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The Limitation of Relief provisions under Article 24 of the India-Singapore tax treaty do not apply to capital gain which is taxable in Singapore under Article 13(4) of the tax treaty

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of D.B. International (Asia) Ltd.[1] (the taxpayer) held that the Limitation of Relief provisions under Article 24[2] of the India-Singapore tax treaty (the tax treaty) do not apply to capital gain derived from the sale of shares, debt instruments and derivatives of an Indian company which is taxable in Singapore under Article 13(4)[3] of the tax treaty. The Limitation of Relief provisions under Article 24 of the tax treaty state that income derived from a source state (i.e. India) should either be exempt from tax or taxed at a reduced rate in the source state. However, the capital gains tax provisions under Article 13(4) of the tax treaty state that gain derived by a resident of a contracting state (i.e. Singapore) shall be taxable only in that state. Thus, Article 13(4) of the tax treaty is not an exemption provision, but it provides taxability of particular income in a particular state by virtue of residence of the taxpayer. Accordingly, Limitation of Relief provisions under Article 24 of the tax treaty do not apply to the transaction undertaken by the taxpayer.

[1] DCIT v. D.B. International (Asia) Ltd (ITA No. 992/Mum/2015) – Taxsutra.com

[2] Limitation Relief – Article 24 of the tax treaty provides that where tax treaty provides that income from sources in a contracting state shall be exempt from tax, or taxed at a reduced rate in that contracting state and under the laws in force in the other contracting state the said income is subject to tax by reference to the amount thereof which is remitted to or received in that other contracting state and not by reference to the full amount thereof, then the exemption or reduction of tax to be allowed under the tax treaty in the first-mentioned contracting state shall apply to so much of the income as is remitted to or received in that other contracting state.

[3] As per Article 13(4) of the tax treaty, the gain derived by the resident of a contracting state from the sale of any property shall be taxable only in that state. In other words, it will be taxed in the country where the taxpayer is a resident.

Facts of the case

- During the Assessment Year (AY) 2011-12, the taxpayer, a tax resident of Singapore, derived capital gain on sale of shares, debt instruments, and derivatives of the Indian company. The taxpayer claimed that the capital gain was exempt under Article 13(4) of the tax treaty since it was liable to tax in Singapore on its worldwide income.

- The Assessing Officer (AO) held that even though the provisions of Article 13(4) of the tax treaty allows exemption of capital gain in the source country i.e., India, the provisions of Article 24 of the tax treaty provides for restriction of such exemption in respect of capital gain to the extent of income repatriated to the country of residence i.e., Singapore. Referring to the provisions of Singapore Income-tax Act, the AO observed that the income had to be taxed on receipt basis in Singapore even for the income received outside Singapore. Since the income from capital gain was not repatriated to Singapore in terms of Article 24 of the tax treaty, it had to be taxed in India under the Income-tax Act, 1961 (the Act) and exemption under Article 13(4) of the tax treaty cannot be allowed. Accordingly, the short-term capital gain was liable to tax in India.

- The Dispute Resolution Panel (DRP) held that the entire income received by the taxpayer from all sources was taxable in Singapore irrespective of the fact whether it is received in Singapore or not. The capital gain derived from the sale of equities, debt securities and derivatives constitutes trade source income accruing in or derived from Singapore and was subject to tax in Singapore under the Singapore Income-tax Act. The taxpayer does not have a Permanent

Establishment (PE) in India, and hence it was held that as per Article 13(4) of the tax treaty, Singapore had the exclusive right to tax the income and the restriction imposed under Article 24 of the tax treaty would not apply.

- The DRP referred to the letter issued by the Inland Revenue Authority of Singapore (IRAS) confirming that the taxpayer was liable to tax in Singapore on its worldwide income.

- The DRP observed that once it was held that the capital gain was to be taxed in the country of residence of the taxpayer, the applicability of Article 24 becomes redundant since the income was taxable in Singapore with reference to full amount and not with reference to the amount remitted to or received in Singapore. Accordingly, the DRP held that the capital gain derived by the taxpayer was not taxable in India under Article 13 of the tax treaty.

Tribunal decision

- On a perusal of Article 13 of the tax treaty, it was observed that the capital gain derived by the taxpayer from the sale of Indian securities would fall within the purview of Article 13(4) of the tax treaty. In the present case, the taxpayer was a resident of Singapore. Therefore, as per Article 13(4) of the tax treaty, the gain derived by the taxpayer from the sale of Indian securities could only be taxed in Singapore. The applicability of Article 24 of the tax treaty would not arise in the present case.

- Article 24 of the tax treaty was applicable on fulfillment of two conditions – (i) income derived from the source state (i.e. India) is either exempt from tax or taxed at a reduced rate in the source state; and (ii) the amount remitted/received out of such income in the resident state (i.e. Singapore), was taxable to the extent of such remittance/receipts. If both the conditions are satisfied, then the exemption is allowed or the reduced rate of tax is levied on the amount so remitted.

