

CROSS BORDER BUSINESS RESTRUCTURING

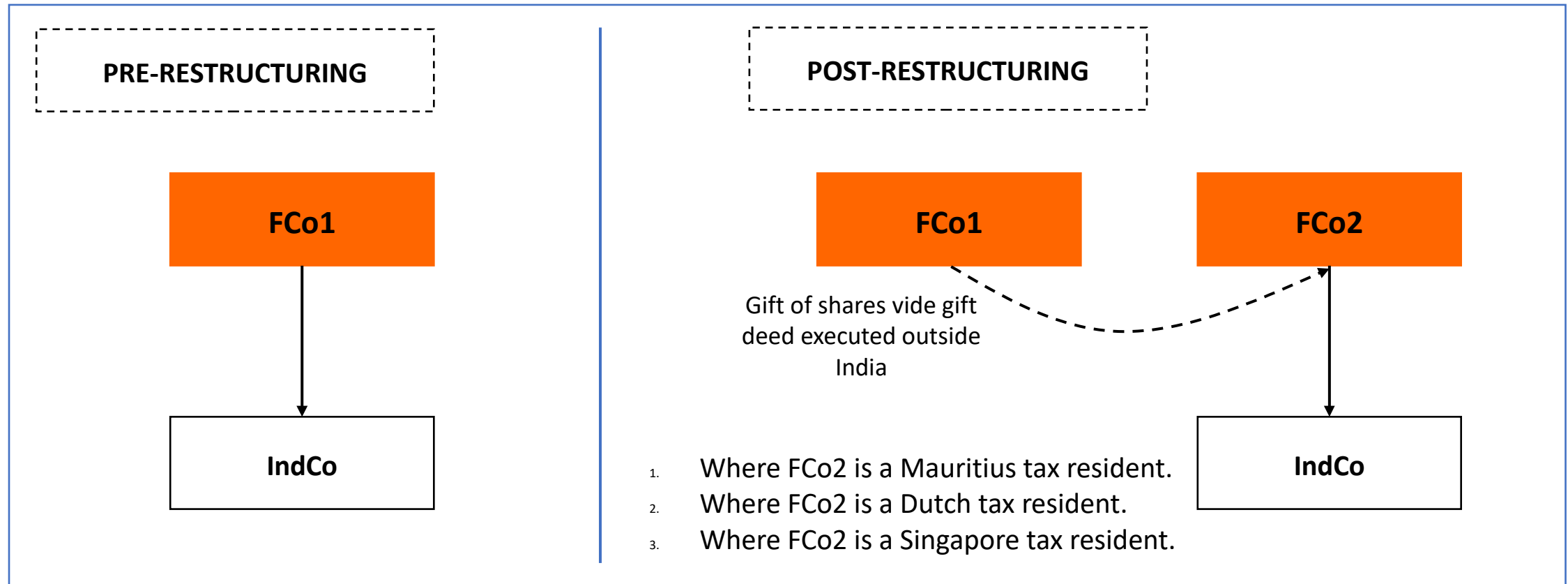
Case studies

Chamber of Tax Consultants, Bangalore Branch Study Circle

September 13, 2019

Speaker: Bharath Lakshminarayana
Singhvi Dev & Unni LLP, Chartered Accountants

Case study 1 – Gift of IndCo shares by FCo1 to FCo2



Whether income accruing / arising / received / deemed to be received in India ?

- Definition of income under section 2(24) of the Act.
- Income defined to include any sum of money or value of property referred to in section 56(2)(x)
- Scope of total income of a non-resident includes all income from whatever source derived which is :
 - Received or is deemed to be received in India;
 - Accrues or arises or is deemed to accrue or arise in India.
- Gift completed when the name of donee is updated in company records in India as the shareholder of IndCo. Plausible view is that since receipt of shares is in India, the income accrues in India and hence is taxable in India for the non-resident.

Whether income accruing / arising / received / deemed to be received in India ?

