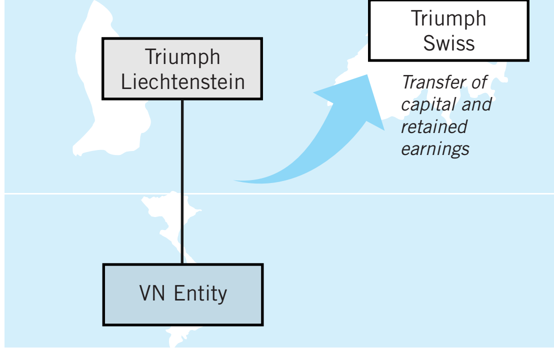
(1) If FBG VN Holding is the party that transfers Foster TG and Foster DN to the JVC, then FBG VN Holding is responsible for declaring and paying taxes to the tax authorities in connection with the income from the transfer of capital.

(2) If APB Australia (FBG VN Holding's parent) is the transferor, then the JVC is responsible for declaring, withholding and paying taxes to the tax authorities in connection with the income from the transfer of capital on behalf of APB Australia.

B. OL 2349/TCT-PCCS (June 15, 2007) regarding the tax implication on the capital assignment between companies in the same group

i. Facts

Triumph Liechtenstein is the owner of Triumph International Vietnam. For restructuring purposes, Triumph Liechtenstein will transfer the legal capital and

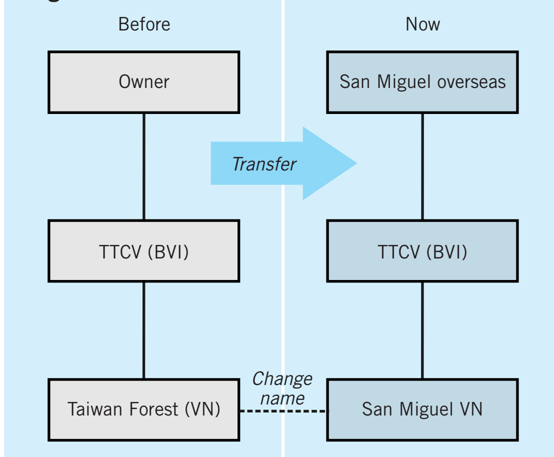


retained earnings in Triumph Liechtenstein Vietnam to Triumph Swiss (a member of Triumph Group).

ii. Conclusion of tax authorities

The tax authorities concluded that the income derived from the transfer of capital and retained earnings of Triumph International Vietnam are subject to CIT in Vietnam. Even though the transfer was made between related parties, the tax authorities nevertheless imposed CIT on such transaction.

C. OL 3306/TCT-CS (September 3, 2008) regarding the tax implication on capital assignment



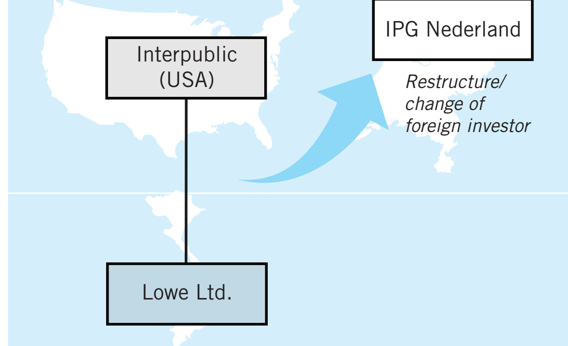
i. Facts

Taiwan Forest – Agriculture Ltd., Co ("Taiwan Forest VN") is a 100 percent foreign owned enterprise in Vietnam and is a subsidiary of TTCV Investment (BVI) CO., Ltd. In 2003, TTCV is transferred (by the ultimate owner) to San Miguel Foods and Beverage International Limited (overseas). As a result of the transfer, Taiwan Forest VN was renamed San Miguel Pure Food Ltd., Co. In this case, only the name of the enterprise and the investor were changed, and no new legal entity was set up.

ii. Conclusion of tax authorities

Under this OL, the tax authorities concluded that the income from the capital assignment is subject to CIT in Vietnam. The reasoning is that the capital assignment led to the change of the investor and the change of name of the company (even though no new legal entity was set up).

