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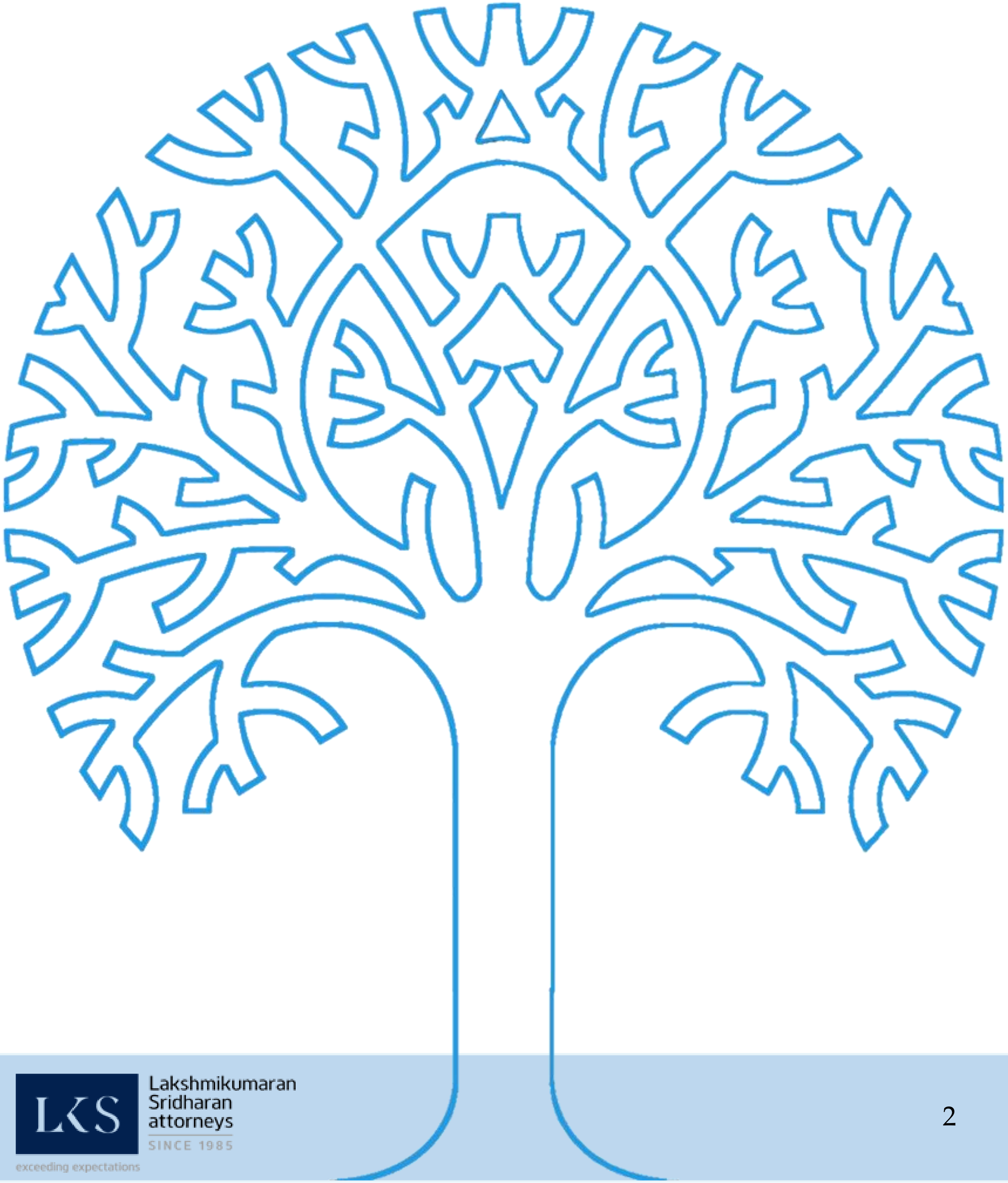
Table of Contents



Article

Fate of Indirect Transfer Tax post *Tiger Global judgment* – Will it add hurdles for MNEs?

