The Pulse

India | FPI Newsletter
August 2020
Deloitte Pulse is a quick guide to ongoing tax and regulatory developments in India that is relevant to Foreign Portfolio Investors (FPIs).

It highlights key components of changes, their impact on FPIs, and the way forward.

Our endeavor is to help you comprehend the changes easily and equip you with the requisite knowledge to assist you stay ahead of the curve.
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Standardisation of stamp duty on securities

The Government of India has amended the Indian Stamp Act, 1899 to streamline the stamp duty regime for financial securities transactions. Effective 1 July 2020, transactions carried out in financial securities across India would be subject to the same stamp duty rates regardless of the state in which the purchaser, the seller, or the broker resides. Stock exchanges, clearing corporations, and depositories have the responsibility of collecting stamp duty on secondary market transactions and passing it on to the relevant state government.

Key highlights

• There will be one stamp duty rate on each instrument type unlike the previous regime where different rates could apply depending upon the place of residence of buyer/seller/broker. In addition, stamp duty will be collected by the same organisation across the country.

• In the previous regime, stamp duty was payable by both the buyer and the seller. In the new regime, it is payable only by buyer or seller except in case of certain instruments of exchange where stamp duty shall be borne by both parties in an equal proportion.

• The collecting agent would remit the stamp duty (after retaining 0.2 percent of the duty) to the relevant state government, i.e., the state of domicile of the buyer. If the buyer is a non-resident, stamp duty will be remitted to the state of domicile of the broker/trading member.

Stamp duty rates and collecting agents

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Rate</th>
<th>Payable (borne) by</th>
<th>Collecting agent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue of securities (including equity shares, debentures, and other securities)</td>
<td>0.005%</td>
<td>Issuer</td>
<td>Depository</td>
</tr>
<tr>
<td>Transfer of security (other than debentures and government security)</td>
<td>0.015%</td>
<td>Transfer through stock exchange:</td>
<td>Transfer through stock exchange:</td>
</tr>
<tr>
<td>on delivery basis</td>
<td></td>
<td>Buyer</td>
<td>Stock exchange/clearing corporation</td>
</tr>
<tr>
<td>Transfer of security (other than debentures and government security)</td>
<td>0.003%</td>
<td>Transfer off the stock exchange:</td>
<td>Transfer off the stock exchange:</td>
</tr>
<tr>
<td>on a non-delivery basis</td>
<td></td>
<td>Transferor/Seller/Issuer</td>
<td>Depository</td>
</tr>
<tr>
<td>Transfer/re-issue of debentures</td>
<td>0.0001%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Futures (equity and commodity)</td>
<td>0.002%</td>
<td></td>
<td></td>
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<tr>
<td>Options (equity and commodity)</td>
<td>0.003%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency and interest rate derivatives</td>
<td>0.0001%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other derivatives</td>
<td>0.002%</td>
<td></td>
<td></td>
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<tr>
<td>Repo on corporate bonds</td>
<td>0.00001%</td>
<td></td>
<td></td>
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<tr>
<td>Government security</td>
<td>0%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

No stamp duty in GIFT city

In India, Gujarat has provided exemption from stamp duty for entities that have their registered offices in Gujarat International Finance Tec-City (GIFT City). Additionally, any stamp duty paid on transactions undertaken by such an entity on the National Stock Exchange/Bombay Stock Exchange would be refunded to such an entity by Gujarat’s state government.

The refund of stamp duty would also apply to foreign investors (including FPIs) whose trades are executed through stockbrokers based in GIFT City.
Mauritius vs. Singapore for investing in India

Mauritius has historically been one of the most popular destinations to set up India-dedicated funds. Right from the time, India opened its capital markets to foreign investors; a large chunk of foreign investments into India have been flowing in from Mauritius. At the same time, Singapore has also been a key contributor to FPI flows into India.

The below chart compares the assets under custody (AUC) of FPIs from top 10 countries in the past nine years.

