Authority for Advance Rulings: Intra-group transfer of shares from Mauritius to Singapore held not taxable in India – allegations of tax avoidance rejected

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Background:

The Authority for Advance Rulings ('AAR') recently upheld the availability benefit under the India-Mauritius tax treaty in respect of capital gains arising on transfer of shares held by ***Dow AgroSciences Agricultural Products Ltd.*** **(Mauritius)** (hereinafter referred to as 'Applicant') in its Indian subsidiary.

The ruling in this case is an important one. It provides several insights into the tax authorities' views on transactions involving sale of shares of Indian companies by Mauritius residents and the consequent availability of relief in respect of capital gains under the India-Mauritius tax treaty. It also provides useful guidance on how allegations of *'tax avoidance'* are evaluated by the AAR.

Facts of the case:

The transaction involved a proposed contribution of shares held by the Applicant in Dow Agrosciences India Private Limited (hereinafter referred to as 'Indian company') to its subsidiary in Singapore. This transaction was proposed to be undertaken pursuant to the restructuring of the group's overall holding structure, which *inter alia* involved dismantling of the Indian, Middle-east and African group and consequent re-alignment of the parent of the Indian company from European region to Asia-Pacific region to achieve better control. Accordingly, this was to be carried out through a transfer of shares of the Indian company by the Applicant to a holding company in Singapore, which was a key jurisdiction in the Asia-Pacific Group.

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Issues raised before the AAR:

It was claimed by the Applicant that the capital gains arising from the transaction were not liable to tax in India by virtue of Article 13(4) of the India-Mauritius treaty. Consequently, it was also claimed that there will be:

a) No liability for Minimum Alternative Taxes (MAT) under section 115JB of the Income-tax Act, 1961 ('the Act');
b) No applicability of transfer pricing provisions under section 92 to section 92F of the Act;
c) No requirement of withholding tax in India under section 195 of the Act in respect of the transaction; and
d) No requirement on the part of the Applicant to file its return of income in India under section 139 of the Act.

Conclusions of the AAR:

Multiple arguments were raised by the tax department to counter the above claims made by the Applicant. These arguments, together with the conclusions of the AAR thereon are briefly summarised below:

Tax Avoidance

It was alleged by the tax department that the transaction was a scheme for avoidance of payment of tax in India. The tax department also contended that the Applicant was a shell company and hence was not entitled to the benefits of the India-Mauritius treaty.

This contention was rejected by the AAR, which noted that the Indian company was incorporated way back in 1994 and that the investment by the Applicant was made in various tranches from 1995 to 2005 after prior approval of Department of Industrial Policy & Promotion and the Reserve Bank of India. It held that a transaction that began more than 20 years ago could not have been a scheme to avoid payment of taxes. The AAR also took note of the circumstances surrounding the re-alignment of companies as part of the group restructuring and concluded that the transaction was clearly for business considerations.

Applicant had a PE in India

While denying the applicability of the India-Mauritius treaty to the Applicant, the tax department's second line of argument was that the Applicant had a Permanent Establishment ('PE') in India. To drive home this point, the tax department came up with a series of arguments that were intended to support their contention that the Applicant had a PE in India. These include:

a) Huge royalty and service charges were being paid by the Indian entity to the US parent;
b) The Indian entity was a trading company;
c) Exports by the Indian entity were on behalf of the US entity;
d) ESOPs were offered by the US entity to the employees of the Indian entity.

However, the AAR found the contentions of the tax department irrelevant, and held that these did not establish that the Applicant had a PE in India considering that it neither carried on any business activity in India, nor had any office/employees/agents in India.

The AAR also pointed out that once it is found that the Applicant has no PE in India, taxability of capital gains arising on the proposed transaction under Article 13(2) of the India Mauritius treaty is ruled out.

Applicant was not the Beneficial Owner

The AAR did not attribute any weightage to the tax department's contention that the shareholder of the Applicant being the US company, was the beneficial shareholder of the Indian company and thus the capital gains should be assessed in the hands of the US company.

Dividend re-characterisation

The tax department also alleged that the Indian company had not declared dividends since 2004, and therefore to the extent of accumulated profits, the sale proceeds should be treated as dividends taxable in India. This argument was rejected by the AAR on the ground that it had no basis in law.

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MAT levy

As regards the applicability of MAT to the Applicant on the gains arising pursuant to the transaction, the AAR ruled that since the Applicant did not have a PE in India, MAT will not be applicable to the Applicant. While coming to this decision, the AAR took cognisance of the Supreme Court's decision in the case of Castleton Investment Limited[1] and Government's circular stating that no MAT would be levied on foreign companies in India if it did not have a place of business/PE in India.