- Situs of shares:
 - Place of registered office of IndCo
 - Ruling of SC in R Vishwanathan v. RS Abdul Wajid (AIR 1963 SC 1)
- Section 56(2)(x) :
 - Aggregate fair market value (FMV) of property as it exceeds the consideration would be taxable as 'Income from other sources' if property is received for consideration less than aggregate FMV by an amount exceeding Rs. 50,000/-
 - Different mode of computation of FMV under Rule 11UA for:
 - Quoted equity shares
 - Unquoted equity shares
 - Unquoted shares and securities other than equity shares⁴ – preference shares,

Interplay of DTAA

- India-Mauritius Double Taxation Avoidance Agreement (DTAA):
 - Article 22(3)
 - Items of income of a resident of Mauritius not dealt with in the foregoing Articles of DTAA and **ARISING** in India may also be taxed in India
 - Arise – context of section 5:
 - Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue *or* arise (Ashokbhai Chimanbhai 56 ITR 42)
 - Arise is defined as ‘to spring up, to come into existence’...‘arise’ is used in contradistinction to the word ‘receive’ and indicate ‘a right to receive’ (Seth Pushalal Mansinghka 66 ITR 159; Govind Prasad Prabhu Nath 171 ITR 417 (All HC))
 - Strictly speaking, ‘accrue’ should not be taken as synonymous with ‘arise’ but in the distinct sense of growing up by way or addition or increase or as an accession or advantage, while the word ‘arises’ means comes into existence or notice or presents

Interplay of DTAA

- Arise does not mean ‘actual’ receipt but some stage prior to the point of time when income has become receivable.
 - In the present facts, the stage prior is the when FCo accepts the gift as a donee.
 - Since transaction takes place outside India, the act of acceptance of gift also takes place outside India.
 - Hence per India-Mauritius DTAA, the same is not taxable in India.
 - Contrary view is to consider the meaning of ‘arise’ as completion of recording of the gift transaction in favour of the donee in India in the records of the Indian company.
- India-Singapore DTAA:
- Article 23

