AAR rules that LTCG from listed securities arising to a non-resident entitled to tax rate of 10%, without indexation benefit

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In brief

Recently, in the case of the applicant[1], the Authority for Advance Rulings (AAR) has held that the tax payable by a non-resident taxpayer on long-term capital gains (LTCG), arising on the transfer of equity shares of an Indian listed company, is required to be computed at a concessional rate as per the proviso to section 112(1) of the Income-tax Act, 1961 (Act).

In detail

Facts

- The Applicant, a foreign development finance company registered in Finland, provides long-term risk capital for private projects.
- The Applicant had acquired certain shares held in an Indian listed company (Company) under the foreign direct investment route.
- During the financial year 2011-12, the Applicant sold certain shares held in the company on a recognised stock exchange in India and the balance shares were sold pursuant to an open offer.

Issues before the AAR

Whether the tax on LTCG arising on sale of shares of the company, pursuant to an open offer, is required to be computed at a concessional rate of 10.506%, following the proviso to section 112(1) of the Act?

Applicant's contentions

- The LTCG arising from sale of listed equity shares, held as investment for more than 12 months shall be taxable at 10.506% (inclusive of surcharge and cess), as per the proviso to section 112(1) of the Act.
- The words "before giving effect to the provisions of second proviso to section 48" cannot be construed as the words of exclusion of a category of taxpayers i.e., non-residents who could not avail the benefit of the second proviso to section 48 of the Act.
- The Applicant placed reliance on the decision of the Delhi High Court (HC) in the case of Cairn UK[2] and various other rulings of the AAR,[3] wherein a similar issue was decided.

Revenue's contentions

- The computation of capital gains was to be done as per section 48 of the Act and the computation of tax on such capital gain was to be done as per section 112 of the Act.
- The first proviso and second proviso to section 48 of the Act are mutually exclusive.

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1 A.A.R. No. 1375 of 2012
2 Cairn UK Holdings Limited *v.* DIT [2013] 359 ITR 268 (Delhi)
3 Timken France SAS, *In re* [2007] 294 ITR 513 (AAR); and Pan-Asia iGate Solutions, Mauritius, *In re* [2014] 364 ITR 331 (AAR - New Delhi).

- The expression “before giving effect to second proviso to section 48” used in the proviso to section 112 (1) of the Act signifies that applicability of second proviso to section 48 was an essential condition for applicability of concessional rate of capital gain tax as per proviso to section 112(1) of the Act.
- To include the class of non-residents within the ambit of the proviso to section 112 will tantamount to rendering section 112(1)(c) infructuous.

AAR’s ruling

- The AAR, has held that the decision of the HC in the case of Cairn UK was applicable to the facts of the Applicant and the benefit under the proviso to section 112(1) of the Act, could not be denied to the Applicant.
- While deciding so, the AAR accepted the interpretation of the HC in Cairn UK, that the language of the section syntactically and grammatically mandates only one interpretation, and therefore, there was no need to examine purposive interpretation or the intention of the legislature.
- The AAR ruled that the tax payable by the Applicant on the LTCGs arising on the sale of equity shares of an Indian listed company, was required to be computed at 10.506% (inclusive of surcharge and cess).

The takeaway

The ruling relies on the HC’s position that for claiming the benefit of lower capital gain tax rate by non-resident taxpayers as per the proviso to section 112(1), applicability of the second proviso to section 48 is not essential.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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