



The AAR upholds the importance of the transfer pricing provision over the capital gains provision in case of an international transaction

In a recent ruling in case of Canoro Resources Limited¹ (the taxpayer) the Authority for Advance Ruling (AAR) has held that

- The transfer pricing provisions shall override the general provisions provided for computing capital gains in the Income-tax Act, 1961 (the Act) in case of transfer of a capital asset by a partner to a firm by way of capital contribution in the firm.
- Thus, the value of consideration will be the Arms Length Price (ALP) in accordance with the transfer pricing provisions of the Act and not the value recorded in the books of accounts of the firm.
- The non-discrimination provision contained in the Article 24 of the India – Canada Tax Treaty (the tax treaty) was applicable only when there is discrimination between two national and not between a resident and a non-resident.

Facts of the case

- The taxpayer was a company registered in Canada and was engaged in the business of exploration and production of petroleum and natural gas.
- In India, it holds Participating Interest (PI) in three oil blocks. Out of the three blocks only 'Amguri' block had started producing oil and gas. The other blocks were still in exploration stage.
- The taxpayer had entered into separate Production Sharing Contracts (PSC) with the Government of India and the concerned participating company in respect of each of the above three blocks and in respect of 'Amguri' block the taxpayer hold 60 percent (PI).

¹ Canoro Resources Limited *In re* (2009-TIOL-10-ARA-IT)

- The applicant proposed to restructure its business in India by transferring its PI in 'Amguri' block to a partnership firm (the proposed firm) to be formed in Canada between the applicant and its wholly owned subsidiary company in Canada, namely Legasi Petroleum International Inc. According to the applicant, the objective of this restructuring was to attract investment in the 'Amguri' block.

Maintainability of the Application

- In response to the tax department's contention on the maintainability of the application on the grounds that the proposed restructuring was merely a device for avoidance of tax, the AAR observed that the mere future possibility of the taxpayer exiting from the 'Amguri' block would not render the transaction itself a tax avoidance device.
- The AAR also relied on the decision of the Supreme Court (SC) in the case of Azadi Bachao Andolan² wherein it was held that the revenue cannot complain when the taxpayer resorts to a legal method to plan his tax liability such that the result would be more beneficial to the taxpayer.
- Hence, the AAR rejected the plea of the tax department and proceeded further.

Issues before AAR

Status/rate of tax of the proposed firm

- Whether the proposed firm can be granted status of 'firm' for the purpose of the Act if it satisfies the conditions specified in section 184 of the Act?
- If the answer to above question is in affirmative then what rate of tax will be applicable?

Chargeability of the transfer of PI

- If the answer to the above question is in affirmative then whether the transfer of a PI in the 'Amburi' block to the proposed firm will attract the provision of section 45(3) of the Act or it will be taxable under the provisions of transfer pricing of the Act?

Applicability of the tax treaty

- Whether by applying the transfer pricing provision to the transfer of PI in the proposed firm, the article 24 (non-discrimination clause) of the tax treaty will be attracted?

² UOI v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

Taxpayer's contentions

Status/rate of tax of the proposed firm

- Taxpayer contended that the proposed firm was partnership firm under the Partnership Act of Alberta (Canada), the provisions of which are similar to the Indian Partnership Act, 1932 and it further contended that since the partnership agreement clearly specifies the partnership interest and the profit and loss sharing ratio of individual partners, the proposed partnership firm should therefore be assessed to tax as a firm since the conditions specified in section 184³ of the Act would be fulfilled.

Chargeability of the transfer of PI

- For computing the value of consideration arises on transfer of capital asset as capital contribution to the proposed firm the special provisions of section 45(3) of the Act should be applied and the same shall prevail over the transfer pricing provisions as they are more general in nature.

Applicability of the tax treaty

- The transfer pricing provisions are in conflict with Article 24 of the tax treaty as a similar transaction between two national of India would not had attracted the transfer pricing provisions of the Act.

Tax Department's contentions

Status/rate of tax of the proposed firm

The wide powers given to the managing partner in the proposed firm resembles the position of the managing director in a company. Further the requirement of section 184 of the Act regarding the individual shares of the partners should be specified in the agreement was not fulfilled as the PI has been defined in terms of number of units, which are subject to adjustment. Thus, the individual shares of the partners are variable and cannot be said to have been specifically defined in the partnership agreement.

Chargeability of the transfer of PI

Since the transaction was in the nature of international transaction the provisions of transfer pricing would be attracted and the value of the capital gains should be computed in line with ALP.