**AUC as on July 31 each year**

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</thead>
<tbody>
<tr>
<td>Mauritius</td>
<td>52</td>
<td>26%</td>
<td>48</td>
<td>22%</td>
<td>72</td>
<td>22%</td>
<td>84</td>
<td>22%</td>
<td>71</td>
<td>19%</td>
<td>83</td>
<td>17%</td>
<td>71</td>
<td>15%</td>
<td>59</td>
<td>13%</td>
<td>45</td>
<td>11%</td>
</tr>
<tr>
<td>USA</td>
<td>51</td>
<td>26%</td>
<td>60</td>
<td>28%</td>
<td>98</td>
<td>30%</td>
<td>117</td>
<td>30%</td>
<td>119</td>
<td>32%</td>
<td>153</td>
<td>32%</td>
<td>162</td>
<td>33%</td>
<td>152</td>
<td>33%</td>
<td>143</td>
<td>34%</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>16</td>
<td>8%</td>
<td>19</td>
<td>9%</td>
<td>26</td>
<td>8%</td>
<td>33</td>
<td>9%</td>
<td>32</td>
<td>9%</td>
<td>44</td>
<td>9%</td>
<td>49</td>
<td>10%</td>
<td>46</td>
<td>10%</td>
<td>36</td>
<td>9%</td>
</tr>
<tr>
<td>Singapore</td>
<td>24</td>
<td>12%</td>
<td>26</td>
<td>12%</td>
<td>39</td>
<td>12%</td>
<td>42</td>
<td>11%</td>
<td>41</td>
<td>11%</td>
<td>49</td>
<td>10%</td>
<td>43</td>
<td>9%</td>
<td>44</td>
<td>9%</td>
<td>42</td>
<td>10%</td>
</tr>
<tr>
<td>UK</td>
<td>12</td>
<td>6%</td>
<td>11</td>
<td>5%</td>
<td>15</td>
<td>5%</td>
<td>17</td>
<td>4%</td>
<td>14</td>
<td>4%</td>
<td>22</td>
<td>5%</td>
<td>23</td>
<td>5%</td>
<td>22</td>
<td>5%</td>
<td>21</td>
<td>5%</td>
</tr>
<tr>
<td>Ireland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>8</td>
<td>2%</td>
<td>9</td>
<td>3%</td>
<td>13</td>
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<td>3%</td>
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<td>Canada</td>
<td>4</td>
<td>2%</td>
<td>4</td>
<td>2%</td>
<td>6</td>
<td>2%</td>
<td>8</td>
<td>2%</td>
<td>9</td>
<td>2%</td>
<td>13</td>
<td>3%</td>
<td>15</td>
<td>3%</td>
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<td>3%</td>
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<tr>
<td>Japan</td>
<td>3</td>
<td>1%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15</td>
<td>3%</td>
<td>18</td>
<td>4%</td>
<td>16</td>
<td>3%</td>
<td>13</td>
<td>3%</td>
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<tr>
<td>Norway</td>
<td>4</td>
<td>2%</td>
<td>5</td>
<td>2%</td>
<td>9</td>
<td>3%</td>
<td>11</td>
<td>3%</td>
<td>10</td>
<td>3%</td>
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<td>2%</td>
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<td>11</td>
<td>2%</td>
<td>11</td>
<td>2%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>3</td>
<td>2%</td>
<td>4</td>
<td>2%</td>
<td>7</td>
<td>2%</td>
<td>7</td>
<td>2%</td>
<td>9</td>
<td>2%</td>
<td>10</td>
<td>2%</td>
<td>11</td>
<td>2%</td>
<td>11</td>
<td>2%</td>
<td>11</td>
<td>3%</td>
</tr>
<tr>
<td>Others</td>
<td>28</td>
<td>14%</td>
<td>34</td>
<td>16%</td>
<td>55</td>
<td>17%</td>
<td>57</td>
<td>15%</td>
<td>61</td>
<td>16%</td>
<td>65</td>
<td>14%</td>
<td>69</td>
<td>14%</td>
<td>73</td>
<td>16%</td>
<td>72</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>196</td>
<td>100%</td>
<td>212</td>
<td>100%</td>
<td>327</td>
<td>100%</td>
<td>383</td>
<td>100%</td>
<td>375</td>
<td>100%</td>
<td>477</td>
<td>100%</td>
<td>486</td>
<td>100%</td>
<td>465</td>
<td>100%</td>
<td>424</td>
<td>100%</td>
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</tbody>
</table>

