

Buy-back under an HC-approved scheme not reorganisation within meaning of exception under Article 13(5) of India-Netherlands tax treaty

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In brief

The Mumbai Income-tax Appellate Tribunal (Tribunal) has, in a recent ruling in the case of a taxpayer, a Netherlands tax resident, held that capital gains arising to it on transfer of shares held in an Indian company under a High Court (HC)-approved buy-back scheme does not qualify as “reorganisation” referred to under Article 13(5) of Double Taxation Avoidance Agreement (tax treaty) between India and Netherlands. This Article provides that capital gains realised in the course of a corporate reorganisation shall not be taxable in India if the buyer or the seller owns at least 10 percent of the capital of the other.

In detail

Facts

- The taxpayer¹ held 38.24% shares in an Indian public listed company (the Company).
- The taxpayer tendered part of its holding to the Company under a scheme of buy-back approved by the Calcutta HC under section 391 of Companies Act 1956 (the Scheme).
- As per Article 13(5) of the tax treaty (the Article), gains arising from alienation of shares of an Indian company, in which its shareholding was more than 10%, would be taxable in India if the alienation was in favour of an Indian resident. However, the Article also provided an

exception, that gains realised by a resident of Netherlands on alienation of shares in an Indian company, would be taxable in Netherlands if they arose in the course of corporate organisation, amalgamation, reorganisation, division or similar transaction, and either the buyer or the seller owned at least 10 percent of the capital of the other.

- The taxpayer claimed the gain on transfer of shares to be exempt from tax in India under this exception.
- The Tax Officer held that the exception did not apply to the said transaction.

Issues before the Tribunal

- Was the buy-back of shares a “re-organisation” as per

the Article, and therefore were the capital gains resulting therefrom exempt from tax in India?

- Alternatively, would the concessional tax rate of 10% as per second proviso to section 112 of the Income-tax Act, 1961 (the Act) apply to the gains in the taxpayer’s hands?

Taxpayer’s contentions

- The shares tendered under a scheme of reorganisation would be covered under the exception in the Article. Accordingly, the capital gains were not taxable in India.
- It was not necessary for the taxpayer to pay tax in one country in order to claim the benefit of the tax treaty in the other country.

¹TS-10-ITAT-2016 (Mum)

- Alternatively, the capital gains arising on transfer of shares would be taxable at the concessional rate of 10% as prescribed under section 112 of the Act.

Revenue's contentions

- The taxpayer's case was covered under the Article. The taxpayer could not claim the benefit of the exception under the Article, as transfer of shares pursuant to a scheme of buy-back could not be considered as a reorganisation.
- The taxpayer had not paid tax in the Netherlands, as the same was exempt. The purpose of the tax treaty was to provide relief where there was double taxation. Hence, the taxpayer could not take recourse to the tax treaty.
- The arrangement was a colourable device.

Tribunal Ruling

- In view of the decisions² relied upon by the taxpayer, the payment of tax in Netherlands was not an essential condition for availing treaty benefits in India.
- As the Scheme was approved by the HC, and as the case involved interpretation of the Article, there was no colourable device.
- As per Dictionary of Accountants by Eric. L. Kohler, reorganisation should involve major change in financial structure of a corporation, resulting in alteration in rights

and interests of security holders. Buy-back of shares resulting in reduction in share capital, as in this case, could not be interpreted as a major change in the financial structure. This is because:

- Security holders continued to enjoy the same types of rights and interests even after reduction of capital. There was no alteration in the rights and obligations of shareholders.
- The change in promoters' percentage of shareholding could not be considered as a change in rights and interests of the shareholders. Promoter group continued to have the same rights and interests after capital reduction.
- The reorganisation contemplated in section 390 of the Companies Act 1956 consists of either consolidation of shares of different classes, or division of shares into different classes, or both.
- The taxpayer's attempt to bring the transfer of shares within the ambit of the term "reorganisation" was incorrect, since the objective of the arrangement was not financial restructuring, but providing exit to non-resident shareholders.
- Considering the above, transfer of shares pursuant to a buy-back scheme could not fall under the ambit of the term, "reorganisation".

- The Scheme involved two activities, viz., buying back of shares and cancellation of the shares bought back. As the Commissioner of Income-tax (A), contended, both activities need not be clubbed.
- With regard to the second issue, placing reliance on the ruling in the case of Cairn UK Holdings Limited³ and Abbott Capital India Limited⁴, the matter was answered in favour of the taxpayer, i.e., that the capital gains were taxable at concessional rate of 10%.

The takeaways

The Tribunal has held that changes in shareholding pattern pursuant to a scheme of buy-back cannot be construed as "reorganisation" within the exception prescribed in Article 13(5) of the tax treaty between India and Netherlands, on the premise that the shareholders' rights remain the same, in spite of change in shareholding.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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² DIT v. ICICI Bank Limited [2015] 370 ITR 17(Bom) and ADIT v. Green Emirate Shipping & Travels [2006] 100 ITD 203 (Mum Trib)

³ Cairn U.K. Holdings Limited v. DIT [2013] 359 ITR 268 (Del HC)

⁴ ADIT v. Abbott Capital India Limited [2014] 65 SOT 121 (Mum Trib)

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