AAR Ruling

Status/rate of tax of the proposed firm

³ Following conditions are specified under section 184 of the Act:

- i) the partnership firm is evidenced by an instrument and
- ii) the individual shares of the partners are specified in the instrument

- The AAR observed that provision of the partnership Act of Alberta (Canada) was very similar to those of the Indian Partnership Act, 1932.
- The AAR further observed that if the individual shares of the partners could be reasonably obtained from the provision contained in the partnership deed, then the requirements of section 184(1)(ii) would be deemed to be satisfied.
- Since the shares of the individual partners could be easily ascertained from the draft deed the proposed firm will be considered as 'Firm' under section 184 of the Act.

Chargeability of the transfer of PI

- Section 45(3) of the Act is a special provision for the computation of capital gains resulting from the capital contribution made by the partner to the firm whereas the provisions relating to transfer pricing are special provisions for the computation of an international transaction between the associated enterprises.
- AAR observed that the interpretation given in the 'Maxwell on the Interpretation of Statutes' (Twelfth Edition) tells that if two provisions of the same statute are conflicting then the provision came later will be attracted. Since the transfer pricing provisions are later in time, they would be applicable in current case.
- AAR then relied on the judgment of the Supreme Court⁴ where in it held that conflict due to same provision has to be resolved by reference to the purpose and policy underlying the two enactments and the clear intent conveyed by the language of the relevant provisions.
- By applying the combined effect of above two observations, AAR held that since the transfer pricing provisions were enacted to tackle the price manipulation and the apprehension of price manipulation is real event in international transactions between associated persons such as partners and firm, the transfer pricing provisions were held to apply.

Applicability of the tax treaty

The AAR held that since the applicability of the transfer pricing provisions is based on the residential status of the entities and not with reference to their nationality as envisaged in Article 24 the plea of discrimination raised by the taxpayer under Article 24 of the tax treaty was without any basis.

⁴ Ashoka Marketing Ltd. v. Punjab National Bank [1990] 4 SCC 406 (SC)

Our Comments

The AAR has upheld the importance of transfer pricing provisions over capital gains provisions. It emphasises the relevance of examining the transfer pricing provisions in any transaction between a resident and non-resident.

The ruling also lays down an important principle that in case of conflict between two special provisions under the Act, the later provision will prevail over the earlier provision. We would like to bring to your attention the decision of the Madras High Court⁵ wherein the court held that if a case appears to be governed by two provisions, it was clearly the right of the taxpayer to claim that he should be taxed under that one which leaves him with a lighter burden.

Further, the AAR ruling also emphasises that the tax planning within the four corners of law is acceptable and not liable to be challenged by the revenue merely because it reduces the liability of the taxpayer.

The AAR's observations on the analysis of treatment of a particular entity as a partnership under the Indian laws may be helpful to analyse the tax treatment of Limited Liability Partnership (LLP) recently introduced in India under the LLP Act.

Disclaimer

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

⁵ CIT v. Bosotto Brothers Limited [1938] (8 ITR 41)

**For further information about KPMG in India and our services,
please contact:**

Bangalore

Maruthi Infotech Centre, 11-12/1
Inner Ring Road
Koramangala, Bangalore 560071
Phone: + 91 80 3980 6000 Fax: +91 80 3980 6999

Chennai

KPMG House
No.10, Mahatma Gandhi Road,
Nungambakkam High Road,
Chennai 600034
Phone: +91 44 39145000 Fax: +91 44 39145999

Delhi

DLF Cyber City, Building no. 10, Block B, Phase II
Gurgaon, Haryana 122 002
Phone: +91 124 307 4000 Fax: +91 124 254 9195

Hyderabad

KPMG, 8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad - 500 034
Phone: +91 40 66305000/23350060 Fax: + 91 40 6630 5299

Kolkata

KPMG Infinity Benchmark
Plot No. G-1, 10th floor Block - EP & GP,
Sector – V, Salt Lake City
Kolkata - 700091
Phone: +91 33 4403 4000 Fax: +91 33 4403 4199

Mumbai

KPMG House, Kamala Mills Compound, 448 Senapati Bapat Marg
Lower Parel, Mumbai 400 013
Phone: +91 22 39896000 Fax: + 91 22 39836000

Pune

703, 7th Floor Godrej Castlemaine, Next to Ruby Hall Clinic,
Bund Garden Road, Pune 411001
Phone: +91 20 30585764/65 Fax: +91 20 3058 5775