



Global Business Tax Alert

Sharp Insights

Alienation of shares of Indian company by Dutch company covered under Article 13(5) of India-Netherlands DTAA, thus, not taxable in India: High Court¹

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¹ Director of Income-tax (International Taxation), Hyderabad vs. Vanenburg Facilities B.V. [82 taxmann.com 433 (Andhra Pradesh & Telangana)]

Background/ Facts

- Vanenburg Facilities B.V. (the 'taxpayer') is a company incorporated in the Netherlands and a resident of the Netherlands as per Article 4 of Double Taxation Avoidance Agreement between India and the Netherlands ('the DTAA').
- The taxpayer holds 100% of shares in an Indian company named Vanenburg IT Park India Private Limited ('VITPL'). VITPL is in the business of developing, maintaining and operating an industrial park at Madhapur in Hyderabad.
- During the financial year 2004-05, the taxpayer sold all its shares in VITPL to another non-resident company (the 'purchaser') under a share purchase agreement.
- In the return of income, the taxpayer claimed that capital gains arising out of sale of shares in VITPL is not taxable in India in accordance with Article 13 of the DTAA read with section 90 of the Act.
- During the course of the assessment proceedings, the taxpayer claimed that in the light of the specific provisions made for capital gains arising out of transfer of shares in Articles 13(4) and 13(5), the same would override the general provisions in other paragraphs of Article 13.
- The Assessing Officer ('AO') observed that in the present case the value of the transferred shares comprised mainly business-purpose immovable property located in India and thus, Article 13(4) would not be applicable and for deciding the taxability of such capital gains, other paragraphs of Article 13 had to be examined. Holding so, the AO opined that Article 13(1), relating to capital gains arising from alienation of immovable property referred to in Article 6 of the DTAA, would be applicable.
- Referring to Article 6, the AO observed that immovable property thereunder was to have the same meaning which it would have under the law of the state in which the property is situated. The AO then referred to Section 2(47) and Section 269UA(d) of the Act and concluded that shares of VITPL partake the character of immovable property under the Act and, therefore, capital gains arising from alienation of such shares are chargeable to tax in India, under Article 13(1) of the DTAA.
- On appeal, the CIT (Appeals) upheld the order of the AO and dismissed the appeal of the taxpayer. The Tribunal, however, allowed the appeal of the taxpayer and quashed the order of the AO.

Ruling of the High Court

- The Andhra Pradesh and Telangana High Court observed that the Hon'ble Supreme Court in the case of Vodafone International Holdings B.V.² pointed out that a company is a separate legal persona and the fact that all its shares are owned by one person has nothing to do with its separate legal existence. This being the settled legal position, the analogy adopted by the AO that by virtue of the taxpayer's shareholding in the company, it acquires rights in the property owned by such company, does not withstand judicial scrutiny.

- The High Court further held that the AO and the CIT (Appeals) failed to note the difference between alienation of the company's immovable property, falling under Article 13(1) of the DTAA, and alienation of the company's shares by a shareholder, attracting Article 13(4) or (5) thereof.
- It was held that the AO and the CIT(A) erred in equating alienation of a company's shares to alienation of its immovable property, by applying the logic that shares partake the character of immovable property.
- The High Court concluded by holding that the Tribunal rightly held that alienation of shares by the taxpayer did not fall under Article 13(1) of the DTAA and that the residuary clause in Article 13(5) thereof would apply and the same would therefore not be taxable in India
- On the contention of the Revenue on falling back on the applicability of Article 13(4), the High Court held that it is not open to the Revenue to now claim that Article 13(4) of the DTAA would have application as the AO, and thereafter, the CIT(A) specifically held that Article 13(4) of the DTAA had no application to the transaction in question. The High Court accepted the taxpayer's objection to the Revenue's claim raised first before the High Court of seeking to tax the transaction under Article 13(4) of the DTAA.

² Vodafone International Holding B.V. vs. Union of India [341 ITR 1 (SC)]

Conclusion

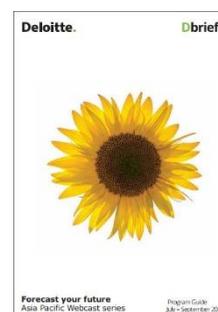
The ruling of the Andhra Pradesh and Telangana High Court in upholding the legal distinction between the concept of 'share sale' as opposed to an 'asset sale' is in line with the law laid down by the Hon'ble Supreme Court in the case of Vodafone International Holdings B.V.

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