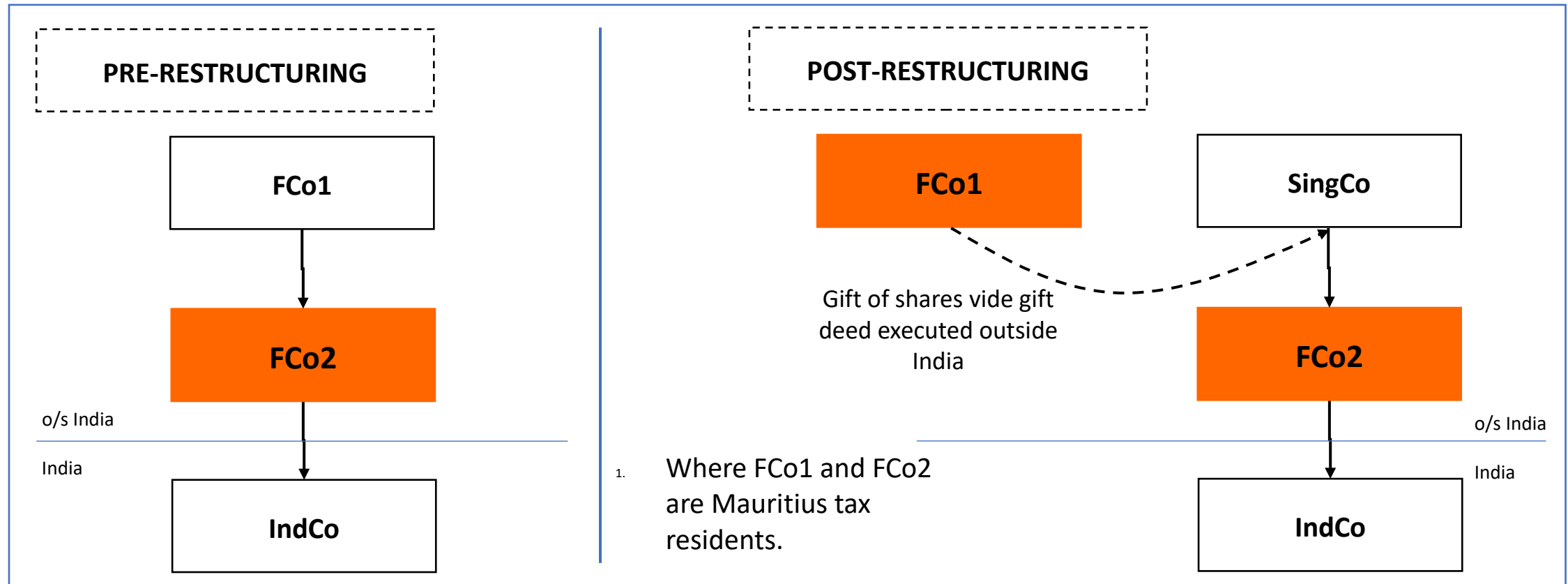
Interplay of DTAA

- India-Netherlands DTAA:
 - No 'Other Income' clause
 - Plausible view – income is not taxable in light of the DTAA in the absence of specific clause
 - ABB FZ LLC (162 ITD 89)
 - RAK Ceramics UAE (176 ITD 294)

Additional considerations

- Transfer pricing.
 - Would compliance with Rule 11UA be sufficient arm's length compliance as well?
 - Can it be stated that the principle of arm's length is on a different footing vis-à-vis compliance under Rule 11UA
 - See analogy of ALP compliance of royalty by reference to RBI's erstwhile ceiling rates under the Foreign Exchange Management Act, 1999 (FEMA)
- FEMA

Case study 2 – Gift of FCo shares (which holds IndCo) to SingCo



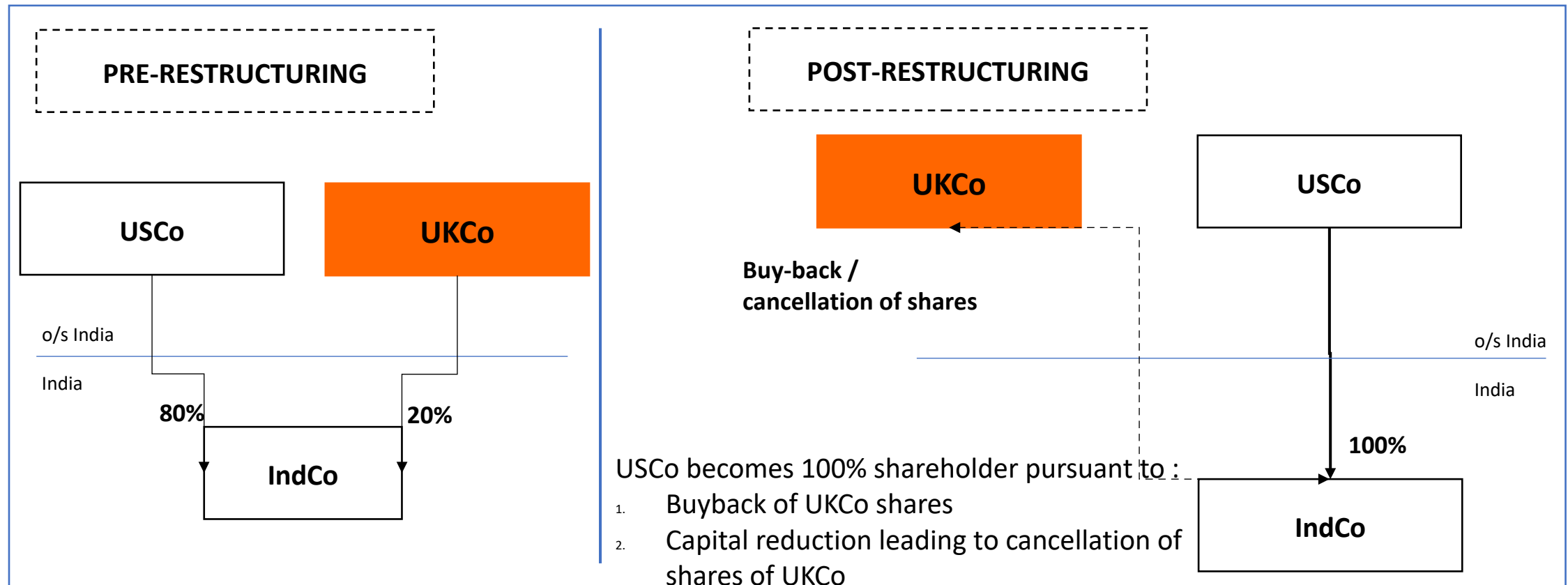
Whether income accruing / arising / received / deemed to be received in India ?

