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Tax Insights

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DTAA access cannot be denied in complete disregard to TRC and other corroborative evidence reaffirmed – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal (Tribunal) has, in a welcome ruling[1] pertaining to the taxation of gains arising out of the sale of shares, provided relief to the taxpayer by upholding the following principles in the context of the Double Taxation Avoidance Agreement (DTAA) access –

- DTAA access cannot be denied to the taxpayer by invoking the doctrine of substance over form by completely disregarding the availability of the Tax Residency Certificate (TRC) and other corroborative evidence and satisfaction of the limitation of benefit (LoB) clause; and
- If the subject transaction is specifically exempt from the purview of General Anti-Avoidance Regulations (GAAR), the Tax Officer (TO) cannot involve the doctrine of substance over form to deny DTAA access.

On the computational aspects, the Tribunal concluded that the premium paid towards acquisition of shares cannot be ignored while computing the cost of acquisition (CoA) on an adhoc basis. While ruling on the above issues, the Tribunal concluded that the directions issued by the Dispute Resolution Panel (DRP) are binding on the TO, and the TO cannot sustain any disallowance on any fresh basis in contradiction to such directions.

In detail

Facts

- The taxpayer, a non-resident company which is a tax resident of Singapore, is engaged in investment holding and general wholesale trade. The holding company of the taxpayer is a tax resident of British Virgin Island (BVI).
- During the captioned assessment year (AY), the taxpayer entered into the following transactions.

Transaction	Result	Tax position adopted by taxpayer
Sale of shares of X Ltd	Short-term capital gain	Exempt under Article 13 of the India-Singapore DTAA

[1] ITA No.1686/Del/2022

Transaction	Result	Tax position adopted by taxpayer
Sale of shares of Y Limited	Long-term capital loss (LTCL)	Carried forward to subsequent year

- The TO issued the draft assessment order on the following basis.
  - Denied DTAA benefits disregarding the TRC by questioning the commercial rationale and substance of the transaction, thus taxing the capital gains in India;
  - Denied deduction of premium paid during the acquisition of shares as CoA, thereby recomputing the LTCL into long-term capital gains (LTCG) and taxing the same.

Revenue's contentions

- The TO alleged that the gain from the sale of shares had to be taxed in India for the following reasons.
  - The investment and sale transaction were routed through Singapore as the holding company is situated in BVI, with which India does not have a DTAA; hence, this entire scheme of arrangement is one of tax avoidance through DTAA shopping.
  - The proceeds from the sale of shares were utilised to repay interest-free loans obtained from the holding company and hence, the taxpayer was not the beneficial owner of shares.
  - The loan repayment does not suffer deduction of tax in Singapore, and the repatriation of sale proceeds in the form of loan repayment does not suffer tax in BVI. Therefore, since the proceeds of share sale did not suffer tax either in Singapore or BVI, they had to be taxed in India.
- The TO also alleged the commercial rationale behind the incorporation of the taxpayer as the shares, being sold in the AY under consideration, were the only shares held by the taxpayer since inception. Moreover, the taxpayer only incurred consultancy expenses and earned consultancy revenue. Hence, there was no consistency, regularity, frequency and volume of economic activities.
- The TO also denied the deduction of premium towards CoA on the basis that there was huge variation in the premium paid towards the acquisition of shares at two different points in time and non-furnishing of valuation report in support of such premium.

Taxpayer's contentions

- Article 13 of the India-Singapore DTAA provides for taxation of gains arising out of the sale of shares acquired before 1 April 2017 in the resident state only. Moreover, the LoB clause in Article 24A of the said DTAA provides the following conditions to avoid abuse of Article 13 benefit.
  - The primary purpose of the company is to take advantage of Article 13 benefit;
  - Non-satisfaction of expenditure threshold in 24 months preceding the sale transaction, deeming the company to be shell or conduit.

The taxpayer contended that the principal business of the taxpayer was investment activity, and it has been in operation since eight years prior to the AY in consideration. Thus, the purchase and sale of shares were *bonafide* transactions. It further relied on the certificate of incorporation issued in Singapore, financial statements and return of income filed in Singapore, assessment orders passed by revenue authorities in Singapore and various such documents to support its contentions. Moreover, the taxpayer also met the expense threshold as stated above. Given the satisfaction of the LOB clause, it vehemently argued that it cannot be denied DTAA access.

