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TAX FLASH NEWS

21 November 2017

Anti-avoidance provisions of Section 93 of the Income-tax Act do not apply where assets are transferred from a non-resident to a resident

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Tata Industries Ltd[1] (the taxpayer) held that no capital gains addition is to be made under Section 93 of the Income-tax Act, 1961 (the Act) on sale of Indian company's shares by a Mauritian subsidiary to another Indian company. Section 93 of the Act prescribes that the property should be transferred by a resident to a non-resident. However, in the present case, a non-resident company has transferred property i.e. shares to a resident and that resident is an unrelated party. Absence of transfer by resident to a non-resident entity takes the transaction out of the ambit of Section 93 of the Act.

Facts of the case

- AT & T Corporation had entered into a Joint Venture (JV) with Birla Group in 1995 for providing wireless tele-communication services in India. The JV obtained license from the Government of India.
- AT & T Group made investment in JV through its Mauritius based company namely AT & T Cellular Mauritius Ltd. (subsequently renamed as Apex).
- In the year 2000, JV and the taxpayer entered into a shareholders agreement, pursuant to which the three parties (Tatas, Birlas and AT & T) agreed to a three-way-venture and to merge Tata Cellular Ltd. into Birla AT &T Communications Ltd. (BACL). Later on name of the Company was changed to Idea Cellular Ltd.
- In 2004, Cingular Wireless Group acquired AT & T Wireless Services and renamed it as New Cingular Wireless Services.
- The taxpayer acquired 371.78 lakh shares of Idea Cellular Ltd from new Cingular Wireless Services and MMM Holdings LLC. The taxpayer paid USD1050,00,000 to New Cingular and USD4,50,00,000 to MMM Holdings. The taxpayer became the holding company of AT & T Cellular Mauritius Ltd. i.e. of Apex.
- Apex was a resident of Mauritius having TRC from Mauritius government in the year 1995 as required by CBDT Circular[2].
- Apex and the taxpayer were holding shares of Idea and both of them sold those shares to Birla group in the year under appeal. The taxpayer paid tax on the capital gains arising out of the sale of shares sold by it and it did not pay tax for the sale transaction entered into by Apex.
- The Assessing Officer (AO) invoked the provisions of Section 93 of the Act and held that capital gains arising out of sale of shares by Apex had to taxed in the hands of taxpayer. The CIT(A) confirmed the order of the AO and held that transaction had to be taxed as short term capital gains and not as long term capital gains.
- The taxpayer argued that the entire capital gain which arose to Apex upon the transfer of shares of Idea was exempt under Article 13(4) of the India-Mauritius tax treaty (the tax treaty).

[1] Tata Industries Ltd. v. ACIT (ITA No. 6750/Mum/2014) – Taxsutra.com

[2] CBDT Circular 789, dated 13 April 2000

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Tribunal's decision

- Section 93 of the Act is successor of Section 44D of Income-tax Act, 1922. The object of both the sections is clear from the title itself. The preamble of section talks of 'avoidance of income-tax by transactions resulting in transfer of income to non-residents'.
- The only and logical conclusion that can be drawn from the above mentioned words is that the object behind the sections is to prevent residents of India from evading the payment of by transferring their assets to non-residents while enjoying the income by adopting questionable methods.
- The language of the section is plain and unambiguous. The purpose of incorporating the provision was to curb the practice of tax avoidance by the resident taxpayers by transferring their assets to non-residents and enjoying the fruits of the assets even after such transfer.
- What matters is the result envisaged by the said section i.e. a non-resident is the transferee of the assets but the taxpayer acquires the power to enjoy the income from those assets. In short, if a resident has power to enjoy the income accruing /arising out of the assets transferred to a non-resident, such resident would be deemed to have received that income and therefore, would be liable to be assessed under the Act.
- Being a deeming provision, Section 93 has to be strictly construed and has to be taken to its logical conclusion. It means that if the situation specified in the section exists, only then it will be applicable.
- One of the basic facts i.e. transfer of property by a resident to a non-resident is not there in the whole transaction. In the instant case, a non-resident company has transferred property i.e. shares to a resident and that resident is an unrelated party. Absence of transfer by resident to a non-resident entity takes the transaction out of the ambit of Section 93 of the Act. Therefore, the tax department wrongly invoked the provisions of Section 93 of the Act.
- Relying on the decision in the case of Azadi Bachao Andolan[3], the Tribunal observed that as far as applicability of tax treaty provision vis-à-vis Section 93 of the Act is concerned, the tax treaty would prevail over the Act.

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

Our comments

The Mumbai Tribunal in the instant case has dealt with the issue with respect to applicability of Section 93 of the Act on transfer of shares of Indian company by a Mauritian company to another Indian company. The Tribunal observed that as per Section 93 there has to be transfer of property from a resident to non-resident and such a resident enjoys the income out of such transferred assets. However, in the instant case, the non-resident has transferred the property to the resident and therefore the provisions of Section 93 of the Act are not applicable.

This decision may help taxpayers in whose cases the tax department has taken a similar stand. In the instant case, the Indian company's shares have been sold by a Mauritian company to another Indian company and the Mauritian company has claimed the benefit of India-Mauritius tax treaty. However, it is pertinent to note that the India-Mauritius tax treaty has been amended to provide that India shall have the right to tax capital gains arising from Financial Year 2017-18 onwards, from the alienation of shares of an Indian resident company acquired on or after 1 April 2017.The shares acquired before 1 April 2017 shall continue to avail exemption on the sale through a grandfathering provision. With respect to capital gains arising in the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50 per cent of the domestic tax rate of India, subject to fulfillment of the Limitation of Benefits (LOB) Article.

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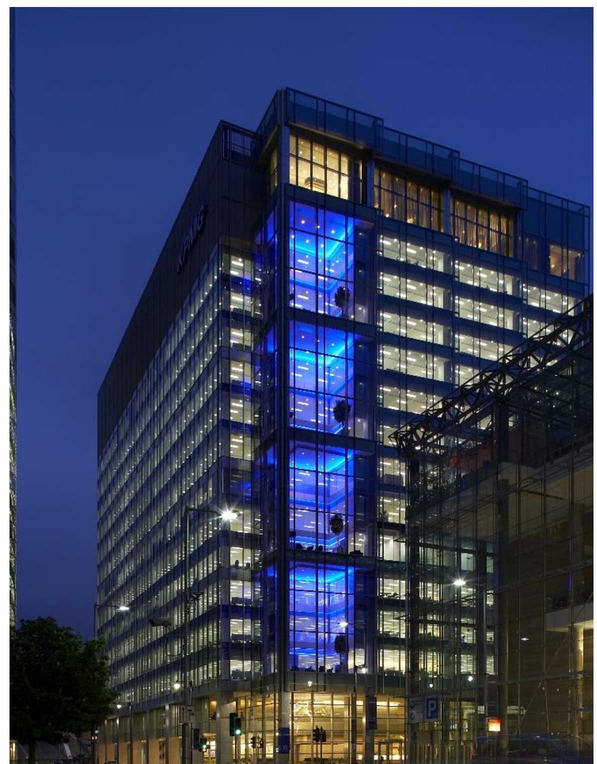

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Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur
Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

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