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### Applicability of capital gains tax, transfer pricing provisions and exemption under section 47(iv) on buy-back of shares of an Indian company

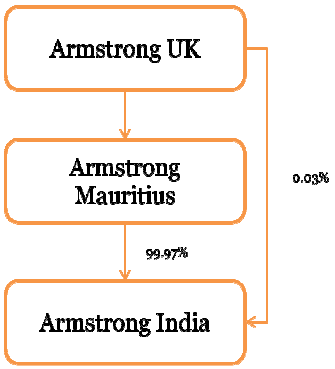
#### In brief

The Authority for Advance Rulings (AAR), in the recent ruling in the case of Armstrong World Industries Mauritius Multiconsult Ltd.[1], held that income on buy-back of shares is not liable to capital gains tax in India by virtue of the India-Mauritius double taxation avoidance agreement (the tax treaty). Exemption under section 47(iv) of the Income-tax Act, 1961 (the Act) would not be available unless all the shares of the subsidiary company are held by the parent company. Furthermore, although income is not liable to capital gains tax in India, transfer pricing provisions would apply.

#### Facts

- Armstrong World Industries Mauritius Multiconsult Ltd. (the applicant) is a wholly-owned subsidiary of Armstrong World Industries Ltd.,UK (Armstrong UK) and is a tax resident of Mauritius.
- Armstrong World Industries India Pvt. Ltd. (Armstrong India) is held by the applicant (99.97%) and the remaining is held by Armstrong UK (0.03%).

[1] Armstrong World Industries Mauritius Multiconsult Ltd., *In re* [TS-628-AAR-2012]




- This share holding pattern was a result of a series of internal restructuring activities within the Armstrong Group.
- Armstrong India now proposes to buyback a part of its shares from the applicant (under section 77A of the Companies Act, 1956).

## Issues before the AAR

- Will the applicant be liable to capital gains tax in India on buy-back of shares by Armstrong India, according to the provisions of the Act read with the India-Mauritius tax treaty?
- In view of section 47(iv) of the Act, will the transfer of shares of Armstrong India by the applicant to Armstrong India in the course of the proposed buy-back of shares, be exempt from capital gains tax in India?
- Will the proposed buy-back of shares attract the transfer pricing provisions of the Act?

## Applicant's contentions

- The series of internal arrangements within the Armstrong Group were approved by various authorities including the High Court(s), and were *bona fide* transactions based on sound commercial considerations.
- According to section 45 of the Act, buy-back is not a 'transfer' by virtue of section 47(iv) of the Act, which provides that any transfer by a parent company to its subsidiary company, would be exempt if the parent company **or** its nominees held the whole of the share capital of the subsidiary company.
- Furthermore, as there is no income subject to tax in India, transfer pricing provisions would not apply.

## Revenue's contentions

- The assessee is a shell entity created for the sole purpose of holding shares in Armstrong India and the series of restructuring arrangements were undertaken with the motive of tax avoidance and the assessee cannot claim the benefit of the India-Mauritius tax treaty by merely relying on the tax residency certificate.
- The benefit of section 47(iv) of the Act was not available as one of the conditions specified (parent company i.e. Armstrong Mauritius **or** its nominees did not hold the entire share capital of the Armstrong India) was not fulfilled.
- Furthermore, as the proposed transfer would generate income in the hands of assessee and is an international transaction between related parties, it would be covered under the transfer pricing provision.

## AAR Ruling

The AAR ruled that:

- Sufficient evidences were not produced by the income-tax authorities to substantiate the argument that the investments were made through the applicant to take advantage of the India-Mauritius tax treaty and to avoid tax in India. Reliance was placed on the Supreme Court decision in the case of Azadi Bachao Andolan[2] and it was held that based on the facts presented, the assessee was eligible to claim the benefit under the India-Mauritius tax treaty and capital gains should only be taxed in Mauritius.

- On the additional queries raised, the AAR placing reliance on the RST[3] ruling, held that the benefit of section 47(iv) of the Act would not be available as the entire share capital of Armstrong India was not held by the assessee but jointly by the assessee and Armstrong UK.

- Furthermore, placing reliance on the ruling in Castleton Investment Ltd.[4], the AAR ruled that transfer pricing provisions would apply on an international transaction between related parties.

## Conclusion

- The AAR, following the Supreme Court decision in Azadi Bachao Andolan (above) held that the benefit of India-Mauritius tax treaty could not be denied merely on argument that the investment was made through Mauritius and held that the buyback of shares was not taxable in India under the India-Mauritius tax treaty.

- Relying on the RST ruling (above), the AAR held that the buyback was not exempt under section 47(iv) of the Act.

- Furthermore, the transfer pricing provisions would be applicable based on the AAR ruling in the case of Castleton Investment Ltd. (above).

[2] UOI *v.* Azadi Bachao Andolan [2004] 10 SCC 1 (SC)
[3] RST, *In re* [TS-162-AAR-2012]
[4] Castleton Investment Ltd., *In re* [TS-607-AAR-2012]

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