- The taxpayer further emphasised that the sale transaction was undertaken by entering into a settlement agreement through a proceeding before the National Company Law Tribunal, thereby reinforcing the genuineness of the transaction.
- Regarding deduction of premium, the taxpayer witnessed the amount of premium paid in the return of allotments filed by the Indian company with the registrar of companies and audited financial statements of

the Indian company. The valuation report was never sought for by the TO; hence, it cannot be the basis to not consider the premium paid during the computation of CoA.

- In addition to the above contentions, the taxpayer specifically raised the following arguments on GAAR before the Tribunal by way of additional grounds of appeal:
  - The share sale transaction was specifically exempt from the purview of GAAR as the shares were acquired in 2016, and the tax benefit arising out of such transaction was lower than the threshold provided under the GAAR provisions;
  - Given that the domestic GAAR provisions were more beneficial than the LoB clause provided under the DTAA, the former had an overriding effect, and the TO cannot deny DTAA benefit in disregard of the GAAR.

Tribunal's observations and ruling

- The Tribunal observed that the TO did not pass the final assessment order in conformity with the DRP directions and concluded that every DRP direction is binding on the TO, and it cannot raise any new basis to sustain the disallowance made in the draft assessment order.
- The Tribunal dwelled upon the following three issues and ruled accordingly:
  - Denial of DTAA benefits, thereby taxing capital gains in India
  - Denial of deduction of premium towards computation of CoA, thereby recomputing LTCL into LTCG
  - Applicability of GAAR

Denial of DTAA access

- The Tribunal noted that the DRP specifically required the TO to verify if the affairs of the taxpayer were controlled from outside Singapore and if any benefit from the said sale was passed on to the parent company. If the answers to both were in the affirmative, then it directed for denial of DTAA access to the taxpayer.
  - The TO did not verify anything in the first aspect but merely reiterated its contentions as in the draft assessment order. On the contrary, the Tribunal noted that the taxpayer furnished enough documents and factual aspects to prove that its affairs were not controlled from outside Singapore. The Tribunal observed that the TO cannot turn a blind eye to the TRC and assessment orders issued by the Singapore tax authorities to deny the DTAA access.
  - As regards the second aspect, the TO contended that consultancy charges paid to related entities of the BVI entity were the benefit passed on by the taxpayer to the BVI entity. The Tribunal noted that during the year under consideration, no consultancy charges were paid by the taxpayer, and the TO denied the DTAA benefits with a preconceived mind in complete disregard of DRP directions and relevant factual and legal positions.

Accordingly, the Tribunal concluded that the taxpayer was entitled to the DTAA benefits, and the gains arising from sale of shares were taxable only in Singapore.

Denial of deduction of premium towards computation of CoA

- As regards the allowance of deduction of premium, the Tribunal observed that the TO did not have any basis for denial of such deduction and hence allowed the LTCL as computed by the taxpayer to be carried forward.

Applicability of GAAR

- Regarding the applicability of GAAR, the Tribunal relied on its order, in the case of taxpayer's sister concern involving the same transaction, which further relied on the Delhi High Court decision[2]. The Delhi High Court in its decision concluded that if a transaction was exempt from the purview of GAAR given the period of acquisition of shares and the tax benefit threshold; the taxpayer cannot be denied DTAA benefit. Moreover,

[2] Black Stone Capital Partners, Singapore – W.P.(C) 2562/2022

the TO cannot apply doctrine of substance over form to deny DTAA benefits as such doctrine is prior to the codification of GAAR provisions, and the legislators consciously provided for the exemptions under the later codified GAAR provisions. Relying on the above decision, the Tribunal allowed the additional grounds of appeal raised by the taxpayer.

The takeaways

The Tribunal has, in a welcome ruling, re-emphasised the significance of TRC and other supporting documents corroborating the economic substance of the taxpayer and the subject transaction for the purpose of availing DTAA access.

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