Source: fpi.nsdl.co.in. For all the years, AUCs for the month of July has been considered, INR has been converted into USD at RBI reference rate as on the last working day of July month each year.
As can be seen from this table, with the amendment of the India–Mauritius tax treaty (which has taken away capital gains tax exemption previously enjoyed by Mauritius entities on sale of shares of Indian companies) and introduction of General Anti-Avoidance Rule in the Indian tax law, effective April 2017, the share of FPI investment from Mauritius has reduced. Though the capital exemption on sale of shares enjoyed by Singapore investors has also gone away in line with the Mauritius treaty amendment, FPI investments from Singapore have remained more or less consistent over the years.

In this context, the following recent developments are noteworthy:

- The Singaporean government has implemented the Variable Capital Company (VCC) regime that allows funds to be set up in the country under a corporate structure without the need to follow regular compliances applicable to companies. The VCC regime fills up the gap Singapore has been lacking when compared with corporate fund regimes available in Mauritius and other countries, such as Luxembourg and Ireland. The regime also allows shifting the domicile of foreign funds to Singapore without the need for winding up in home registration and setting them up afresh in Singapore.

- In September 2019, the Securities and Exchange Board of India (SEBI) replaced FPI Regulations, 2014 with the new FPI Regulations, 2019. In the new 2019 Regulations, FPI categories were consolidated from three to two wherein the previous Category II FPIs (under 2014 Regulations) were deemed as Category I (under 2019 Regulations), provided those FPIs were based in FATF member countries. As Mauritius is not a FATF member country, FPIs from Mauritius could not qualify as Category I unless they appointed an investment manager (which registered itself as a Category I non-investment FPI with SEBI). Besides additional KYC requirements and other consequences, Category II status meant that Mauritius-based FPIs were exposed to Indian indirect share transfer rules whereby redemption/transfer of investors’ shares/interest in the FPI could be subject to Indian capital gains tax.

In April 2020, the FPI Regulations were amended to provide that in addition to FATF member countries, FPIs set up in a country notified by the government could also qualify for Category I FPI registration. Immediately after this amendment, the government issued a notification to specify Mauritius as an eligible country for granting category I FPI registration to FPIs based in the country.

- In February 2020, FATF placed Mauritius in the list of “jurisdictions under increased monitoring” commonly referred to as the “grey list”. This created apprehensions in India that Mauritius-based FPIs could be banned from investing in India. Fortunately, SEBI came out with a quick clarification that placing of Mauritius into the FATF grey list only requires Indian intermediaries to carry out enhanced due diligence per FPI norms; it does not warrant banning Mauritius-based entities to register/continue in India as FPIs.

From a commercial standpoint, Mauritius continues to be one of the most efficient jurisdictions in terms of cost and ease of setting up and operating funds. One would need to wait and see how soon it addresses the FATF AML concerns and how it reacts to initiatives undertaken by other countries (e.g., the VCC regime in Singapore) in attracting the fund industry.
The Finance Act 2020 reintroduced the classic system of taxing dividends in the hands of shareholders with effect from April 2020. Before this date, the dividends were exempt from tax in the hands of shareholders, whereas Indian companies were required to pay a distribution tax on dividends at the effective rate of 20.56 percent. Under the new framework, the effective tax rate on dividends ranges from 20.8 percent to 28.496 percent for non-residents. For residents, the tax rate ranges from 0 to 42.744 percent, depending on the type of taxpayer and the total income.

