ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 6

I. ANSWERS TO MCQs (Most appropriate answers)

1. (b)
2. (c)
3. (d)
4. (a)
5. (d)
6. (d)
7. (c)
8. (b)
9. (c)
10. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Income of a non-resident from transfer of a capital asset situated in India is deemed to accrue in India as per the provisions of section 9(1)(i) of the Income-tax Act,1961. As per *Explanation 5* to section 9(1)(i), an asset being any share or interest in a company or entity incorporated outside India shall be deemed to be situated in India if, if the share or interest, derives directly or indirectly, its value substantially from assets located in India.

Further, *Explanation 6* to section 9(1)(i), provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets:
- exceeds the amount of INR 10 crores; and

- represents at least 50% of the value of all assets owned by the company, or entity, as the case may be

Specified date for this purpose would be the date on which the accounting period of the company or entity ends preceding the date of transfer of a share or an interest.

However, in case the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer, the date of transfer shall be the specified date.

Value of an asset means Fair Market value as on specified date, of such asset without reduction of liabilities in respect of the asset.

Further, section 90(2) provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act or the provisions of the DTAA, whichever is more beneficial to the taxpayer, shall apply.

In light of the above, the provisions of the DTAA and the provisions of the Act have been examined with respect to the each of the Groups below.

(a) Transfer of shares of Singapore Intermediary Co by US Co.

In the instant case, specified date is 31.05.2019

Fair value of assets of Singapore Intermediary Co as on 31.5.2019 - INR 50 crores

Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Singapore Intermediary Co (20%) - INR 40 crores

Since, the value of assets located in India i.e., INR 40 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Singapore Intermediary Co, the shares of Singapore Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Singapore Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Singapore Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of US Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-US DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Singapore Intermediary Co by US Co, since in the instant case, India is the 'country of source' and US is the 'country of residence'.

As per Article 13 of the India-US DTAA, US and India may tax capital gains in accordance with the provisions of its domestic law. Hence, the capital gains income from transfer of shares of Singapore Intermediary Co by US Co shall be taxable in India.

(b) Transfer of shares of Mauritius Intermediary Co by Germany Co.

In the instant case, specified date is 31.05.2019

Fair value of assets of Mauritius Intermediary Co as on 31.5.2019 - INR 60 crores

Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Mauritius Intermediary Co (25%) - INR 50 crores

Since, the value of assets located in India i.e., INR 50 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Mauritius Intermediary Co, shares of Mauritius Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Mauritius Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Mauritius Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of Germany Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-Germany DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Mauritius Intermediary Co by Germany Co, since in the instant case, India is the 'country of source' and Germany is the 'country of residence'.

Clauses (1) to (3) of Article 13 of the India-Germany DTAA, would not be relevant to the instant case. As per clause (4) of Article 13 of the India-Germany DTAA, *"gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State".*

In the instant case, the shares being transferred are those of Mauritius Intermediary Co, which is not a resident of India. Accordingly, the instant case would not be covered under clause (4) of Article 13 and the residual clause (5) of Article 13 would be applicable. As per clause (5), *"Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident"*. The alienator is Germany Co, which is a resident of Germany and not India and accordingly, the capital gains shall be taxable only in Germany and is not taxable in India.

Since the provisions of the DTAA can be applied, where they are more beneficial to the taxpayer than the provisions of the Act, in the instant case, the provisions of the DTAA can be applied and accordingly, the capital gains would not be taxable in India.

(c) Transfer of shares of Australian Intermediary Co by Cyprus Co.

In the instant case, specified date is 31.05.2019

Fair value of assets of Australian Intermediary Co as on 31.5.2019 - INR 300 crores

Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Australian Intermediary Co (51%) - INR 102 crores

Since, the value of assets located in India i.e., INR 102 crores exceeds INR 10 crores but it does not represent at least 50% of the value of assets of Australian Intermediary Co, shares of Australian Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Australia Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Australia Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of Cyprus Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

(d) Transfer of shares of Spain Intermediary Co by UK Co.

