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TAX FLASH NEWS

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Capital gains arising to a foreign company on transfer of shares held in an Indian company under the court approved buy-back scheme is taxable in India under India-Netherlands tax treaty

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Accordis Beheer B V [1] (the taxpayer) held that capital gains arising to a foreign company on transfer of shares held in an Indian company, under the court approved buy-back scheme, is taxable in India under the India-Netherlands tax treaty (the tax treaty). The arrangement entered by the taxpayer in selling part of its shareholding to the company in the scheme of buy-back does not fall under the definition of 'reorganisation'. The Tribunal also held that the taxpayer is entitled to a concessional rate of tax at 10 per cent on the said capital gains.

Facts of the case

- The taxpayer is a resident of Netherlands. It held 38.24 per cent of shares comprising of 1,09,52,280 shares in the paid-up capital of Century Enka Ltd, an Indian public listed company.
- During the year under consideration, the taxpayer tendered 85,93,109 equity shares having a face value of INR10 each to Century Enka Ltd at INR122 per shares under a scheme of arrangement, by way of buy-back of own shares, as per the approval given by the Calcutta High Court under Section 391 of the Companies Act, 1956. The said tendering of shares resulted in a capital gain of INR58.64 crore.
- The taxpayer, relying on Article 13(5) of the tax treaty, claimed that the capital gain referred above is not taxable in India. The Article 13(5) of the tax treaty provides that gains shall be taxable in Netherlands if such gains are realised in the course of corporate organisation, reorganisation, amalgamation, division or similar transaction.
- The Assessing Officer (AO) observed that the taxpayer did not pay tax on the impugned capital gains in Netherlands since the same was exempt under the tax provisions of that country. The basic purpose of the tax treaty, as well as Section 90 of the Income-tax Act, 1961 (the Act), is that the taxpayer should not be liable for double taxation, whereas, in the

[1] Accordis Beheer B. V. v. DIT (ITA No.4688/Mum/2010) – Taxsutra.com

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present case, the taxpayer is trying to claim double benefit by taking recourse to the tax treaty. Accordingly, the AO held that the aforesaid capital gains are taxable in India under Article 13(5) of the tax treaty.

- With regard to the rate at which the capital gain is taxable, the AO held that the concessional rate of taxation at 10 per cent, provided in the second proviso to Section 112 of the Act, is not applicable to the taxpayer. Accordingly, the AO levied tax at 20 per cent.

- The Commissioner of Income-tax (Appeals) CIT(A) upheld the action of the AO in taxing the capital gain arising on account of buy-back of shares of CE Group. However, the CIT(A) held that the taxpayer is eligible for concessional rate of tax at 10 per cent on capital gains.

Tribunal ruling

Taxability of capital gain under the tax treaty

- In view of decisions[2] relied on by the taxpayer, it has been observed that payment of tax on capital gains in Netherlands may not be a condition for availing tax treaty benefits in India.

- The CIT(A) relying on the decision of McDowell & Co.[3] observed that colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods. In the present case, the taxpayer is pleading for relief on the basis of its own interpretation of Article 13(5) of the tax treaty. The fact that it has tendered the shares to Century Enka Ltd under a scheme of arrangement approved by the Calcutta High Court is not disputed. Therefore, there is no colourable device in the claim made by the taxpayer.

- The taxpayer contended that it has transferred the shares under a scheme of arrangement approved by the High Court, and the same falls in the category of 'reorganisation' specified in Article 13(5) of the tax treaty. The Tribunal observed, upon perusal of the dictionary[4] meaning of reorganisation, it indicates that there should be a major change in the financial structure and the same should result in alteration in the rights and interest of security holders. However, in the present case, there is a reduction in the share capital and the same cannot be considered as a major change in financial structure.

- Further, the security holders continue to enjoy the same type of rights and interests even after the reduction of share capital and, hence, there is no alteration in the rights and interests of security holders. Accordingly, the arrangement entered by the taxpayer in selling part of its share holding to the company in the scheme of buy-back does not fall under the definition of 'reorganisation'.

- The taxpayer relied on a study material titled as 'Strategic Financial Management' issued by the Institute of Chartered Accountants of India (ICAI). However, these discussions made by the ICAI only explain various forms of financial management.

- There is no change in the rights and interests of the shareholders. Only change that occurred on reduction of share capital through writing-off of the shares purchased from the taxpayer is in the shareholding pattern of the promoter groups. The same cannot be considered as change in the rights and interests of shareholders. Before and even after the reduction of share capital, the promoter groups continue to remain as promoter groups with the same rights and interests.

- On reference to the definition of the term 'arrangement' given under Section 390 of the Companies Act, 1956, it is observed that it consists of either consolidation of shares of different classes or division of the shares into different classes or both.

[2] DIT v. ICICI Bank Ltd [2015] 370 ITR 17 (Bom)
DIT v. Green Emirate Shipping & Travels [2006] 100 ITD 203 (Mum)
[3] McDowell & Co. v. CTO [1985] 154 ITR 148 (SC)

[4] Given in the Dictionary titled as 'Dictionary for Accountants' by Eric L Kohler

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- The decision of Securities and Exchange Board of India[5], relied on by the taxpayer, is distinguishable on the facts of the present case and may not help the taxpayer.

- The CIT(A) observed that the scheme of arrangement framed by Century Enka Ltd was only with the purpose of providing an exit route to the non-resident shareholders. Thus, the objective of the scheme was to enable the taxpayer to transfer its shareholding. It was observed that the subsequent cancellation or writing off the shares has nothing to do with the transfer made by the taxpayer, even though the same has resulted in reduction of paid-up share capital of the company. The Tribunal agreed with the observations made by the CIT(A).

- The view taken by the CIT(A) is agreed upon that they are two different actions and both should not be clubbed together, even though Century Enka Ltd has combined the same, for the sake of its convenience, in the scheme of arrangement. The taxpayer should in no way concerned by the action of cancellation of share resulting in reduction of share capital.

- Accordingly, the attempt of the taxpayer to bring the transferring of shares within the ambit of the term 'reorganisation' may not be correct, since the object of the arrangement was not financial restructuring, but to provide an exit route to the non-resident shareholders. In view of the above, the CIT(A) was justified in upholding the view taken by the AO on this issue.

Rate for the purpose of payment of tax

- The taxpayer contended that this issue is covered in favour of the taxpayer by the decision of the Delhi High Court in the case of Cairn U.K. Holdings Ltd[6] [2013] 359 ITR 268 (Del), which was followed by the Tribunal in the case of Abbott Capital India Ltd.[7]. Accordingly, it has been held that the taxpayer is entitled to concessional rate of tax at 10 per cent on the impugned capital gains.

Our comments

The Mumbai Tribunal in the present case held that the attempt of the taxpayer to bring the transfer of shares within the ambit of the term 'reorganisation' may not be correct since the object of the arrangement was not financial restructuring, but to provide an exit route to the non-resident shareholders. As per the dictionary meaning of reorganisation, there should be a major change in the financial structure and the same should result in alteration in the rights and interest of security holders. However, in the present case, there is a reduction in the share capital and the same cannot be considered as a major change in financial structure. Accordingly, capital gains arising to a foreign company on transfer of shares held in an Indian company under the court approved buy-back scheme is taxable in India under the India-Netherlands tax treaty.

[5] Securities and Exchange Board of India & Union of India v. Sterlite Industries (India) Ltd [113 Company cases 273]

[6] Cairn U.K. Holdings Ltd. v. DIT [2013] 359 ITR 268 (Del)

[7] ADIT v. Abbott Capital India Ltd [2014] 65 SOT 121 (Mum)

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