Indian companies are required to withhold tax at source while paying dividends to their shareholders. For non-residents, dividend tax withholding is governed by two separate provisions under the Indian Income Tax Act, 1961 (ITA): Section 196D for FPIs and Section 195 for other non-residents. In terms of section 196D of ITA, income paid to FPIs in respect of securities (for example, dividend income) is subject to withholding tax (WHT) at 20 percent, whereas under section 195 of the ITA any sum payable to non-residents is subject to WHT at the rates in force. The expression “rates in force” is defined in the ITA. For the purpose of section 195, it means WHT rates provided in the Finance Act of the respective year or the rates provided in the relevant tax treaty, as the case may be.

For FPIs, the shift in the dividend taxation regime from DDT to WHT is a positive change as it allows FPIs to benefit from lower tax rates under the treaties. It also allows them to claim credit of tax in their home countries. Please see Annexure 1 for tax rates on dividend income for FPIs under select treaties. However, FPIs face the following challenges in this regard:

No treaty relief at source: As discussed above, the tax withholding on dividend income paid to FPIs is governed by section 196D of the ITA. This section prescribes a flat WHT rate of 20%. It does not allow the payer of income (Indian company) to consider the treaty benefits for the purpose of WHT. Consequently, even if an FPI is eligible for a lower tax rate on dividend income under the tax treaty (for instance, 10 percent tax rate under the India–UK tax treaty), the Indian company is still required to withhold tax at 20% (plus the applicable surcharge and cess). Though one could argue that wherever the treaty applies, the taxpayer should be subject to the provisions of ITA or treaty (whichever is more beneficial), such argument would not hold good anymore as the Hon’ble Supreme Court of India in a recent ruling3 has held that where the section (under which tax is to be withheld) does not allow the payer to consider treaty rates, taxes are to be withheld at the rates.

2 The WHT of 20% is to be increased by the applicable surcharge and cess as provided in the Finance Act of each year.
specified in ITA and not as per treaty. In this ruling, the Supreme Court also held that if the non-resident taxpayer qualifies for treaty benefits, it can reclaim the excess taxes withheld as a tax refund in its annual tax return.

**Higher surcharge on dividend income:** The effective tax payable under ITA consists of the tax (base tax), surcharge on tax, and health and education cess (cess) on tax and surcharge. With regard to dividend income arising to FPIs, though the base tax rate remains constant at 20 percent and cess remains constant at 4 percent across categories of FPIs, the rates of surcharge varies depending upon the legal status and the total income of an FPI. For a corporate FPI, the surcharge on dividend tax ranges from 0 percent to 5 percent. For a partnership FPI, it ranges from 0 percent to 12 percent and for other FPIs, (e.g., trusts) it ranges from 0 percent to 37 percent. As a result, the effective tax rate for FPIs other than corporates and partnership can go as high as 28.496 percent. While enacting the Finance Act 2020, the government intended to cap the surcharge on dividend tax for non-corporate and non-partnership taxpayers to 15 percent. This cap has been introduced in the schedule to the Finance Act 2020. However, the main sections of the Finance Act 2020 do not specifically mention this cap and therefore, arguably the higher surcharge would continue to apply.

**Indian companies WHT at maximum rates regardless of dividends paid to an FPI:** There have been quite a few dividend payouts by Indian companies in the first quarter of the financial year 2020–21. While deducting tax on such dividends, some companies have withheld tax at the appropriate slab rates. Some companies have withheld tax at the highest effective tax rates (e.g., 28.496 percent), even if the amount of dividend is much lower than the respective slab rates. This approach is not in line with the provisions of the ITA wherein different surcharge rates are to be applied at the time of deducting tax under the specified section (including section 196D), depending on the income or aggregate of such income paid or likely to be paid.