Applicability of transfer pricing provisions

With regard to applicability of transfer pricing provisions to the Applicant, the AAR relying on its previous rulings[2] held that since there would be no income chargeable to tax in India, transfer pricing provisions under section 92 to section 92F of the Act will not apply.

Withholding requirement

On the question of applicability of withholding tax by the Singapore company in respect of gains arising to the Applicant, the AAR ruled that since the gains were not taxable in India, the provisions of section 195 of the Act with respect to withholding will not apply. While coming to this decision, the AAR relied on the Supreme Court's decision in the case of Transmission Corporation[3].

Requirement of filing return of income in India

On the requirement of filing of a return of income in India by the Applicant in respect of the transaction, the AAR distinguished its earlier ruling in the case of Castleton Investment Limited and ruled that the provisions of section 139(1) of the Act in respect of filing of return of income in India were not applicable. While coming to this decision, the AAR relied upon rulings of FactSet Research Systems Inc. and Vanenburg Group B.V. and the Federal Court's decision in the case of Chatturam vs CIT[4] which held that liability to tax was found under section 4 and 5 of the Act and that section 139 was were merely a machinery provision to determine the amount of tax.

Dhruva comments:

Although the decision in this case was in favour of the taxpayer, it does indicate the aggressive position taken by the tax authorities as regards the availability of the benefits of the India-Mauritius treaty. The law itself is extremely well settled that where the taxpayer holds a valid tax residency certificate, no further enquiry is warranted, and relief under the India-Mauritius treaty ought to be available. At the practical level however, nearly every claim is challenged by the tax authorities, by either asserting that the transaction involves tax avoidance or by contending that the taxpayer has a PE in India and thus gains arising on the transaction are taxable as business income.

However, in this case, the AAR was not swayed by these arguments and held that the Applicant was eligible for relief under the India-Mauritius treaty. It gave cognisance to the fact that the Indian company was held by the Applicant for a considerable period of time before it is being proposed to be transferred as part of group re-structuring.

Lastly, this ruling also highlights the adversarial nature of AAR proceedings. Globally, obtaining an advance ruling is an administrative process, whereby a taxpayer can get certainty on the tax treatment of his proposed transactions. However, in an Indian context, these tend to be treated as quasi-judicial proceedings, where adversarial positions have become the norm. If this trend continues, the intended objective of speed and certainty could be undermined.

[1] 379 ITR 363

[2] Dana Corporation [2010] (227 CTR 441) (AAR), M/s. Praxair Pacific Limited (326 ITR 276) and Vanenburg Group B.V. vs. CIT (289 ITR 464)

[3] Transmission Corporation of AP Ltd. vs. CIT, 239 ITR 587

[4] FactSet Research Systems Inc. (317 ITR 169); Vanenburg Group B.V. vs. CIT AAR No.727 of 2006 and Chatturam vs. CIT [1947] 15 ITR 302 (FC)

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Key Contacts

Dinesh Kanabar, CEO
dinesh.kanabar@dhruvaadvisors.com

Punit Shah, Partner
punit.shah@dhruvaadvisors.com

Rakesh Dharawat, Partner
rakesh.dharawat@dhruvaadvisors.com

Sudhir Nayak, Partner
sudhir.nayak@dhruvaadvisors.com

Mehul Bheda, Partner
mehul.bheda@dhruvaadvisors.com

Sandeep Bhalla, Partner (Delhi)
sandeep.bhalla@dhruvaadvisors.com

Vishal Gada, Partner (Ahmedabad)
vishal.gada@dhruvaadvisors.com

Ajay Rotti, Partner (Bengaluru)
ajay.rotti@dhruvaadvisors.com

Our offices

Mumbai
12th Floor
Discovery of India Building (Nehru Centre)
Dr. Annie Besant Road
Worli, Mumbai 400 018
Tel: +91-22-6108 1000
Fax:+91-22-6108 1001

Bengaluru
Prestige Terraces
5/1, Union Street
Infantry Road
Bangalore 560001
Tel: +91-80-4660 2500
Fax: +91-80-4660 2501

Ahmedabad
B3/3rd Floor, Safal Profitaire, Prahladnagar,
Corporate Road,
Opp. Auda Garden, Ahmedabad 380 015.
Tel: +91-79-6134 3400
Fax: +91-79-6134 3434

Delhi
1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon, Haryana
Tel: + 91-124 6687000
Fax: + 91-124 6687001

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