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Vesting of shares of an Indian company pursuant to an overseas upstream merger not liable to capital gains tax– exemption under section 47(via) is not available due to inability to satisfy one of the prescribed conditions

In brief

The Authority for Advance Rulings (AAR) in the case of Credit Suisse (International) Holding AG[1] (the Applicant) considered a situation where the shares of the Applicant's wholly owned subsidiary company in India were vested with the Applicant's parent in Switzerland due to an upstream merger of the Applicant into its parent. The AAR observed that in this instance the exemption under section 47(via) of the Income-tax Act, 1961 (of the Act) would not be available to the Applicant as condition (a) of the section was not satisfied. The AAR however held that as there was no consideration for the transfer of the Indian subsidiary pursuant to the merger, capital gain is not determinable and accordingly there would be no capital gains tax under section 45 of the Act.

Facts

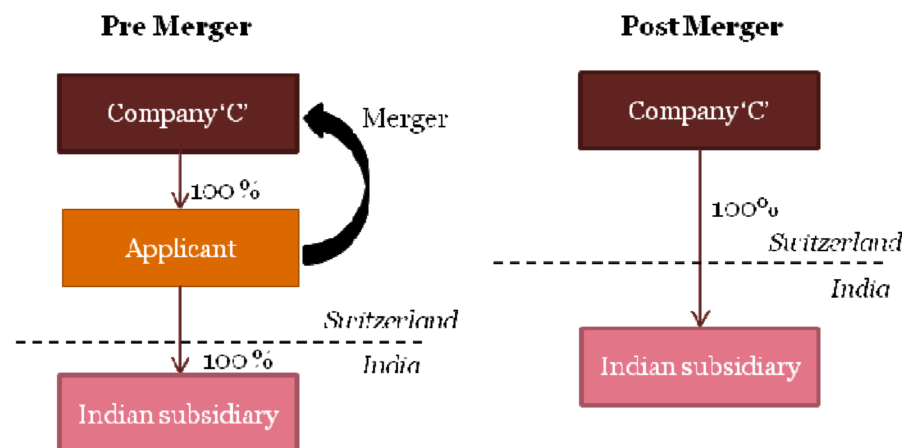
- The Applicant, a company incorporated in Switzerland, is a wholly owned subsidiary of another Swiss incorporated company (Company C or Parent).
- The applicant has a wholly owned subsidiary incorporated in India, Credit Suisse Services (India) Pvt. Ltd (CSSIPL or Indian Subsidiary).

[1] Credit Suisse (International) Holding AG., *In re* [TS-626-AAR-2012]

- The Applicant intends to merge into Company C by means of a merger by absorption pursuant to the provisions of the Swiss Merger Act.

- All the assets and liabilities of the Applicant would be assumed by its Parent, and the Applicant would be dissolved without liquidation. Importantly, no consideration would flow from the parent to the Applicant consequent to the merger.

Schematic representation



Issues before the AAR

The key issues raised for the consideration of the AAR were as follows:

- Whether any capital gains liability would arise on the Applicant under section 45 of the Act as a result of vesting of shares of its Indian subsidiary with the Parent due to the merger.

- Whether, considering the facts of the case, the exemption from capital gains tax under section 47(via) of the Act is available to the Applicant.

The remaining questions placed before the AAR involved the rate of tax applicable, the requirement for the Parent to withhold taxes, the need for the applicant to file a return of income in India etc., which would be relevant once the question of chargeability of capital gains tax in India was determined.

Applicant's contentions

The Applicant contended that there was no capital gains liability in India on the following grounds:

- The merger between the Applicant and Company C could not be construed as a transfer under section 2(47) of the Act.

- Even if the transaction was construed as a transfer, there was no consideration accruing to the Applicant.

- The transaction was exempt from the charging provisions of section 45 of the Act due to the applicability of section 47(via) of the Act. The Applicant contended that section 47(via) of the Act provides a relaxation to condition (iii) of section 2(1B) in relation to the shareholder's proportion, reducing it from 75% to 25%.

Revenue's contentions

The Revenue argued that the transaction was taxable under the Act on the following grounds:

- That the merger between the Applicant and Company C is within the ambit of a transfer contemplated under section 2(47) of the Act.

- That there was a consideration for the transfer and that it is easily capable of being quantified because the Indian subsidiary is prosperous and continues to exist.

- That section 47(via) of the Act was not applicable to the present case.

AAR Ruling

Ruling that there would be no capital gains arising on the applicant in India as a result of the merger, the AAR held that:

- The definition of 'transfer' under section 2(47) of the Act is an inclusive and not a restrictive definition. It includes within its purview any sale, exchange, or relinquishment of an asset, or the extinguishment of any right therein. An earlier ruling by the AAR[2] held that the change of ownership of the shares from the Applicant to the amalgamated company would involve a transfer and there was therefore no necessity to pursue that aspect in this ruling.

- In the AAR's view, in order to decide whether the transaction generates income chargeable under section 45 of the Act, the question to be considered is whether the merger in this instance is an amalgamation under section 2(1B) of the Act and accordingly, whether section 47(via) of the Act exempts the transaction from chargeability under section 45 of the Act.

- The AAR held that in the case in hand, while conditions (i) and (ii) of section 2(1B) of the Act are satisfied, condition (iii) relating to the requirement of shareholders holding at least 75% in value of the shares of the amalgamating company becoming shareholders of the amalgamated company, is not satisfied. The shareholders of the Applicant merging with Company C do not and cannot become shareholders of Company C as Company C is the only shareholder of the Applicant.

- While section 47(via) of the Act contains a relaxation with respect to the proportion of shareholding, i.e. from 75% to 25%, the condition itself cannot be met and accordingly the exemption provided in section 47(via) of the Act would not be available to the Applicant.

- Though the transaction would attract the provisions of section 45 of the Act, the AAR applied the ruling in Dana Corporation[3] and held that the capital gains in this case, if any, are not determinable within the scope of section 45 and section 48 of the Act. Accordingly, there would be no capital gains taxable under the Act as a result of the merger.

PwC observations

In its ruling, the AAR has made some far-reaching observations about the tax liability that would arise in India due to an overseas parent-subsidiary merger. By holding that the merger in this instance does not qualify as an amalgamation as envisaged by section 2(1B) of the Act due to the inability to satisfy condition (iii) of the definition, the AAR has prompted many questions in relation to the taxability of such mergers involving the transfer of shares of an Indian company.

The implications of newly introduced section 50D of the Act would also need to be analysed. Section 50D of the Act provides that when consideration is not determinable, fair market value should be adopted for the purpose of capital gains computation.

[2] P-3 of 1994, *In re* [1999] 240 ITR 518 (AAR)

[3] Dana Corporation, *In re* [2009] 321 ITR 178 (AAR)

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