Any relief measures by the government to address these challenges faced by FPIs would be welcome.
Tax exemption for sovereign wealth funds and pension funds

To attract long-term foreign funding into Indian infrastructure facilities, the Indian government rolled out a tax exemption for sovereign wealth funds (SWFs) and foreign pension funds, effective 1 April 2020.

Income eligible for exemption
The exemption applies to income in the nature of dividend, interest, or long-term capital gains arising from investments in India in the nature of debt or share capital or units.

Entities eligible for exemption
The exemption applies to SWFs, a wholly owned subsidiary of the Abu Dhabi Investment Authority, and foreign pension funds, subject to such investors complying with certain eligibility conditions that the government prescribed. In respect of an SWF and a pension fund, the exemption shall be available only if such a fund is notified by the government for the purpose of this exemption. If an SWF or a pension fund wants to avail the tax exemption, it would need to make an application to the government for being notified for this purpose.

Investment conditions
- The investment should be made between 1 April 2020 and 31 March 2024.
- The investment should be held for a period of three years.
- The investment should be made in either of the following:
  - An Indian Infrastructure Trust
  - A Category I or Category II Alternative Investment Fund regulated under SEBI (AIF) Regulations that invests only in companies or enterprises engaged in the infrastructure sector
  - A company or enterprise or an entity engaged in the infrastructure sector

Scope of the infrastructure sector extended widely
Initially, the exemption was available for investments (either directly or through Category I/II AIFs) in an entity carrying on the business of developing; or operating and maintaining; or developing, operating, and maintaining specified infrastructure facilities (such as road, highway project, water supply project, water treatment system, solid waste management system, irrigation project, port, airport, inland waterway).

Vide a notification issued on 6 July 2020, the Indian tax board (the Central Board of Direct Taxes or CBDT) has extended the scope of the eligible infrastructure sector to include transportation and logistics, energy, water and sanitation, communication, and social and commercial infrastructure.
Recent tax rulings

Losses suffered by sub-trusts of a Delaware Trust would be available for carry forward upon conversion of such sub-trusts into series (funds) of LLC

Aberdeen Asia Pacific Including Japan Equity Fund, Aberdeen Emerging Markets Equity Fund and Aberdeen Asia Pacific Excluding Japan Equity Fund vs DCIT (IT) 1(1)(1), Mumbai and others - Writ Petition No. 2796/2019, 2803/2019 and 3525/2019 - High Court, Mumbai

A Delaware Trust was registered in India as a Foreign Institutional Investor (FII) and three of its sub-trusts were registered as sub-accounts. The three sub-trusts were registered as separate taxpayers in India, implying that they had taken separate permanent account numbers (PANs) in India. The Delaware Trust converted itself into a Limited Liability Company (LLC) whereby the sub-trusts became series (funds) of the LLC. The trust filed an application with the Authority for Advance Ruling (AAR) to get clarity on whether upon conversion of Trust into LLC, the loss suffered by sub-trusts would be available for carry forward by the LLC. The AAR ruled in the negative on the basis that as the LLC has not filed any return in India, it did not possess any losses that it could carry forward. Based on the AAR order, the tax officer sought to reject losses of sub-trusts claimed by sub-funds of the LLC. The taxpayer filed a petition with the High Court against the AAR order and appealed the court to stay the order passed by the tax officer. The High Court ruled that though the LLC was not entitled for the loss carry forwards as it did not file the tax returns in India, the LLC’s sub-funds would qualify for carry forward of the losses as the tax returns for those losses were duly filed by them in their earlier avatar of sub-trusts.

The following observations of the High Court are noteworthy:

a) As the conversion of trust into LLC is not regarded as a change in taxpayer in the US, the losses suffered by the LLC in its earlier avatar as a trust should be allowed.
b) In the case of Technip SA,\(^4\) the Hon'ble Supreme Court has settled the position that ordinarily question of status of an entity would have to be decided according to the laws of domicile or place of incorporation. The trust and LLC continue to be the same person in terms of the law of Delaware, US. This position is accepted in India as well.

