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Tax on indirect transfer under India-Belgium tax treaty

The Mumbai Bench of the Tribunal has held that capital gains arising to a Belgium tax resident, on transfer of shares of a Singapore company, would not be taxable under the Indian indirect transfer provisions as per Article 13(6) of the India-Belgium tax treaty

Facts of the case:

- Sofina S.A (the taxpayer)[1] is a venture capital investor and a tax resident of Belgium. It had vide separate share subscription agreements dated 09 June 2014 and 23 December 2014, subscribed to Series B and Series C preference shares, respectively, of Accelyst Pte. Ltd. (APL). APL is a tax resident of Singapore.
- The taxpayer held 11.34 percent stake in APL.
- APL held 99.99 percent of the shares in an Indian subsidiary, Accelyst Solutions Pvt Ltd (ASPL). APL did not have any asset except for its investment in ASPL.
- The taxpayer sold its entire stake of 11.34 percent in APL to Jasper Infotech Pvt Ltd (JIPL), an Indian company, for a consideration of US$ 47,362,724. JIPL deducted tax at source while making payment to APL for acquisition of shares.
- The taxpayer was of the view that Article 13(6) of the India-Belgium Tax Treaty (Tax Treaty) was applicable and accordingly, capital gains if any, arising from the transfer of shares of APL would be taxable in Belgium and not in India. The taxpayer thus, filed its Indian income-tax return declaring 'Nil' income and claimed refund of the tax deducted at source.
- The Assessing Officer (AO) in the draft order held that the gain on alienation of shares was taxable in India under the Income-tax Act, 1961 (Act), as well as the Tax Treaty, on the following basis:
  - The shares of APL were deemed to be the shares of a company resident in India;
  - The transfer of shares of APL was an indirect transfer of assets situated in India;
  - The transaction under consideration was taxable in India under Article 13(5) and not exempt from India tax under Article 13(6) of the Tax Treaty;
  - The AO rejected the taxpayer's reliance on the judicial precedent of the Hon'ble Andhra Pradesh High Court in the case of Sanofi Pasteur[2], on the basis that the Revenue had preferred a Special Leave Petition before the Hon'ble Supreme Court.
- Aggrieved against the AO's draft order, the taxpayer filed objections before the Dispute Resolution Panel (DRP). The DRP upheld the AO's order.
- Aggrieved by the AO's final order, the taxpayer filed an appeal with the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

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[1] ITA no 7241/Mum/2018

[2] Sanofi Pasteur Holding SA vs Department of Revenue, Ministry of Finance (2013) 30 taxmann.com 222 (Andhra Pradesh)

Decision of the ITAT:

- The ITAT held that as per Article 13(5) of the Tax Treaty, the gains are taxable in India, only if:
  – The shares of an India-resident company are transferred; and
  – They represent participation of at least 10 percent of the capital stock of the company.
- In the present case, the shares transferred by the taxpayer are of APL which is tax resident of Singapore. Therefore, in the absence of satisfying the pre-conditions, Article 13(5) of the Tax Treaty will not be applicable.
- Unlike indirect transfer provisions under Explanation 5 to Section 9(1)(i) of the Act, Article 13(5) of the Tax Treaty does not adopt a see-through approach (see-through approach is that, if a person holds shares of a company outside India, which derive their value substantially from the assets located in India, then, such shares of a company outside India are deemed to be located in India). The ITAT placed reliance on the judicial precedent of Sanofi Pasteur[2] in this regard.
- The ITAT held that transfer of shares of APL cannot be regarded as transfer of shares of ASPL.
- With respect to the observations of the lower authorities, the ITAT held that:
  - Amendments made either prospectively or retrospectively to the provisions of the Act cannot be read into the provisions of a tax treaty. The provisions of the Act do not operate to modify or subject the provisions of the tax treaty to the provisions of the Act. The ITAT relied on the judicial precedents[3] of the Delhi and Bombay High Courts in this regard.
  - Accordingly, unilateral amendment by way of Explanation 5 to Section 9(1)(i) of the Act, cannot be read into the Tax Treaty.
  - The purpose of incorporating Explanation 5 to Section 9(1)(i) of the Act was to deem the shares or interest in a foreign company or entity to be situated in India (if it derived substantial value from India) for the purpose of taxation of capital gains under the Act and not for treating the foreign company itself as a resident of India.
  - Accordingly, in the absence of any provision deeming a company resident of Singapore as a resident of India either under the India-Belgium Tax Treaty or under the India-Singapore tax treaty, APL (due to its holding in ASPL) cannot be considered to be a tax resident of India.
- The ITAT affirmed the judicial precedent[2] relied upon by the taxpayer in support of its claim and held that the gains on transfer of APL shares are assessable under provisions of Article 13(6) of the Tax Treaty. Therefore gains, if any, arising therefrom would be taxable only in Belgium and not in India.

Observations:

- This ruling affirms the principle laid down by the Hon'ble Andhra Pradesh High Court in the case of Sanofi Pasteur[2] and would be relevant in cases involving indirect transfer in cases where tax treaties have similar provisions.
- The case also reaffirms the principle that tax treaty benefit would prevail over the domestic laws.

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[3] Director of Income-tax vs New Skies Satellite BV (2016) 382 ITR 114 (Delhi HC) and CIT vs Siemens Aktiongesellschaft (2009) 310 ITR 320 (Bom)