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Capital gains arising to Mauritius Investment Company are not taxable in India under India- Mauritius tax treaty

Background

The Authority of Advanced Ruling (AAR) in the case of Shinsei Investment I Limited [1] (the applicant), held that, the capital gains arising from the transfer of shares is not taxable in India in view of Article 13(4) of the India- Mauritius tax treaty (tax treaty). The AAR distinguished the decision of the Bombay High Court in the case of Aditya Birla Nuvo Ltd [2] (AB Nuvo) and upheld the applicability of the tax treaty to the transaction of transfer of shares of its Indian subsidiaries.

The AAR also held that since the applicant taxpayer is not liable to capital gains tax in India, no return of income is required to be filed in India. Further, Minimum Alternate Tax (MAT)[3] related provisions are not applicable in view of clarification issued by the government.

Facts of the case

- The applicant, a subsidiary of Shinsei Bank Limited- Japan (SBL), is a company incorporated in Mauritius and holds a valid Tax Residency Certificate (TRC). It does not have a Permanent Establishment (PE) in India.
- The applicant held 75 per cent and 99 per cent of shares in Shinsei AMC (SAMC) and Shinsei Trustee (ST) company which are the asset management and trustee company of Shinsei Mutual Fund (SMF) respectively. The SBL is the sponsor and settler of SMF. All SAMC, ST and SMC are registered with SEBI in terms of SEBI (Mutual Funds) Regulations, 1996 (MF Regulations).
- Pursuant to a Share Purchase Agreement (SPA) in 2010, the applicant and its other shareholders proposed to sell their stakes in SAMC and ST to Daiwa and its affiliates.

Issues before the AAR

- Whether the applicant is liable to capital gains tax in India, in respect of the transfer of shares of SAMC and ST under the tax treaty?
- Whether Daiwa and its affiliates would be required to withhold tax as per Section 195 of the Act?
- Whether the applicant is required to file return of income in India as per Section 139 of the Act?
- Whether applicant can be subject to MAT provisions under the Act?

Tax department's contentions

- The benefit of the tax treaty cannot be extended to the transaction of transfer of shares of SAMC and ST for the following reasons:
  - Under SPA, SBL has been included as 'Party no. 1' and the applicant has been merely introduced as a 'permitted transferee' into the SPA arrangement and does not possess any rights and obligations as regards the shares.

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[1] Shinsei Investment I Limited [AAR. No.1017 of 2010] - taxsutra.com
[2] Aditya Birla Nuvo Ltd v. DDIT and Union of India [2011] 342 ITR 308 (Bom)
[3] Section. 115JB[1] of the Income-tax Act, 1961 (the Act)

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- On the other hand, SBL holds all the rights and obligations in respect of the transaction like right to notify fulfillment of conditions to other partners, right to be notified about the composition of the Board of SAMC and ST, tax indemnifications and claims by the purchasers, investigation of tax claims, etc.

- Mauritius entities are mere nominee shareholders as the sole responsibility for the conduct and effective control of the transaction lies with SBL.

- The place of arbitration is also Japan or India and not place of incorporation of the applicant (i.e. Mauritius).

- As per the structure and arrangement, SBL enjoys the rights and obligations to the transactions while the applicant has no such right and responsibility. This gives rise to suspicion about the legal, actual and beneficial capacity of the applicant in the scheme of things.

- CBDT Circular No. 682 and 689 extending benefits under the tax treaty are not applicable where the investments are made in India by non-Mauritian entities.

- Relying on the Bombay High Court's decision in the case of AB Nuvo, benefit of India- Mauritius tax treaty cannot be given to the applicant.

Applicant's contention

- Applicant distinguished the facts of the case of AB Nuvo as follows:

  - In the case of AB Nuvo, AT&T- U.S. paid for the shares and obtained the shares in the name AT&T Mauritius as 'permitted transferee' and all rights in the shares vested with AT&T- U.S. While in the instant case, the applicant obtained shares of SAMC and ST in its own name and not for the benefit of SBL.

  - In case of AB Nuvo, as per the terms of the Joint Venture (JV) agreement, the owner of the Indian entity was the main parent while in the current case no such clause is present. The applicant has been accepted and approved by all parties to the SPA as the real and beneficial owner of shares.

  - In case of AB Nuvo, a clause in the JV agreement suggested that subsidiary was not more than a representative and the entire obligation rested with the parent company. Further, the arrangement between the parties and JV would remain only until the telecom licenses remain in force. Therefore, in AB Nuvo, This showed that investments were routed through Mauritius to avail tax treaty benefits. No such facts exist in the current case.

- The case of AB Nuvo cannot be applied to the facts of the current case. SBL was party to the SPA in its capacity of the sponsor of the mutual fund. The bank statements evidenced that payment for shares were done by the applicant and not by SBL or for the benefit of SBL.

AAR's ruling

- The applicant paid for the shares of the companies and held the shares in its own capacity and not on behalf of SBL.

- The SBL was made party to the SPA only in its capacity as a sponsor of the mutual fund and in order to comply with MF Regulations.

- The facts of the case in AB Nuvo are entirely different since AT&T had paid and subscribed for share in JV Company while Mauritius was merely a 'permitted transferee'.

- Once it is established that the applicant is the beneficial owner of the shares in India and SBL acts merely in its capacity of a sponsor to ensure compliance with MF Regulations, there is no bar on application of Article 13(4) of the India-Mauritius tax treaty.

- The applicant is the tax resident of Mauritius and has obtained valid TRC from Mauritius revenue authorities.

- Capital gain arising from transfer of shares is not liable to tax in India as per beneficial provisions contained in Article 13(4) of the tax treaty.

- Also since applicant is not liable to tax in India, return of income need not be filed in India

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- In view of the clarification issued by the government, MAT provisions would not be applicable in case of foreign companies not having permanent establishment in India. Thus, applicant is not liable to tax under Section 115JB of the Act.

Our comments

The share transfer transactions involving entities resident in Mauritius have been a subject matter of litigation. The India- Mauritius tax treaty provides a favourable taxation regime for investments made by Mauritius residents in India by providing relief on capital gains taxability in India.

The Indian judiciary at several occasions has dealt with the business purpose test and sought to evaluate the 'substance over form' in appraising the transactions. The tax treaty benefits have been denied where the taxpayer has constructed a scheme of transactional relationship in documents with a sole view to take advantage of the tax treaty. In May 2016, India and Mauritius have signed a protocol amending the tax treaty to provide India rights to tax capital gains in a phased manner. Pursuantly, India gets right to tax the transfer of shares acquired on or after 1 April 2017. The Protocol provides relaxation (tax rate @ 50% of domestic tax rate in India) in respect of capital gains arising to Mauritius residents from alienation of shares between 1 April 2017 and 31 March 2019. However, such benefits shall not be available to a Mauritius resident who is a shell/conduit company and does not satisfy business purpose test. The protocol further provides how to consider a company as a conduit or a shell company.

MAT provisions have also been amended by Finance Act, 2016 with retrospective effect from 1 April 2001, to exclude foreign companies not having PE in India in accordance with the provisions of the respective tax treaty.

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Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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