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Born in the USA, adopted in India

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BANGALORE: At present it is spoken of in hushed tones, but it's a reality. US companies, especially if the founders are of an Indian origin, are definitely thinking of a flip, where the subsidiary in India becomes the parent company and the erstwhile US parent company becomes its subsidiary. This is done through a swap of shares. The newly-formed Indian parent company then proceeds to get listed in India.

"Service companies command better valuation in India compared to the US. Also cost for listing in the US is comparatively high and regulations more stringent. Thus, many US-based service companies having development centres in India are looking at an Indian listing that is achieved through a flip," said **Shefali Goradia**, head (international tax practice), **Nishith Desai Associates**.

A couple of IT-enabled services (ITES) companies, where the parent was set up in Silicon Valley with subsidiaries in southern India, are in the final stages of discussions with their consultants on adopting this model.

The recent Central Board of Direct Taxes (CBDT) circular calling for attribution of a major chunk of profits in the hands of a foreign company, in those cases where its captive in India is engaged in core activities, could be another reason for the sudden interest in flips. "This CBDT circular could in future make the "India-company owns a US-company" structure more tax efficient than the other way round," explains Nitin Karve, partner, Bharat S Raut and Co.

Another attraction for flips is dual listing. "The largest driver for US companies to consolidate at the India-level is to have the option of being listed on both Indian and overseas stock bourses — in the form of GDRs and ADRs. Indian bourses help the company capitulate on higher PE ratios compared to overseas," states Dinesh Kanabar, partner, RSM and Co. But there are regulatory and tax hurdles to be crossed, both in India and the US.

"In most advanced countries, transfer of shares under a group restructuring exercise, is tax free if there is no change in ultimate ownership. But, in India, the value of the Indian company's shares issued under the swap is treated as the sale consideration and capital gains are levied," points out Mr Kanabar.

"Valuation as per the specified regulations is a fundamental issue. Stamp duty and capital gain implications arise on transfer of shares at both ends. There are also transfer pricing implications since both the parties in the swap deal are related," said Indraneel Roy Choudhury, executive director (tax), PricewaterhouseCoopers.

"From a regulatory perspective the swap requires the Foreign Investment Promotion Board (FIPB) approval for the inward leg of the transaction. Only recently, the swap has been brought under the automatic route in respect of the outward leg," said Mr Kanabar.

"An Indian Depository Regime would have enabled foreign companies to list directly in India, but this mechanism is still not in place. A flip transaction entails heavy tax cost on the US companies and its shareholders. Flips are tax exempt in the US only if certain conditions are met, which is not always possible. Further, reporting of a flip transaction to the US Inland Revenue Service is now mandatory," adds **Ms Goradia**.

Employees play a crucial role in the services sector. "Thus, the effects on existing stock option plans and implications arising on issue of Indian shares to US employees have to be weighed carefully," said Mr Karve.

But complications notwithstanding, US Inc having subsidiaries in India, appears to be ready to do the flip.