KPMG

Tax Flash News

8 September 2023

The Singapore company is eligible for tax treaty benefits on capital gains arising from the transfer of shares of Indian companies

Executive summary

The claim of tax treaty benefits on capital gains arising in the hands of non-resident shareholders from the sale of shares of an Indian company has been a controversial issue from a long time. In many cases[1], the Assessing Officer (AO) has been disregarding intermediary company and treating the ultimate holding company as a beneficial owner. The AO has been denying the tax treaty benefits to the taxpayer. The Courts/Tribunal have given the benefit of the tax treaty based on facts of each case and on the basis of various factors like valid Tax Residency Certificate (TRC), period of holding, genuineness of business, place of decision, etc.

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of the Golden State Capital Pte Ltd[2] (the taxpayer) dealt with the issue of eligibility of India-Singapore tax treaty (the tax treaty) benefits to the Singaporean company on the capital gain arising from the transfer of shares of Indian companies. The Tribunal held that the taxpayer had furnished valid evidence to prove the commercial substance and residency in Singapore. The documents proved that the affairs of the taxpayer were not controlled from outside Singapore. The AO had approached the entire issue with a pre-conceived mind to reach the pre-determined destination of denying the tax treaty benefits. Accordingly, the taxpayer was eligible for the tax treaty benefit. Further, the GAAR provisions did not apply to the taxpayer's transaction. The Tribunal allowed exemption to Short Term Capital Gains (STCG) from taxability in India. Further, the carry forward of Long-Term Capital Loss (LTCL) was also allowed.

[1] Especially in Mauritius and Singapore tax treaties related cases
[2] The Golden State Capital Pte Ltd v. DCIT (ITA No. 1686/Del/2022) (Del) – Taxsutra.com

Facts of the case

- The taxpayer is a Singapore-based company incorporated in 2009. It is engaged in investment holding and general wholesale trade. It is a subsidiary of a British Virgin Islands (BVI) based company. The taxpayer was the owner of shares issued by two Indian companies i.e., DFHPL and DFSPPL.

- In the Financial Year (FY) 2017-18, the taxpayer sold the shares and earned STCG on account of the sale of shares of DFHPL and incurred LTCL on account of the sale of shares of DFSPPL. The taxpayer claimed that STCG is exempt under Article 13 of the tax treaty. Further, LTCL was carried forward to a subsequent year. The taxpayer furnished the TRC issued by the Singaporean Tax Authorities to claim the tax treaty benefit.

- The Assessing Officer (AO) held the taxpayer was not eligible for the tax treaty benefit due to lack of commercial substance in Singapore. The TRC was not sufficient evidence to establish the tax residency. The scheme of arrangement employed by the taxpayer was one of tax avoidance through a treaty shopping mechanism. The beneficial owner was the BVI company.

- The Dispute Resolution Panel (DRP) observed that the AO had not established that the beneficial owner was the BVI company. Accordingly, the DRP directed the AO to verify:

  - Whether the affairs of the taxpayer were controlled from outside Singapore?

  - Whether the benefits arising out of the transactions were passed on to the parent company?

- The DRP observed that if the answer to the above verifications are in affirmative, then the tax treaty benefit can be denied. However, in case these issues are not established, the AO is to give the benefit of the tax treaty to the taxpayer.

- With regard to the denial of the deduction of the premium component of the cost of acquisition of shares of DFSPPL for computing LTCL, the DRP held that the observation of the AO that there is a huge variation in the share premium was not correct. The AO was directed to consider the premium on the shares if no other anomaly was observed.

- Without considering the DRP's direction, the AO passed the final order.

Tribunal decision

Procedural issue

- The AO while passing the final assessment order had not followed the directions of the DRP.

- As per the DRP provisions, every direction issued by the DRP shall be binding on the AO. Further the AO is not empowered to raise any new issue in giving effect to the proceedings and continue the addition based on some other reasoning. Once the directions were issued by the DRP, there cannot be any occasion for the AO to seek and consequently, to assert, non-submission of any documentation.

Whether the affairs of the taxpayer were controlled from outside Singapore?

- The taxpayer company had duly reflected the acquisition of shares of two Indian companies at a premium in its balance sheet. This was subjected to verification by the Singapore Tax Authorities and tax assessment orders were passed on the taxpayer for the last three years.

- The AO ought to have accepted the assessment orders of Singapore Tax Authorities which goes to prove that the taxpayer was a tax resident of Singapore and was independently carrying on its business activities in Singapore.

- The documents submitted by the taxpayer prove that the affairs of the taxpayer were not controlled from outside Singapore.

Whether the benefits arising out of the transactions were passed on to the parent company?

- The AO had confirmed that no interest was paid by the taxpayer on the loan to the BVI entity as the loan was interest-free.

- From the financials of the taxpayer, it was observed that no consultancy charges were paid to any entity and there was no debit towards consultancy charges paid in the financials. The AO had considered the payment of consultancy charges made by the taxpayer in the earlier years and linked the same to the year under consideration.

- The AO had approached the entire issue with a pre-conceived mind to reach the pre-determined destination of denying the tax treaty benefits.

Short-term capital gain

- The taxpayer had provided enough evidence (TRC) to prove the case of entitlement of the tax treaty benefits. Hence, it was held that the short-term capital gains on the sale of shares were eligible for tax treaty benefit and were not taxable in India.

Long-term capital loss

- With regard to LTCL, the AO in the draft assessment order had not doubted the quantum of sale consideration but had only doubted the cost of acquisition of unlisted equity shares.