In the instant case, specified date is 31.03.2019

Fair value of assets of Spain Intermediary Co as on 31.3.2019 - INR 12 crores

Fair value of Ind Co as on 31.3.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Spain Intermediary Co (4%) - INR 8 crores

Since, the value of assets located in India i.e., INR 8 crores does not exceed INR 10 crores, shares of Spain Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Spain Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Spain Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of UK Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

Answer to Q.2:

(i) Computation of capital gains chargeable to tax and tax amount in India on transfer of shares of Singapore Intermediary Co by US Co

S. No	Particulars	Amount (INR crores)
1.	Full value of consideration for transfer of shares of Singapore Intermediary Co	50.00
2.	Cost of acquisition of shares of Singapore Intermediary Co	10.00
3.	**Long-term capital gains**	**40.00**
4.	Fair Market Value of all the assets of the Singapore Intermediary Co as on the specified date (31 May 2019)	50.00
5.	Fair Market Value of assets of the Singapore Intermediary Co located in India as on the specified date (31 May 2019) , i.e., Fair value of Ind Co as held by Singapore Intermediary	40.00
6.	Long-term capital gains (income) attributed to assets located in India [(3)*(5)/(4)]	32.00
7.	**Long-term capital gains tax at 10% (as per section 112)**	**3.20**

Notes:

1. The capital assets, being transferred, in the instant case, are the shares of Singapore Intermediary Co. Since, the shares of Singapore Intermediary Co have been held by US Co for more than 24 months, the capital gains would be long-term capital gains.
2. As per Rule 11UC, the income attributed to assets located in India would be based on the proportion of fair market value of assets located in India on the specified date, from which the share derives its value substantially to the fair market value of all assets of Singapore Intermediary Co.
3. As per section 112(1)(c)(iii), in case of a foreign company, the long term capital gain on unlisted securities is chargeable to tax @10% without indexation and fluctuation benefit.
4. The rate of 10% is excluding cess and surcharge, if any, depending on the total income of the company.

(ii) **Computation of capital gains chargeable to tax and tax amount in India on transfer of shares of Ind Co by Singapore Intermediary Co**

S. No	Particulars	Amount (INR crores)
1.	Full value of consideration for transfer of shares of Ind Co	45.00
2.	Cost of acquisition of shares of Ind Co	5.00
3.	**Short-term capital gains (since shares of Ind Co have been held for less than 24 months)**	**40.00**
4.	Short-term capital gains chargeable to tax @40%	14.00

Note: The rate of 40% is excluding cess and surcharge, if any, depending on the total income of the company

Taxability as per India-Singapore DTAA

Under the provisions of the Income-tax Act, 1961, the capital gains from transfer of shares of Ind Co would be chargeable to tax in India in the hands of Singapore Intermediary Co. However, the provisions of the India-Singapore DTAA can be applied to the extent they are more beneficial to the taxpayer.

As per Clause 4B of Article 13 of the India-Singapore DTAA, dealing with capital gains, gains arising from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxable in that State.

However, where such gain arise during the period beginning on 1 April 2017 and ending on 31 March 2019, it may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State.

In the instant case, Singapore Intermediary Co acquired shares of Ind Co on 1 March 2018 (i.e., after 1 April 2017). Accordingly, the gains may be taxable in India, being Contracting State in which the Ind Co is resident. However, restriction of 50% of tax rate shall not be applicable in this case since the capital gain arises after 31.3.2019.

(iii) **Amalgamation of US Co with another group company US Co 2**

As per section 47(viab), any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in the *Explanation 5* to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, shall not be regarded as transfer, if—

(A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;

Accordingly, in the instant case, if 25% of shareholders of US Co continue to remain shareholders of US Co 2 and if such transfer (by way of amalgamation) does not attract capital gains tax in US, then the amalgamation of US Co with US Co 2 would not be regarded as a 'transfer' under the Income-tax Act, 1961 and hence, not chargeable to tax in India.

Other option available with US Co is to demerge its one or more undertaking

As per section 47(vicc), any transfer, in a scheme of demerger, of a capital asset, being a share of a foreign company, referred to in the *Explanation 5* to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, shall not be regarded as transfer, if—

(A) the shareholders, holding not less than three-fourth in the value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated;

Accordingly, if three-fourth value of the shares of US Co continue to remain shareholders of resulting company and if such transfer (by way of demerger) does not attract capital gains tax in US, then the demerger of one or more undertaking of US Co would not be regarded as a 'transfer' under the Income-tax Act, 1961 and hence, not chargeable to tax in India.