**No assessment can be framed in a company's name if it ceases to exist in the eyes of law and its PAN ceases to be valid**

**Diversey India Hygiene Private Ltd vs DCIT (IT) 2(2)(1), Mumbai (ITA No. 7292/Mum/2019) - ITAT, Mumbai**

An Assessing Officer (AO) initiated assessment proceedings under the name of an amalgamating Indian company that had ceased to exist and its PAN (Indian tax ID) was no longer valid. Upon the matter reaching ITAT, it was held (based on judicial precedents\(^5\)) as follows:

a) When two companies are merged and are joined, as to form a third company or one is absorbed into one or blended with another, the amalgamating company loses its entity.

b) Upon the amalgamating company ceasing to exist, it cannot be regarded as a person under Section 2(31) of the ITA against whom assessment proceedings can be initiated or an order of assessment can be passed.

c) The date on which the assessment proceedings were initiated, was after the scheme of amalgamation had been approved by the jurisdictional High Court. Moreover, as the AO issued the notice under the name of the amalgamating company, despite the fact that a communication was issued to the AO intimating the fact of amalgamation, the initiation of assessment proceedings against an entity that ceased to exist is null and void ab initio. It is not merely a procedural defect that can be cured.

d) The participation by the amalgamated company would have no effect as there could be no estoppel against law. An assessment order passed subsequently in the name of a non-existing company would be without jurisdiction and a nullity.

**Tax residency certificate issued by Mauritian authorities sufficient for accepting the status of residence and beneficial ownership to claim treaty benefits in respect of interest income**

**DCIT vs HSBC Bank (Mauritius) Ltd [TS-6201-ITAT-2020(MUMBAI)-O] - ITAT, Mumbai**

A Mauritian LLC (carrying on bona fide banking business in Mauritius - taxpayer), was registered as an FI with SEBI. In India, the taxpayer earned interest income from foreign currency loans (advanced to Indian corporates from its owned funds, i.e., capital, reserves and surplus and deposits received from its depositors) and debt securities. The taxpayer claimed such interest income as exempt under Article 11(3)(c) of the India-Mauritius tax treaty.

However, the AO rejected the treaty claim of the taxpayer on the basis that the taxpayer was not the beneficial owner of the interest income. The taxpayer appealed to the Commissioner of Income Tax - Appeals (CIT-A). The CIT-A had already ruled in favour of the taxpayer for a similar issue in the prior years and disallowed the AO's claim. The AO appealed to the Income Tax Appellate Tribunal (ITAT) that also ruled in favour of the taxpayer on the following grounds:

a) As clarified by CBDT in its circular number 789 dated 13 April 2000, the Certificate of Residency issued by the Mauritian authority will constitute sufficient evidence for accepting the status of residence and as well as beneficial ownership for applying treaty provisions.

b) The interest income in question was derived by the taxpayer and carrying on bona fide banking business.

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\(^4\) Technip SA Vs. SMS Holding (P) Ltd., (2005) 5 SCC 465

\(^5\) PCIT Vs Maruti Suzuki India Ltd [(2019) 416 ITR 613 (SC)] and Spice Entertainment Ltd. vs Commissioner Of Service Tax (In the High Court of New Delhi ITA 475 OF 2011 & ITA 476 OF 2011)
c) Earlier judicial precedents\(^6\) and a press clarification\(^7\) issued by the Ministry of Finance upholds the validity of the CBDT circular and supports the assertion of the taxpayer that the Certificate of Tax Residency issued by the Mauritian authority is sufficient evidence to accept the position that the 'beneficial ownership' of the interest income is with the taxpayer.

