Transfer of shares of an Indian company by a Mauritius based company to a Singapore based company under group reorganisation is not taxable under the India-Mauritius tax treaty and it is not a tax avoidant transaction

Background

Recently, the Authority for Advance Rulings (the AAR), in the case of Dow AgroSciences Agricultural Products Limited (the applicant), held that the proposed transfer of shares of an Indian company by a Mauritius based company to a Singapore based company under group reorganisation is not taxable under the India-Mauritius tax treaty. The proposed transfer of shares did not amount to a scheme to avoid payment of taxes in India.

Facts of the case

- The applicant, a company, incorporated and registered in Mauritius, is a tax resident of Mauritius. The applicant is part of Dow group of companies (the Group). The applicant received the Tax Residency Certificate (TRC) and the Certificate from the Registrar of Companies in Mauritius.

- Dow AgroSciences India Private Limited (DAS India) is a company incorporated in India and is part of Dow Group. DAS India is engaged in manufacturing and trading of pesticides and insecticides.

- The applicant is a holding company of DAS India and had acquired shares of DAS India during the period 1995 to 2005.

- The applicant proposes to contribute shares held in Dow India as its capital in DAS Singapore. By virtue of this, DAS India would become 100 per cent subsidiary of DAS Singapore.

- The value of DAS Singapore’s shares recorded in the books of DAS Mauritius would be considered as the sales consideration for the transfer of shares of DAS India.

- The applicant contended before the AAR that Dow Group is a large and complex group having the presence in several countries across the world. In order to reduce complexities, improve efficiency and reduce costs in the group companies worldwide, Dow Group is transforming its holding model. The group reorganisation will change the business model of the group giving the capability to support more diverse, growing business that is also expected to be more profitable in the long-term.

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1 In re, Dow AgroSciences Agricultural Products Ltd. [2015] 65 taxmann.com 245 (AAR)
• The applicant has relied on the decision in the case of Vodafone International Holdings BV\(^2\), wherein it is held that setting up of a wholly owned subsidiary in Mauritius by principle/genuine, substantial long-term FDI in India from/through Mauritius, under the tax treaty and Circular 789 can never be considered to be set-up for tax evasion.

• The applicant has also relied upon the decision of Azadi Bachao Andolan\(^3\) wherein the Supreme Court declared that treaty shopping is not taboo, and on the decision of AAR in the case of E*Trade Mauritius Limited\(^4\), which also reiterates the principles of treaty shopping. The applicant has also relied upon various other decisions\(^5\).

The AAR’s ruling

Not a scheme to avoid payment of taxes in India

• This transaction began almost 20 years back hence, could not have been a scheme to avoid the payment of taxes. DAS India was incorporated on 7 December 1994. The investment made in the DAS India was with the prior approval of Department of Industrial Policy & Promotion (DIPP).

• The subsequent investment also was with the approval of RBI and hence it cannot be said the shares were acquired with a view to selling in future through the Mauritius company and thus to avoid the taxes on possible capital gains.

• The shares were acquired at a substantial cost of about INR610 million and if they are sought to be now transferred to a Singapore concern which is the own subsidiary of the applicant, it cannot amount to a design or a scheme to avoid payment of taxes in India.

• Dow IMEA Group was dismantled in 2010 and that is how the need for realignment of the group arose whereby DAS entity was to be shifted from an entity, which falls under Europe region to an entity, which would fall in the Asia-Pacific region. This was to be done with a view to achieving better control.

• Singapore is one of the upcoming countries in Asia-Pacific region in the opinion of the applicant and therefore, the Dow group contemplated to shift the shareholding of DAS India from Mauritius to Singapore. All this exercise is also more than five years old from the date of the last acquisition of the shares.

• Thus, the proposed transfer of shares did not amount to a scheme to avoid payment of taxes in India. It was for the business considerations.

• In Ardex Investments Mauritius Limited, it was held that mere investment through a Mauritius company cannot be viewed or characterised as objectionable treaty shopping when investments have been held for a period ten years, and the arrangement has not come all of a sudden. If setting-up Mauritius Company is with an eye on the tax treaty, it by itself will not make it a tax avoidance arrangement.

• Though DAS India has not declared and distributed dividends since 2004, sale proceeds cannot be assessed in India to the extent of accumulated profits.

• Accordingly, this transaction did not amount to a scheme to avoid payment of taxes in India.

No Permanent Establishment in India

• The applicant has produced a TRC from Mauritius. It does not have an office, employees or agents in India. Accordingly, the applicant does not have a Permanent Establishment in India.

Business income v. Capital gains

• Based on the Instruction\(^6\) issued by CBDT and Supplementary Circular\(^7\), for distinguishing shares held as stock-in-shares and those held as investments, and applying the key tests i.e. accounting test, intention test and quantum test, it is held that the shares held in DAS India would be in the nature of the capital asset.