D. OL 3678/TCT-CS (September 9, 2009) regarding the tax policy on internal restructuring



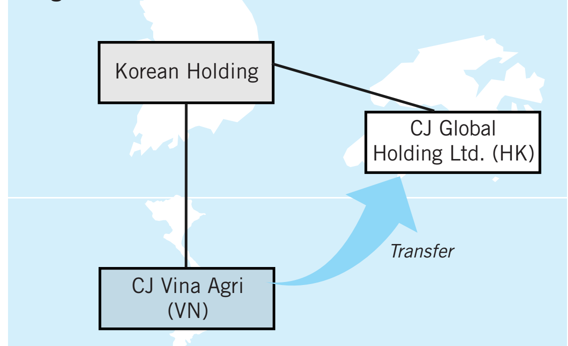
i. Facts

Interpublic Group of Companies Inc (USA) ("Interpublic") is the investor of Lowe Ltd., Co., a 100 percent foreign-owned company Vietnam. Due to management restructuring, Interpublic transferred Lowe Ltd. to IPG Nederland B.V., which is a subsidiary within Interpublic Group of Companies Inc. (Note that we do not know if Interpublic owns 100 percent of IPT Nederland.)

ii. Conclusion of tax authorities

Under this OL, if the change of foreign investor in an enterprise with foreign owned capital in Vietnam does not generate income, then CIT from capital assignment will not be applicable.

E. OL 4203/TCT-DTNN (November 13, 2006) regarding the tax liabilities relating to change in ownership



i. Facts

CJ Vina Agri (Vietnam) is owned 100 percent by Korean holding company ("Korean Holding"). Korean Holding transferred the shares of CJ Vina Agri to CJ Global Holdings Ltd (a Hong Kong entity), which is also 100 percent owned by Korean Holding.

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ii. Conclusion of tax authorities

The tax authorities ruled that this transaction is not subject to tax on capital assignment. The tax authorities' reasoning is that the change in the name of investor/owner was for the purpose of decentralising management.

III. Conclusion: Is Vietnam following the Vodafone approach?

The legal merits of this issue in Vietnam tax law quite quickly lead to a number of basic questions of interpretation. The first question would in my view be, "must we simply look through the SPV?" If so, the sale of the shares in SPV as such would be ignored, and treated for tax purposes as a transfer of shares in the Vietnam company. To put the same question another way, does "transfer of securities" ("*Chuyn nhýng chng khoán*") or "transfer of a capital interest" ("*chuyn nhýng vn*") in the PIT and CIT refer to a purely legal concept, or is there room for a more economic interpretation? Clearly, the predominant current practice is that only an actual legal transfer of capital in the Vietnam entity is treated as "transfer" in that sense. It is often said that in Vietnam "it is rather form over substance than substance over form" but one cannot help but wonder if that will also be true in a high profile, highly publicised case such as the Vodafone acquisition in India. At this time, however, there does not seem to be an established or well documented general principle in Vietnam tax law that would allow for a more "economic" interpretation of Vietnam tax law or of the term "transfer" in the PIT and CIT more particularly. That being said, "capital assignment" has often been more associated primarily with a transfer of a business or an investment from one investor to another and less with transfer of shares or other titles. By the same token, there is not really a statutory basis in Vietnam tax law to ignore legally valid acts such as the establishment of a foreign company and the contracts concluded by that company, although civil law definitely recognises doctrines such as sham (Article 129 Civil Code).

Income tax is still relatively new in Vietnam. It is not surprising that certain questions of interpretation of income tax provisions, particularly questions that relate to tax avoidance, abuse and form v. substance, are not yet fully explored. There are indeed a number of recent (and a few older) rulings by Vietnam tax authorities that are directly or indirectly relevant to the issue of offshore transfers, but their exact meaning and impact are debated. Still, even with some questions surrounding these rulings, the trend does not look positive at all for taxpayers.

It is probably fair to say that nobody is really certain if (or which) offshore transfers remain effectively untaxed in Vietnam, or under which circumstances an offshore transfer would be exempt in Vietnam right now. For example, we are not certain which intragroup reorganisations might be exempt, or whether all transfers of offshore SPV's to third parties trigger corporate tax in Vietnam. But based on the rulings discussed above, it is clear that in the view of the Vietnam tax authorities there are indeed a number of situations where Vietnam can treat the transfer or shares in the SPV as if it were a transfer of Vietnam shares or capital.

In any event, investors are recommended to carefully re-examine their existing shareholding structures and their new acquisitions for the post-Vodafone era of taxation, also for Vietnam.

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