**General Anti-Avoidance Rules cannot be applied retrospectively**

**M/s JCT Limited v. DCIT (ITA No. 84 / Kol / 2019 and ITA No. 2389 / Kol / 2018) - ITAT Kolkata**

A wholly owned subsidiary amalgamated with its holding company (a public listed company - taxpayer) with effect from 1 April 2010 under a scheme of amalgamation duly approved by High Court. The subsidiary had no substantial business activities, and only earned income from sale of investment and rent. During fiscal year 2010-11, the subsidiary sold land and reported long-term capital gains on such sale after claiming indexation benefits allowed under the tax law for long-term gains. Further, long-term gains were offset against the losses brought forward by the holding company from the pre-amalgamation period. The AO changed the classification of gains from long term to short term on the basis that the land was sold within 36 months of being converted from leasehold property to freehold property. On further appeal to CIT-A, gains were re-classified as long-term gains but CIT-A did not allow loss to be offset on the grounds that the entire purpose of amalgamation was a colourful device to avoid payment of tax. Hence, the corporate veil was to be lifted to look through the entire transaction, based on substance rather than form. He concluded that the merger was done to avoid capital gains tax. CIT-A acknowledged that GAAR\(^8\) provisions were not applicable for the relevant year but he drew strength from these provisions.

Aggrieved by the CIT-A's order, the taxpayer and the AO filed cross appeals before the ITAT that ruled in favour of the taxpayer. In its ruling, the ITAT held that as the Honorable High Court had approved the amalgamation scheme and specifically ordered that income and profits of the merging company should be treated as income and profits of the merged company, CIT-A could not take a view contrary to the High Court order. Further, **GAAR provisions were not applicable for the year under consideration (i.e., financial year 2010-11) and therefore, could not be invoked**. Accordingly, the ITAT allowed the taxpayer to set-off carried forward losses against capital gains.

**Capital gains exemption under the India-Mauritius tax treaty denied on the premise that the affairs were arranged for avoidance of tax in India**


Three companies (taxpayers) were set up in Mauritius with the primary objective of undertaking investment activities with the intention of earning long-term capital appreciation and investment income. Taxpayers invested in a Singaporean company that further invested in India and derived its value substantially from assets located in India. In August 2018, taxpayers sold shares of the Singaporean company as a part of a broader transaction of acquisition of the Singapore company by a US company. Taxpayers filed applications with the tax authorities for a "Nil" withholding certificate claiming exemption from tax under the India-Mauritius tax treaty. The "Nil" withholding application was rejected by the tax authorities on the basis that the taxpayers were not independent in their decision-making, and the control over decision-making relating to purchase and sale of shares did not lie with taxpayers.

Subsequently, taxpayers filed applications with the AAR to determine whether the gains arising from the sale of shares of the Singaporean company would be chargeable to tax in India under Income-tax Act, 1961 (ITA), read with the India-

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\(^6\) Hyundai Motor India Ltd vs DCIT [TS-5906-ITAT-2017(Chennai)-O]

\(^7\) Press Clarification dated 01.03.2013 issued by the Ministry of Finance

\(^8\) General Anti-Avoidance Rules introduced in the Indian tax law effective April 1, 2017
Mauritius tax treaty. AAR rejected the application on the basis that the transaction was designed prima facie for tax avoidance in India. The AAR noted and held the following:

- Taxpayers’ principal objective was to act as an investment holding company for a portfolio investment domiciled outside Mauritius.
- Control and management did not mean day-to-day affairs of the business but meant the head and brain of the company.
- The authority to operate taxpayers’ bank account for transactions above US$ 250,000 was with two personnel who were not on the Board of Directors of the taxpayer and was required to be countersigned by one of the Mauritius-based directors.
- The said two personnel were key personnel of the Tiger Global group, and managing and controlling the affairs of the entire organisation structure.
- Thus, the funds were ultimately controlled by two personnel.
- While taxpayers’ Board of Directors took the decision for investment or sale but the real control over the decision was with one of the two personnel managing and controlling the affairs of the entire organisational structure.
- In view of this, taxpayers’ head and brain and consequently their control and management was not located in Mauritius, but in the US.
- Considering that taxpayers’ real management and control was in the US, they were only see-through entities set up for availing the benefits of the India-Mauritius tax treaty.
- The India-Mauritius tax treaty (original as well as amended vide Protocol signed on 10 May 2016) never intended to exempt the sale of shares of a company not resident in India, from capital gains tax.
- As taxpayers had sold shares of the Singaporean company, they were not entitled to claim benefit of India-Mauritius tax treaty on such sale.

