



Global Business Tax Alert

Sharp Insights

The Bangalore Tribunal in the case of Fidelity Business Services India Pvt. Ltd¹. has held that claim for capital gains exemption by the Mauritius holding company towards buy back of shares needs to be substantiated by evidence that buy back price is not artificially inflated.

Issue no: GBTA/33/2017

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¹ M/s Fidelity Business Services India Pvt. Ltd. vs. ACIT I.T. (T.P) A. No. 416/ Bang/ 2016

Background / Facts

- Fidelity Business Services India Pvt. Ltd. ('the taxpayer'), an Indian company bought back 2,933 shares (face value INR 10) from its ultimate Mauritius holding company holding 99.99% shares, of INR 2,85,108 per share.
- The assessing officer ('AO') was of the view that the payment made by the taxpayer towards such buy back is deemed dividend under the ² Income tax Act 1961 ('Act') and accordingly, subject to ³Dividend Distribution Tax ('DDT') for the assessment year 2011-12.
- AO computed the dividend being the difference between the face value of shares and the amount paid by the taxpayer towards the buy back price to the holding company.

²Section 2(22)(d) of the Act

³Under Section 115-O of the Act

Revenue's key contentions

- The taxpayer has adopted a colourable device to make the payment out of the reserves and surplus to its holding company in the garb of buy back of shares at a very exorbitant high price without payment of taxes.
- The transaction should be subject to DDT liability under the Act.

Taxpayer's key contentions

- ⁴Prior to June 1, 2013, buy back of shares is subject to capital gains tax in the hands of the shareholder under Section 46A of the Act. Since such capital gain is not taxable as per ⁵India-Mauritius tax treaty, ⁶AO cannot reclassify the said transaction of buy back of shares into transaction of dividend distribution with a view to tax it in India.
- ⁷Central Board of Direct Taxes ('CBDT') has clarified that any consideration received on buy back of shares between the periods April 1, 2000 to May 31, 2013 would be taxed as capital gains. Since, capital gains are exempt from tax as per India Mauritius tax treaty, subject transaction is not taxable in India.
- Separately, section 2(22) which deals with provisions of deemed dividend specifically excludes buy back of shares in the definition of dividend. Hence, such transaction cannot be taxed as deemed dividend.

⁴Finance Act 2013 has inserted Section 115QA under the Act w.e.f. June 1, 2013 whereby the buy back of shares by the unlisted companies will attract distribution tax @ 20% (plus applicable surcharge and cess) in the hands of the company.

⁵Refer Article 13(4) of the Double Taxation Avoidance Agreement entered into between Indian and Mauritius.

⁶Relied upon a decision rendered by the Mumbai bench of Tribunal in the case of 'Goldman Sachs India Pvt. Ltd. vs. ITO' (International Taxation) 70 Taxmann.com 46

⁷Circular no. 3/16 dated February 26, 2016

Ruling of the Tribunal

- Tribunal took note of the fact that the subject transaction cannot be taxed as capital gain due to specific exemption provided under the India- Mauritius tax treaty.
- It was held that if the buy back price paid to the holding company is unrealistic and highly inflated, then to that extent, the subject transaction can be said to be given a colour of payment towards buy back.
- The tribunal remanded back the case to AO to examine the Fair market value ('FMV') of the share vis-à-vis the buy back price as the tribunal found that the AO and the DRP had not recorded an express finding on the FMV of the shares.

Conclusion

The tribunal has upheld the legal position that transaction of buy back of shares from a Mauritius company prior to 01.06.2013 is exempt from tax provided assessee brings on record robust documentation to substantiate the transaction value.

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Contacts

Ahmedabad

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

Coimbatore

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

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

Bangalore

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

Delhi/Gurgaon

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

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

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

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

Pune

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



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