

TAX FLASH NEWS

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Short Term Capital Gains arising to a Non Resident on sale of units of equity oriented mutual funds are not taxable under India-UAE treaty

Background

For a taxpayer qualifying to be a non-resident (NR) in India, income received, accrued or arising or deemed to be received, accrued, arising in India would be subject to tax in India. However, taxation in case of NR is subject to benefits available under the provisions of the relevant Double Taxation Avoidance Agreement between India and the Country of Residence of such NR.

In this context, the Cochin bench of the Income Tax Appellate Tribunal (the Tribunal) recently held¹ that for a taxpayer who is a resident of UAE [for the purposes of the Double Taxation Avoidance Agreement between India and the UAE (the Treaty)], Short Term Capital Gain (STCG) arising from sale of units of equity oriented mutual funds are not liable to tax in India in accordance with the provisions² of the treaty as such STCG would be taxable in the country of residence on the basis that shares and equity oriented mutual funds are two separate types of securities.

Facts of the case

- The taxpayer, a NR in India for the Assessment Year (AY) 2012-13, was a resident of the UAE and had obtained a Tax Residency Certificate from the revenue authorities of the UAE for the relevant period.
- During the AY 2012-13, the taxpayer had sold equity oriented mutual funds in India and had STCG from such sale amounting to INR13,499,407.
- While filing the India tax return for the said AY, the taxpayer had claimed such STCG as exempt by virtue of Article 13(5) of the Treaty.

- During the scrutiny assessment, the Assessing officer (AO) had held that the underlying instrument of an equity oriented mutual fund is a share and consequently, as per Article 13(4) of the Treaty, STCG should be taxable in India. Accordingly, the AO denied such exemption claimed by the taxpayer and added a sum of INR13,499,407.
- Aggrieved by the order passed by the AO, the taxpayer had filed an appeal with the Commissioner of Income-tax (Appeals) CIT(A). The CIT(A) relying on a judicial precedent³ held that STCG would not be taxable in India as the equity oriented mutual funds are not shares and therefore Article 13(5) of the Treaty (and not Article 13(4)) would be applicable.
- Aggrieved by the order of the CIT(A), the tax department had filed an appeal with the Tribunal.

Tax department's contentions

- The tax department contented that the underlying instrument of any equity oriented mutual fund is nothing but a share and hence the gains arising from the sale of equity oriented mutual fund would result in sale of shares.
- Accordingly, such gains from sale of shares (units of mutual funds in the instant case) is taxable under Article 13(4) of the Treaty which provides that income arising to a resident of UAE from transfer of shares (and not any other property) in India, may be taxed in India.

Tribunal's observation and ruling

- Tribunal observed that the taxpayer had qualified to be a NR and accordingly, the sale of equity oriented mutual fund in India would be taxable⁴ in India.

¹ DCIT (International Taxation) Kochi v. Sri.K.E.Faizal (ITA No.423/Coch/2018)

² Article 13(5) of the Treaty

³ ITO (IT) v. Satish Beharilal Raheja [2013] 37 taxmann.com 296 (Mum)

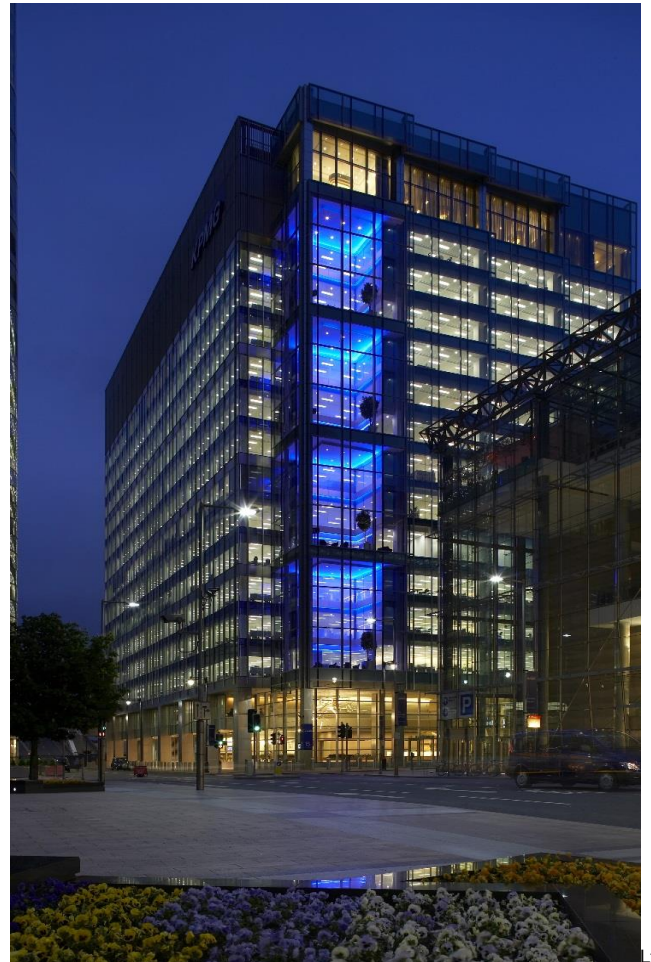
⁴ Section 5(2) of the Income-tax Act, 1961

- However, considering the provisions of the treaty, the Tribunal observed the following:
 - Term, 'share' is not defined under the treaty; hence share would carry the meaning as per the Act
 - As per the provisions of Securities and Exchange Board of India (Mutual Funds) Regulations, 1995, mutual funds in India can be established only in the form of 'trusts' and 'not companies'
 - The definition of Security under the Securities Contract (Regulation) Act, 1956, it can be inferred that shares and units of mutual funds are two different types of securities
 - As per Article 13(5) of the Treaty, income arising to a resident of UAE from transfer of property other than shares in an Indian company, are liable to tax only in the UAE.
- The Tribunal also placed reliance of judicial precedents⁵ wherein it was held that units of mutual funds cannot be regarded as shares.
- Given the above, the Tribunal held that for a taxpayer who is a resident of UAE, STCG arising from sale of units of mutual funds (and not shares) are not liable to tax⁶ in India and consequently dismissed the appeal of the tax department.

Our comments

This decision provides clarity that shares and units of a mutual fund are two separate types of securities. The Tribunal also upheld that provisions of the treaty shall apply to the extent that they are more beneficial to the taxpayer as compared to the corresponding provisions of the Act.

Considering this is a fact specific case and a ruling of the Tribunal, adoption of the same in other jurisdictions /set of facts could be evaluated on a case-to-case basis.



⁵ Income-tax Officer v. Satish Beharilal Raheja [(2013) 37 taxmann.com 296], Apollo Tyres Ltd v. CIT [2002] 122 Taxman 562 (SC)

⁶ Article 13(5) of the Treaty

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