- The first condition which Article 24 of the tax treaty provides that the income derived from a source state should either be exempt from tax or taxed at a reduced rate in that state. Article 13(4) of the tax treaty does not state that the capital gain derived in a source state is exempt from taxation in that state. Article 13(4) of the tax treaty states that capital gain derived by a resident of a contracting state shall be taxable only in that state.

- Thus, Article 13(4) of the tax treaty is clear and unambiguous, and it states the taxability of particular income in a particular state by virtue of residence of the taxpayer. The provisions of Article 24 of the tax treaty do not have much relevance insofar as it relates to the applicability of Article 13(4) of the tax treaty to income derived from capital gain.

- The expression 'exempt' with reference to the capital gain derived by the taxpayer was loosely used. On the contrary, the overriding nature of Article 13(4) of the tax treaty makes the capital gain taxable only in the country of residence of the taxpayer. Accordingly, it was held that the capital gain derived by the taxpayer was not taxable in India under Article 13(4) of the tax treaty.

Our comments

The applicability of Limitation of Relief clause under the India-Singapore tax treaty vis-a-vis taxation of capital gain has been a matter of debate.

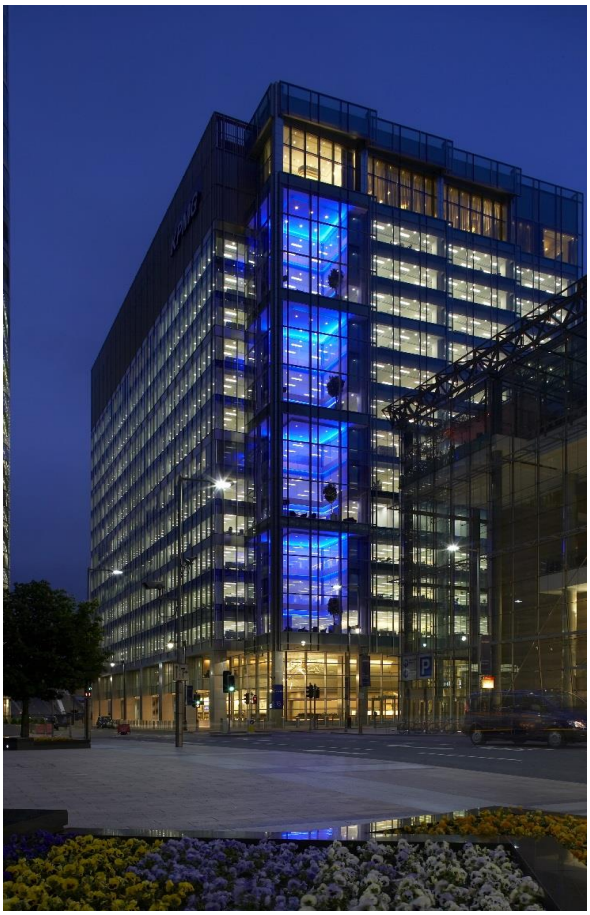
The Mumbai Tribunal in the case of Citicorp Investment Bank (Singapore) Ltd[4] upheld the capital gains tax exemption under Article 13(4) of the tax treaty on the sale of debt instruments. The Tribunal disregarded the applicability of the Article 24 of the tax treaty.

In the present case, the Mumbai Tribunal observed that Article 24 of the tax treaty was not applicable since first condition of exemption/taxation at a reduced rate in source state was not fulfilled. The capital gains tax provisions under the tax treaty state that gain derived by a resident of a contracting state (i.e. Singapore) shall be taxable only in that state. Such provisions were not exemption provisions, but it provides taxability of particular income in a particular state by virtue of residence of the taxpayer.

It is important to note that the tax treaty has been amended with effect from 1 April 2017. However, this decision deals with the tax treaty as it stood prior to the amendment. Under the revised tax treaty, India has a right to tax capital gains

[4] Citicorp Investment Bank (Singapore) Ltd [2017] 81 taxmann.com 368 (Mum)

arising on sale of shares of Indian companies acquired on or after 1 April 2017. However, the principles emerging from this decision are still relevant as under the amended tax treaty, capital gains on the sale of (a) instruments other than shares; and (b) shares acquired before 1 April 2017 continue to remain outside the purview of Indian taxation. Further, under the amended tax treaty, capital gains on the sale of shares acquired and disposed between 1 April 2017 and 31 March 2019 (transition period) are taxable in India at 50 per cent of the tax rate applicable under the Act. Thus, based on this decision, Article 24 would only apply to capital gains which are taxable in India at a 'reduced rate' during the transition period provided such gains are taxable in Singapore on a remittance basis.



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