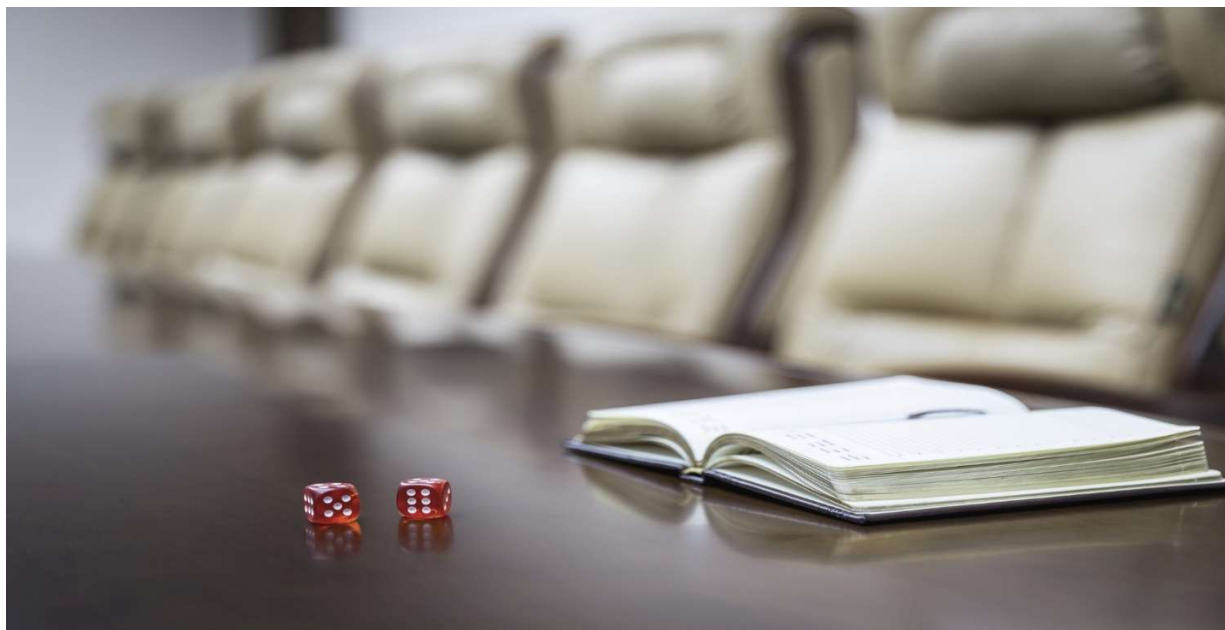


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## India & Singapore sign Protocol amending the provisions of India-Singapore Tax Treaty

03 January 2017



### Background

In a significant development, the Government of India announced the signing of a Third Protocol (Protocol) amending the provisions of India-Singapore Tax Treaty.

Under this Protocol, India will get the right to tax capital gains arising on alienation of shares acquired on or after 1 April 2017. For shares acquired and alienated between 1 April 2017 and 31 March 2019, the tax rate will be limited to 50% of the tax rate applicable in the source country subject to fulfilment of conditions specified under Limitation of Benefits (LoB) Article<sup>1</sup>.

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<sup>1</sup> In order to be eligible for concessional tax rate during the transition period, the LoB Article, inter-alia, prescribes a condition to incur annual operating expenditure of at least

The Protocol, among others, also seeks to provide for bilateral discussions for elimination of double taxation arising from transfer pricing or pricing of related party transactions.

A brief analysis of the key amendments is set out below.