- The AO in the draft assessment order had never alleged the absence of a 'valuation report' for denying the deduction for the premium component involved in the cost of acquisition of shares of DFSPL. The same was claimed under the final assessment order.

- The Tribunal held that this was a gross violation of DRP's directions as the non-submission of the valuation report could not be considered as an anomaly in the instant case, as it was never asked by the AO.

- In any case, there was no need for the taxpayer to even furnish a valuation report to justify the share premium component. No provisions of the Act mandate such a requirement on the taxpayer.

- The acquisition of shares at premium had been duly reflected by the taxpayer in its audited balance sheets.

- The shares were allotted by the Indian Companies to the taxpayer at a premium and the return of allotment in the prescribed form had been duly filed by those Indian Companies with the Registrar of Companies in India.

- The shares were acquired by the taxpayer at a premium and sources for making payments for the same had been duly drawn from the books of accounts.

- Hence, when shares that were lying in the audited balance sheets, were sold by the taxpayer, there was no case for the AO to deny the benefit of such cost (including the premium component) as a deduction. Hence, the AO was directed to allow the benefit of carry forward of LTCL to the taxpayer.

Applicability of General Anti-Avoidance Rules

- This issue was adjudicated by the Delhi Tribunal in the taxpayer's sister concern's case in Reverse Age Health Services Pte Ltd[3]. The Tribunal in the case of Reverse Age Health Services Pte Ltd held that:

    - Domestic GAAR cannot be pressed into operation for denial of a tax benefit, where the taxpayer's case falls within one of the conditions prescribed under Rule 10U(1)(a)[4] and Rule 10U(1)(d)[5] of the Rules.

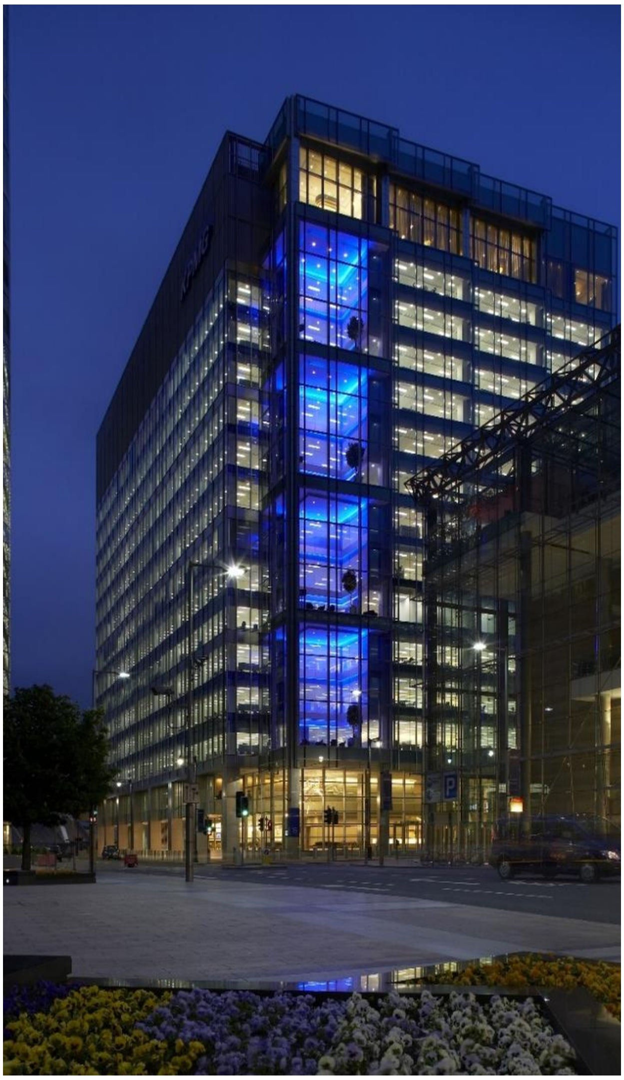
    - Tax on STCG was below the threshold limit of 3 crore and the shares were acquired by the taxpayer prior to the cut-off date of 1 April 2017.

    - Thus, the GAAR provisions did not apply to the taxpayer.

- The facts adjudicated by the Tribunal in the Reverse Age case were identical to the facts of the taxpayer in the present case and therefore GAAR provisions did not apply to this case.

Our comments

While dealing with the eligibility of India-Singapore tax treaty benefits on capital gains transactions, the Delhi Tribunal considered various factors like whether the affairs of the taxpayer were controlled from outside Singapore, whether the benefits were passed on to the parent company, commercial substance in Singapore, etc. In recent times, the Courts/Tribunal after considering similar factors and specific facts of the case, have given the benefit of a tax treaty to the Singaporean/Mauritian taxpayers. However, determining the tax treaty eligibility is fact-driven exercise and the eligibility will be always dependent upon the sanctity of the transaction. The issue may become more complex for the period subsequent to the introduction of GAAR provisions in the Income-tax Act and Principal Purpose Test provisions in the tax treaties.



---

[3] Reverse Age Health Services Pte Ltd v. DCIT (ITA No. 1867/Del/2022, dated 17 February 2023) (Del)
[4] An arrangement where the tax benefit in the relevant assessment year arising in aggregate, to all parties to an arrangement does not exceed the sum of INR3 crores.
[5] Any income accruing or arising to or deemed to accrue or arise to or received or deemed to be received by any person from the transfer of investments made before 1 April 2017 by such person

KPMG in India addresses:

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

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

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

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

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

Mumbai
2nd Floor, Block T2 (B Wing),
Lodha Excellus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

30 years and beyond

https://kpmg.com/in/en/home/social

kpmg.com/in/en/home/social

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000