India | Tax & Regulatory | For private circulation only | 13 November 2017

Global Business Tax Alert
Sharp Insights

CBDT clarification on indirect transfer provisions in case of redemption of share or interest outside India

Issue no: GBTA/66/2017

In this issue:

Background

- In 2012, the government had amended the domestic law retroactively to provide that gains from transfer of shares or interest in an entity outside India would be taxable in India if such share or interest derive their value (directly or indirectly) substantially from assets located in India. These provisions are popularly referred to as the "indirect transfer" provisions.
- Concerns have been raised by investments funds investing in India, including private equity funds and venture capital funds set-up as multi-tier investment structures, about multiple taxation of the same income at the time of redemption or buy-back. This multiple taxation arises due to:
  - Firstly, at the level of the fund in India (on its business income / capital gain); and
  - Then, at every upper level of investment in the fund chain on subsequent redemption or buy-back.
- The Central Board of Direct Taxes ("CBDT") had received representations to exclude from the ambit of the "indirect transfer" provisions, investors above the level of direct investor (who is already chargeable to tax in India on such income).
- To address these concerns, the Finance Minister in his Budget Speech on 01 February 2017 had stated that:
  - Category I and Category II Foreign Portfolio Investors ("FPIs") will be exempted from the indirect transfer provisions;
  - A clarification will be issued that indirect transfer provisions shall not apply in case of redemption of share or interests outside India as a result of or arising out of redemption or sale of investment in India which is chargeable to tax in India.
- Necessary amendments have been made to the Income-tax Act, 1961 ("the Act") by the Finance Act, 2017[1], in terms of which Category I and Category II FPIs have been exempted from the indirect transfer provisions.

[1] Through insertion of the proviso to the Explanation 5 to section 9 (1) of the Act with retrospective effect from 01 April 2015.

Further concern and clarification thereon by the CBDT[2]

While the situation has been addressed in the case of Category I and Category II FPIs, there could still be situations of multiple taxation, in multi-tiered investment structures where shares or interest held indirectly by a non-resident in specified funds (viz., investment funds, venture capital company or a venture capital fund) is redeemed in an upstream entity outside India. This redemption is consequent to a transfer of share or security held in India by the specified funds, the income of which has been subjected to tax in India.

Accordingly, it has now been clarified by the CBDT that indirect transfer provisions on redemption of share or interest will not be applicable where:

- Interest or share held indirectly by a non-resident in specified funds, is redeemed in an upstream entity outside India. The redemption is consequent to transfer of shares or securities held in India by the specified funds; and
- Such income on transfer of shares/interest is chargeable to tax in India.

It has further been clarified that the above benefit shall be applicable only in cases where:

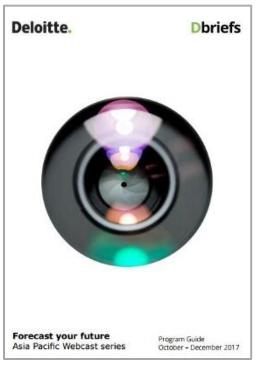
- The proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India; and
- A non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

[2] Vide Circular No. 28/2017 dated 07 November 2017

Comments

This clarification issued by the CBDT addresses the concerns of a select category of overseas investors and with conditions/limits attached thereto.

Do you know about Dbriefs?



Dbriefs are live webcasts that give valuable insights on important developments affecting your business. To register, visit the Dbriefs page

Download the report

Contacts

Ahmedabad
19th Floor, Shapath - V
SG Highway,
Ahmedabad – 380 015.
Tel: + 91 (079) 6682 7300
Fax: + 91 (079) 6682 7400

Bangalore
Deloitte Centre, Anchorage II,
100/2, Richmond Road,
Bangalore 560 025.
Tel: +91 (080) 6627 6000
Fax: +91 (080) 6627 6010

Chennai
No.52, Venkatanarayana Road,
7th Floor, ASV N Ramana Tower,
T-Nagar,
Chennai 600 017.
Tel: +91 (044) 6688 5000
Fax: +91 (044) 6688 5050

Coimbatore
Shanmugha Manram
41, Race Course,
Coimbatore
Tamil Nadu - 641018
Tel: + 91 (0422) 439 2801
Fax: +91 (0422) 222 3615

Delhi/Gurgaon
Building 10,
Tower B, 7th Floor,
DLF Cyber City,
Gurgaon 122 002
Tel : +91 (0124) 679 2000
Fax : + 91 (0124) 679 2012

Hyderabad
1-8-384 and 385, 3rd Floor,
Gowra Grand S.P.Road,
Begumpet,
Secunderabad – 500 003.
Tel: +91 (040) 6603 2600
Fax:+91 (040) 6603 2714

Kolkata
Bengal Intelligent Park Building
Alpha, 1st floor, Block EP and GP
Sector V, Salt Lake Electronics
Complex,
Kolkata - 700 091.
Tel : + 91 (033) 6612 1000
Fax : + 91 (033) 6612 1001

Mumbai
Indiabulls Finance Centre,
Tower 3, 28th Floor,
Elphinstone Mill Compound,
Senapati Bapat Marg, Elphinstone
(W),
Mumbai – 400013
Tel: + 91 (022) 6185 4000
Fax: + 91 (022) 6185 4101

Pune
706, B-Wing, 7th Floor,
ICC Trade Tower,
Senapati Bapat Road,
Pune – 411 016.
Tel: + 91 (020) 6624 4600
Fax: +91 (020) 6624 4605

Deloitte makes an impact that matters