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AAR holds that transfer of shares of an Indian company by a non-resident without consideration is not liable to tax in India

The Authority for Advance Rulings ("AAR") has delivered an important ruling on whether the transfer of shares of an Indian Company by a non-resident to another non-resident without any consideration would result in a tax liability in India.

Facts of the case

Amiantit International Holding Ltd ("Applicant") was an investment company in Bahrain, holding shares in various Asian, European and Latin American companies. The shares of the Applicant were listed on the Saudi Stock exchange and were owned by Saudi Arabian Amiantit Company ("SAAC"). The Applicant held 70 percent of the equity shares in Amiantit Fiberglass Industries (India) Private Limited ("IndCo"), an Indian company engaged in the production of glass reinforced polyester pipes, storage tanks, etc. The Applicant was receiving only dividends from IndCo and had no other sources of income in India. The Applicant had a wholly owned subsidiary, Amitech Cyprus Holding Limited ("Cyprus Co"), a Cypriot company, which was also an investment company and held shares of other group entities.

The Applicant wished to restructure its investments and as a part of its restructuring plan, the Applicant decided that all the international investments in companies engaged in pipe manufacturing should be held through Cyprus Co, as Cypriot holding allows certain economic advantages such as credibility of being a part of the European Union, access to international banking and finance, etc. The Applicant proposed to contribute the shares of IndCo along with other non-European investments to Cyprus Co under a contribution agreement executed outside India,

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without any consideration for the same. The Applicant applied for a ruling on the Indian tax implications of such contribution.

Issues before the AAR

- Whether the Applicant was liable to capital gains tax in India on the contribution of shares of IndCo to the Cyprus Co?
- Whether the proposed contribution of shares by the Applicant to Cyprus Co attracts the Transfer Pricing (“TP”) provisions under the Income-tax Act, 1961 (“Act”)?
- Whether Cyprus Co was required to withhold tax in accordance with the provisions of section 195 of the Act?

Applicant’s contentions

- Since no consideration (which was capable of being ascertained in monetary terms) was received by it for the contribution, no profit or gain accrued to the Applicant.
- The contribution of the shares was in the nature of a gift and it was not regarded as transfer for the purpose of levy of capital gains tax as per section 47(iii) of the Act.

Revenue’s contentions

- The Applicant was liable to capital gains tax in India as the contribution was not without consideration. There were underlying business considerations aimed at deriving certain financial advantages as a part of the reorganization process.
- Though the contribution was characterized as a gift, there was no substance in the gift as the Applicant, as a donor, was not poorer to the extent of assets contributed. The expression 'gift' has to be assigned a meaning as per the Transfer of Property Act, 1889.
- The TP provisions would be applicable for all international transactions and the Arms Length Price (“ALP”) should be determined and be treated as being liable to capital gains tax in India.

Ruling of the AAR

- Under the Act, any profit or gain arising from transfer of capital asset is liable

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to tax and such gain can be determined only based on the consideration received or receivable for the transfer.

- Income tax is a tax on real income arrived at on commercial principles subject to the provisions of the Act. If income does not arise, there cannot be any levy of tax. Since the contribution of shares by the Applicant is without any consideration, it is not possible to perceive or identify any profit or gain, which is capable of being ascertained at the time of contribution.
- Unless the 'consideration' of potential improvement of overall business of the Applicant due to re-organization is capable of being quantified based on commercial and accounting principles, it cannot be treated as consideration for the purpose of capital gains. A mere possibility of improvement of business in the near or distant future cannot be regarded as a consideration for the transfer.
- The TP provisions cannot bring to charge any income to tax, which was otherwise not chargeable under the Act. TP provisions are machinery provisions, which would not apply in the absence of any income.
- It is settled law that the charging section relating to capital gains and the computation provisions together constitutes an integrated code. If the computation provisions fail, the charge to tax should also fail. Accordingly the AAR ruled that the transaction was not liable to capital gains tax in India under the Act, since the contribution is without any consideration.
- The AAR held that the Cyprus Co was not liable to withhold tax under section 195 of the Act since there was no income of the Applicant that is liable to tax in India.

BMR comments and analysis

The ruling reaffirms the principle that only real income would be liable to tax and such income must be capable of being determined at the point of liability to pay tax under the Act. It also reaffirms the principle that there would be no obligation to withhold tax if the related income is not liable to tax in India.

The Finance Bill 2010 has introduced a provision to bring to tax the difference between the fair market value of shares and the actual consideration (or nil consideration) paid by a firm or company while acquiring shares of an unlisted

company. This difference will be liable to tax as income from other sources for the buyer of the shares

Once enacted, the new provision could create a tax liability in cases of transfer of shares without consideration or for inadequate consideration. In case of cross border transfers, the provisions of the Tax Treaty could however, be relied upon.

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