By **Harshit Khurana and Devanshi Khurana**

The Delhi High Court has recently held that the capital gains arising from the sale of shares of a Singaporean company (holding shares in Indian company) by a Mauritius-based investor were not taxable in India due to the grandfathering benefit provided under Article 13(3A) of the India-Mauritius Double Taxation Avoidance Agreement. The article in this issue of Direct Tax Amicus analyses the impact of the judgment on taxation of indirect transfer of shares of an Indian company where grandfathering benefit is not available. Discussing the position prior to the judgement, key findings of the said decision and the potential issues post this decision, the authors conclude by stating that while the recent decision is of utmost importance when it comes to applicability of the tax avoidance principles and granting of tax treaty benefit, it may pose hurdles in the cases of indirect transfers where grandfathering benefit is not available.

Fate of Indirect Transfer Tax post *Tiger Global judgment* – Will it add hurdles for MNEs?

By Harshit Khurana and Devanshi Khurana.

Introduction

Recently, the High Court of Delhi delivered a ruling marking significant victory for international investors. The High Court reversed the findings of the Authority of Advance Ruling ('**AAR**') in the case of *Tiger Global*. The Court has ruled that the capital gains arising from the sale of shares of a Singaporean company (holding shares in Indian company) by a Mauritius-based investor were not taxable in India due to the grandfathering benefit provided under Article 13(3A) of the India-Mauritius Double Taxation Avoidance Agreement ('**India-Mauritius DTAA**').

While the judgment provides a significant relief for all the investors who are eligible for the grandfathering benefit, it may raise concerns for others. For instance, cases where acquisitions were made post 1 April 2017 (in the context of Mauritius treaty) or where the relevant tax treaty does not confer any grandfathering benefit at all (such as in case of France).

This article seeks to analyse the impact of *Tiger Global* judgment on taxation of indirect transfer of shares of an Indian company where grandfathering benefit is not available.

Treaty benefits in case of Indirect Transfers: Position prior to *Tiger Global*

In 2012, post the popular *Vodafone* ruling, amendments were proposed in the Indian domestic law to tax indirect transfer of assets (including shares) located in India as a result of transfer of shares of overseas entity. As per the amendment, in case the overseas entity's shares derive substantial value from assets located in India, the capital gains arising on transfer of shares of overseas entity shall be taxable in India. The shares are considered to have derived substantial value from assets in India only if the value of assets exceed INR 10 crore and the value of assets situated in India (including shares held in I Co) represent at least 50% of all assets owned by the overseas entity.

Considering the amendments in the domestic law, the question which gained utmost importance is whether as per the relevant tax treaty, India shall have taxing right in case of indirect transfers or not.

In many of the tax treaties entered by India, there lies a specific paragraph which allocates taxing rights in case of transfer of shares of a company (‘**Share Transfer para**’). For instance, Article 13(3A) of India-Mauritius tax treaty, paragraph 14(5) of Indo-French tax treaty. In the said paragraph, if shares of Indian company are transferred, the tax treaty grants taxing rights to India.

Apart from the above paragraph, there lies a paragraph which applies if ‘any other property’ is transferred (‘**Residual para**’). For instance, Article13(4) of India-Mauritius tax treaty or Article 14(6) of India-France tax treaty. In terms of said paragraph, taxing rights are granted to the country where the alienator of the property is a resident. Meaning thereby, if a Mauritius resident sells said property, only Mauritius shall have taxing right.

In cases of indirect transfers of Indian Co’s shares, the key question which needs to be addressed is whether the Share Transfer para shall be applicable or Residual para of the tax treaty. The question is relevant because in case of indirect transfers, the shares of overseas company get transferred (and not Indian company). It is only as a result of such transaction that the controlling interest in the shares of Indian Co. gets shifted to the new shareholders.

The question has been adjudicated by the High Court of Andhra Pradesh in the case of *Sanofi Pasteur*[1]. In said case, the shares of a French entity were being transferred. The French entity’s shares derived value from shares of an Indian company. The Court in said case held that as the shares of French company were being transferred, only France shall have the taxing right in terms of Article 14(5) of the Indo-French tax treaty. According to the Court, the language or text of the provision did not specifically include taxation of indirect transfer of shares of an Indian entity and a ‘see through’ approach cannot be adopted as it would transgress the terms of the tax treaty. The Court also observed that the transfer of controlling interest in the Indian Co. shall fall within the ambit of the Residual para, and India does have taxing right in respect of the same.