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\(^2\) Vodafone International Holdings BV [2012] 341 ITR 1 (SC)

\(^3\) Union of India v. Azadi Bachao Andolan[2003] 132 Taxman 373(SC)

\(^4\) E*Trade Mauritius Limited[2010] 324 ITR 1 (AAR)


\(^6\) CBDT Instruction No.181-1-89-IT(AI) dated 31.8.1989

\(^7\) Supplementary Circular No.2/2007 dated 15 June 2007
The shares in DAS India held by the applicant have to be treated as a capital asset as defined under Section 2(14) of the Income-tax Act, 1961 (the Act) and therefore, income from transfer of these shares cannot be treated as a business income.

**Capital gains not taxable in India**

- The capital gains arise to the applicant and not to the DAS U.S.A. (the holding company of the applicant), as contended by the tax department.
- Provisions of Article 13(1) and (3) are not applicable in the present case. Further, considering the nature of the assets (equity shares in an Indian Company) being transferred, even Article 13(2) of the tax treaty will also not be applicable since the applicant does not have a PE in India.
- In the case of JSH Mauritius Ltd., the AAR had already taken a view that a Mauritius company would be fully entitled to the benefit of Article 13(4) of the tax treaty. Relying on this decision, there would be no taxation on the capital gains arising from the proposed transfer of shares of DAS India by the applicant to the DAS Singapore.

**MAT provisions do not apply**

- The question of applicability of Section 115JB of the Act in the case of Castleton Investment Ltd. has been disposed of by the Supreme Court in favour of the taxpayer.
- A Circular and a statement which was made by the Attorney General for India mentioned that the Supreme Court decision would be followed. The Circular mentions that the FIs/FPIs having no PE/place of business in India would not be covered by Section 115JB of the Act.
- As the applicant does not have a PE in India, there will be no applicability of Section 115JB to the applicant.

**Transfer pricing provisions do not apply**

- Unless the transaction is taxable in India, there would be no application of Sections 92 to 95 of the Act (transfer pricing provisions). Section 92 of the Act is not an independent charging section and would be applicable only if there is any chargeable income arising from the international transaction.
- In the present case, even though the proposed transfer of shares could result in income/capital gain from the international transaction since this income is not chargeable to tax in India in accordance with Article 13 of the tax treaty, Section 92 to 92F of the Act will not be applicable. Reliance is placed on various decisions.

**No withholding of tax under Section 195**

- The capital gains earned out of proposed transaction are not taxable, and therefore, Section 195 of the Act shall not be applicable, in view of the Supreme Court’s decision in the case of Transmission Corporation of AP Ltd.

**No requirement to file return of income**

- In the decision of Castleton Investment Ltd., the view was taken by the AAR that when any person claims the benefit of the tax treaty, that person invokes Section 90(2) of the Act. Hence, the relief under the tax treaty could be done only by the consideration of his return of income.
- The law laid down in the decisions of Factset Research Systems Inc., Vanenburg Group BV and Chatturam, was not considered in the decision of Castleton. Therefore, the decision of Castleton is not accepted as far as the applicability of Section 139(1) of the Act to the present applicant is concerned.
- In view of the binding Federal Court’s decision in the case of Chatturam, the applicant is not required to file any return of income.

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8 JSH Mauritius Ltd (AAR No. 995 of 2010, dated 10 October 2015)
9 CBDT Instruction No. 9/2015 dated 2 September 2015

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Our comments

Taxation of an international transaction involving the transfer of shares of an Indian company and the applicability of the tax treaty has been a matter of debate over last several years. In the instant case, the AAR held that the transaction is not devised for tax avoidance but business considerations, the Mauritius company is having a valid TRC and therefore, the gains arising from the transfer of shares of an Indian company by a Mauritius company cannot be taxed under the tax treaty. Further, the MAT, transfer pricing, and withholding tax provisions are not applicable to the applicant. The AAR has also differentiated its earlier ruling in the case of Castleton Investments and held that in the absence of any liability of tax, there is also no obligation to file a tax return in India.

The AAR in the case of SmithKline Beecham Port Louis Ltd.\(^{16}\) held that capital gains arising on the proposed transfer of shares of an Indian company by a Mauritius company to the Singapore company are not taxable under the Article 13(4) of the tax treaty. Accordingly, the sale consideration receivable by the applicant is not liable for withholding of tax as per Section 195 of the Act.

Even though the ruling of the AAR is legally binding only on the parties involved in a particular case, the ruling would have a persuasive value in similar matters before the Indian tax authorities and Courts.

\(^{16}\) SmithKline Beecham Port Louis Ltd [2012] 24 taxmann.com 153 (AAR)
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