Capital gains arising to a Belgium tax resident on transfer of shares of a Singapore company - not taxable under the Indian indirect transfer provisions as per Article 13(6) of the India-Belgium tax treaty

Sofina S.A vs ACIT (IT)- 4(2)(2), Mumbai - ITA No.7241/Mum/2018- ITAT, Mumbai
A Belgian investor (taxpayer) sold preference shares of a Singaporean company that in turn held 99.99 percent shares in an Indian subsidiary. The taxpayer contended that under Article 13(6) of the India-Belgium tax treaty, capital gains arising on the aforesaid sale would not be taxable in India.

However, the AO disallowed the taxpayer's claim and held that the shares of the Singaporean company were deemed to be shares of an Indian company and the transfer constituted an indirect transfer of assets located in India. Hence, the same was taxable in India under Article 13(5) and not exempt from India tax under Article 13(6) of the India-Belgium tax treaty. Aggrieved by the AO’s order, the taxpayer filed objections before the Dispute Resolution Panel (DRP). However, the DRP upheld the order of the AO. The taxpayer then filed a further appeal with the ITAT wherein it was held as follows:

a) Per Article 13(5) of the tax treaty, gains are taxable in India only if the shares transferred are of an India-resident company. However, in the present case, the shares are of a Singaporean company and hence Article 13(5) will not be applicable.

b) Unlike indirect transfer provisions under the ITA, Article 13(5) does not adopt a see-through approach. The ITAT placed reliance on the judicial precedent of an earlier ruling9 in this regard. Accordingly, the transfer of shares of the Singaporean company cannot be regarded as the transfer of shares of its Indian subsidiary.

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9 Sanofi Pasteur Holding SA vs Department of Revenue, Ministry of Finance (2013) 30 taxmann.com 222 (Andhra Pradesh)
c) Amendments made either prospectively or retrospectively to the provisions of the ITA cannot be read into the provisions of a tax treaty. The provisions of the ITA 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 of the High Courts\(^\text{10}\) in this regard.

d) 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-Singaporean tax treaty, the Singaporean company (due to its holding in the Indian company) cannot be considered to be a tax resident of India.

The ITAT ruled in favour of the taxpayer and held that gains on transfer of the shares of the Singaporean company are not taxable in India under provisions of Article 13(6) of the India-Belgium tax treaty.

\(^{10}\) 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)
Key trends at a glance

Monthly FPI Investments (Net)

Yearly FPI Investments (Net)

Foreign Exchange Reserves & US$/INR Rate

Macroeconomic Indicators

- **Monthly FPI Investments (Net)**
  - Graph showing monthly investment trends from July-19 to July-20.
  - Three categories: Equity, Debt, Total.

- **Yearly FPI Investments (Net)**
  - Graph showing yearly investment trends from 2010 to 2020.
  - Three categories: Equity, Debt, Total.
  - Note: Data up to July 31, 2020.

- **Foreign Exchange Reserves & US$/INR Rate**
  - Graph showing foreign exchange reserves and US$/INR rate.
  - Categories: Forex Reserves (US $Billion), INR per US$.

- **Macroeconomic Indicators**
  - Graph showing GDP Growth rate, Fiscal Deficit, Consumer Price Inflation.
  - Categories: GDP Growth rate %, Fiscal Deficit (As a % of GDP), Consumer Price Inflation % (Average).
Annexure 1

Taxation of dividends under select treaties

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