The reasoning laid down in *Sanofi Pasteur Holdings* was eventually relied on and followed by the Tribunals in other judgments such as *Sofina S.A.*, [2020] 116 taxmann.com 706

[1] [(2013) 354 ITR 316 (AP)]

(Mumbai - Trib.), *GEA Refrigeration Technologies GmbH*, In re [2018] 89 taxmann.com 220 (AAR - New Delhi).

In view of the above cases, in case of indirect transfer of Indian Co's shares, the Share Transfer para does not provide taxing right to India as the shares of Indian Co. are not directly getting transferred. Also, the transfer of controlling interest in the Indian Co. shall fall within the ambit of Residual para which grants taxing right to the country where alienator is resident.

Key findings of the *Tiger Global* judgement

In the judgment of *Tiger Global*, the primary aspect which the Court dealt with is whether the case in hand was designed to avoid tax and whether tax treaty benefit should be granted to the taxpayer or not. The Court reaffirmed the judicial principles laid down by the Supreme Court in the case of *Azadi Bachao Andolan* for grant of tax treaty benefits and followed in umpteen number of decisions thereafter. The Court held that presence of TRC and fulfilment of conditions mentioned in Limitation of Benefit clause in tax treaty, are sufficient to grant treaty benefit, unless some exceptional circumstances such as fraud, illegality, complete absence of economic substance, etc. exist. Also, the Court noted that the onus entirely lies on the Revenue to bring forth convincing evidence to prove existence of such exceptional circumstances.

By giving the above reasoning, the Court held that the benefit of grandfathering benefit clause in Article 13(3A) of India-Mauritius treaty should be granted in the present facts.

In this case, the Court did not express any views on the applicability of Residual para of the tax treaty and also on the aspect that whether India shall have taxing right under Article 13(3A), even without grandfathering benefit since the shares of Singapore company are being transferred. Although, the taxpayer argued on the applicability of the Residual para by placing reliance on the case of *Sanofi Pasteur*, the Court did not comment on said aspect, and rather restricted their conclusion to granting grandfathering benefit.

Potential issues post *Tiger Global* judgment

Considering the findings in the case of *Tiger Global* in relation to Article 13(3A), the Revenue Authorities may argue in other cases that cases of indirect transfers are covered under the Share Transfer para [such as Article 13(3A)]of tax treaty, and it is only because of the grandfathering benefit that the capital gains shall not be taxable in India. Resultantly, in cases where there is no grandfathering benefit in the tax treaty, India shall have the right to tax the capital gains (such as in case of India-France tax treaty).

In view of the authors, there lie arguments to defend the above allegation. One needs to appreciate that the Court in *Tiger Global* did not comment on the applicability of Residual para of the tax treaty and restricted its analysis to the grandfathering benefit. Accordingly, it can be argued that the Court has not given any finding on the applicability of Residual para.

It is a settled legal principle that a judgment is a law for what it states and not for what it can be logically inferred out of it.

Accordingly, it can be argued that if the Court in *Tiger Global* has not discussed the applicability of Residual para, the judgment should not be read to be contrary to the judgment in the case of *Sanofi Pasteur*. The plausible interpretation can be that the Court in *Tiger Global* provided relief only on grandfathering and has not expressed views on the correctness or otherwise on the other grounds raised by the taxpayer including applicability of Residual para in case of indirect transfers.

Conclusion

While the *Tiger Global* judgment shall be of utmost importance when it comes to applicability of the tax avoidance principles and granting of tax treaty benefit, it may pose hurdles in the cases of indirect transfers where grandfathering benefit is not available. Although there lie defenses to cross the hurdles, however, the path is not going to be as smooth as it was assumed post the judgment of *Sanofi Pasteur.*

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Notifications & Circulars

– PAN and Aadhaar linkage – Exception of application of higher rate of TDS/ TCS in the event of death of deductee/ collectee before linkage

PAN and Aadhaar linkage – Exception of application of higher rate of TDS/ TCS in the event of death of deductee/ collectee before linkage

As per Circular No. 6 of 2024 dated 23 April 2024, the taxpayers could link PAN and Aadhaar for the transactions entered into up to 31 March 2024 by 31 May 2024.