### Capital Gains

- The Protocol amends the Capital Gains Article by giving India the right to tax capital gains arising on alienation of shares acquired on or after 1 April 2017. The current exemption from Capital Gains taxation in India will be withdrawn in a phased out manner as under:

*SGD 200,000 or INR 5 million as the case may be in immediately preceding period of 12 months from the date on which the gains arise.*

Gains from alienation of shares of Indian company	Taxability in India
Acquired on or before 31 March 2017	Not taxable as per India-Singapore Tax Treaty subject to fulfilment of conditions mentioned in <i>LoB</i> Article
Acquired on or after 1 April 2017 and transferred before 31 March 2019	Limited to 50% of the tax rate subject to fulfilment of conditions mentioned in <i>LoB</i> Article
Acquired on or after 1 April 2017 and transferred after 31 March 2019	Taxable at the full applicable rate of tax

### **Limitation of Benefits**

- The Protocol to India-Singapore Tax Treaty also incorporates a new LoB clause which provides that the benefit of grandfathering or the benefit of reduced rate of tax on capital gains from the alienation of shares (i.e. 50% of normal tax rate) will not be available in the following cases:
  - a) If the affairs are arranged with the primary purpose to take benefit of grandfathering provisions or to take benefit of provisions granting reduced rate of tax; or
  - b) The company claiming the aforesaid benefit is a 'shell or a conduit company'.
- A 'shell or a conduit company' is defined to mean any legal entity with negligible/nil business operations or carrying on no real and continuous business activities.
- Further, a resident is deemed to be a shell/conduit company, if (a) it is not listed on a recognised stock exchange of the Contracting state; or (b) its annual expenditure on operations in its home country is less than INR 5 million or SGD 200,000, as the case may be, for each of 12-month period in the immediately preceding

period of 24 months from the date on which the gains arise ('Expenditure test').

- However, for transitory relief for shares acquired on or after 1 April 2017 and transferred before 31 March 2019, all the above LoB conditions need to be met except that the 'Expenditure test' is required to be fulfilled only in the immediately preceding period of 12 months from the date on which the capital gain arises.

### **Other amendments**

#### Applicability of domestic anti-avoidance provisions

- The Protocol provides that the Tax Treaty will not prevent a country from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion.
- Thus, the provisions of Indian General Anti-Avoidance Rule (GAAR) (effective from FY 2017-18) and other domestic anti-abuse rules can be invoked to override the provisions of India-Singapore Tax Treaty.

#### Correlative adjustment on account of transfer pricing provisions

In line with India's commitment as part of Action 14 on Dispute Resolution Mechanism of OECD's BEPS project, the Protocol provides for correlative adjustments in the profits of the entity in the other Contracting State subject to satisfaction of certain conditions.

#### Entry into force

- India as well as Singapore shall notify each other post completion of their respective legal procedures to bring this Protocol into force. It is provided that the Protocol shall enter into force on the date of the latter of these notifications.
- If the Protocol does not enter into force as on 31 March 2017 due to either of aforesaid notifications remaining pending, then the Protocol shall enter into force on 1 April 2017.

## Comments

Given that India-Mauritius Tax Treaty was revised earlier this year, clarity was warranted with respect to the position on taxing rights for capital gains under the India-Singapore Tax Treaty. This was because the existing India-Singapore Tax Treaty provides for a capital gains exemption, which is co-terminus with the capital gains exemption under the India-Mauritius Tax Treaty.

As per the new Protocol, source-based taxation in India is limited to “shares” of a company resident in India and does not extend to any other securities including convertible or non-convertible debt instruments, or to shares of a foreign company which may derive substantial value from Indian assets. Also, unlike the earlier Protocol, the revised LoB conditions are not made applicable in respect of capital gains arising from transfer of assets other than shares of a company resident in India. However, the domestic GAAR provisions could potentially be made applicable even if the LoB conditions are met.

The impact of Protocol amending India-Mauritius Tax Treaty on Foreign Institutional Investors/ Foreign Portfolio Investors, Private Equity Funds/ Holding companies, convertible instruments, etc. as detailed in our alert dated 13 May 2016 shall largely apply to India-Singapore Tax Treaty as well. Refer the following link for details:

<http://dhruvaadvisors.com/admin/upload/leadership/14631422901.pdf>

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