- Transfer of shares of a foreign company to another foreign company outside India.
- Recording of donee as the owner of shares is completed in Mauritius.
- *Key consideration – Shares of FCo2 derive their value from assets situated in India.*
- Scope of total income of a non-resident includes all income from whatever source derived which is :
 - Received or is deemed to be received in India;
 - Accrues or arises or is deemed to accrue or arise in India.
- Deeming provisions of section 9:

Whether income accruing / arising / received / deemed to be received in India ?

- Does gift accrue to trigger section 9?
 - In light of Explanation 5, would shares of FCo2 be situated in India? Is SingCo in possession of shares which are deemed to be situated in India?
 - In light of section 9(1), all income accruing or arising ‘through’ any asset in India is subject to tax under section 9(1).
 - ‘Through’ includes ‘in consequence of’, consequently, per section 56(2)(x), SingCo is taxable in India.
 - Per section 9, income need not arise only to ‘transferor’; income can also arise to a ‘recipient’.
- Contrary view – can the deeming fiction in Explanation 5 be extended to section 56(2)(x)
 - Deeming fiction applies only to transfer of shares and not ‘receipt’ of

Case study 3 – Consolidation of overseas shareholding in IndCo



Buy-back of shares – whether section 56(2)(x) applies

- Section 56(2)(x) applies where a person receives ‘any property’
- ‘Property’ is defined to mean ‘capital asset’
- Bought back shares whether ‘capital asset’ of a company
 - Shares bought back which are to be extinguished whether can be considered as property?
 - See Vora Financial Services (96 taxmann.com 88)
- Can it be said that for shares that are being extinguished the right FMV is ‘nil’ FMV? Hence, no amount should be brought to tax?

Buy-back of shares – whether transfer pricing provisions apply

- Buyback not taxable for shareholders
 - Hence transfer pricing provisions would not apply to shareholders
- Buyback does not result in any income for the company undertaking the buyback
- Mandate of section 115QA – whether diluted due to application of arm's length principle resulting in notional consideration
 - This notional consideration is taxable in whose hands?
 - Since TP provisions are anti-abuse provisions, above considerations are not relevant?

Capital reduction – whether section 56(2)(x) applies

- For IndCo and UKCo
 - Excess capital is reduced under a statutory scheme
 - No ‘receipt’ of shares or ‘money’ pursuant to capital reduction
 - Hence section 56(2)(x) does not apply?
- For USCo
 - Shareholding of USCo increases from 80% to 100% pursuant to capital reduction
 - Is this a ‘benefit’ that is ‘received’ by USCo
 - No shares or any income received by USCo under the capital reduction

Capital reduction – whether transfer pricing provisions apply

- Reduction of capital leads to ‘reduction’ of loss of IndCo
 - Hence international transaction?
- Loss on capital reduction allowable
 - Kartikeya Sarabhai (228 ITR 163)
 - Bangalore ITAT in Jupiter Capital Pvt. Ltd. (ITA 445/Bang/2018)
- Hence should share valuation be undertaken and the ALP determined?
 - If yes, what is the impact on the court order sanctioning the capital reduction?
 - Would the ALP determination in any manner disturb/prejudice the court order?

THANK YOU