Several grievances were received citing instances of demise of deductee/ collectee during the said period before the option to link PAN and Aadhaar could have been exercised. In such cases tax demands are standing against the deductor/ collector as the result of such failure.

To redress the grievances of the taxpayers, the Central Board of Direct Taxes has provided that in relation to transactions undertaken up to 31 March 2024 and in case of demise of deductee/ collectee on or before 31 May 2024 i.e., before linkage of PAN and Aadhaar, there shall be no liability on the deductor/ collector to deduct/ collect the tax under Section 206AA/ 206CC, as the case may be. CBDT Circular No. 8/2024, dated 5 August 2024 has been issued for the purpose.

Ratio Decidendi

- Indirect transfer of shares by Mauritius Resident is not taxable in India – Delhi High Court
- Valuation – Face value of shares to be considered as FMV, if shares allotted to employees were subject to lock-in restrictions – *Delhi High Court*
- Consideration received on relinquishment of rights in respect of sweat equity shares is Capital Gain income – *Delhi High Court*
- Discretionary compensation received for diminution in ESOP value is taxable as Perquisite under Section 17(2)(vi) – *Madras High Court*
- Faceless mechanism applicable on reassessment proceedings of international taxation cases – *Bombay High Court*
- Shares subscribed from foreign remittance is 'Capital Account Transaction' and no income accrued in India – *Delhi High Court*

Indirect transfer of shares by Mauritius Resident is not taxable in India

The Delhi High Court has recently delivered a decision marking significant victory for international investors by reversing the decision of Authority for Advance Rulings. The Court has ruled that the capital gains arising from the sale of shares in a Singaporean company (holding shares in Indian company) by a Mauritius-based investor were not taxable in India due to the grandfathering benefit provided under Article 13(3A) of the India-Mauritius Double Tax Avoidance Agreement. ***Please refer to the detailed Update also covering comments from the LKS Direct Tax Team, here.***

[*Tiger Global International III Holdings* v. *AAR* – TS-624-HC-2024(DEL)]

Valuation – Face value of shares to be considered as FMV, if shares allotted to employees were subject to lock-in restrictions

In the facts of the case, the Assessee was allotted 11,50,500 shares at the face value of INR 15/- per share under the Employees Stock Purchase Scheme ('**ESPS**'). This ESPS was subject to a lock in period, wherein 25% of the stock were subject to lock in period of 12 months, while the remaining 75% of the stock were subject to a lock period of 18 months.

In the return of income, the Assessee took a view that since the shares were not marketable in view of the lock-in condition, the Fair Market Value ('**FMV**') cannot exceed the face value of shares. During the assessment proceedings, the Assessing officer taxed the allotted shares under Section 17(2)(iiia) of Income-tax Act, 1961 ('**Act**') *(akin to current Section 17(2)(vi) of the Act)* taking FMV of shares.

In this regard, the Delhi High Court reversed the order of the ITAT to rule in favour of the Assessee. The High Court placed reliance on the Supreme Court judgment of *Commissioner of Income Tax, Bangalore* v. *Infosys Technologies Ltd.*[2] to hold that the shares have no realizable value during the lock in period nor it is possible for employees to foresee the potential value the shares may obtain in future. Accordingly, the potential benefit cannot be considered as income of the employees, which can be taxed as under the head of salaries.

In relation to this, the Court also referred to *Commissioner of Income Tax* v. *Excel Industries Ltd.*[3] to observe that it is well-

[2] (2008) 2 SCC 272

[3] (2014) 13 SCC 459

settled position in law that tax cannot be levied on 'notional income.' In consideration of the aforementioned judgments, the Court ruled that FMV should be considered as face value of shares due to restrictions imposed on the marketability of shares by the lock-in clause.

[*Ravi Kumar Sinha* v. *CIT* – TS-590-HC-2024(DEL)]

Consideration received on relinquishment of rights in respect of sweat equity shares is Capital Gain income

In the present case, the Assessee was an employee working in the capacity of Chief Operating Officer in the company. On 8 June 2010, the company issued 50,000 sweat equity shares along with share certificates to the Assessee as per the terms of employment agreement. Shortly thereafter, the company terminated the employment contract with the employee and refused to record the employee's name in the Register of Members.

Aggrieved by this, the Assessee approached the Company Law Board ('**CLB**') to record his name in the Register of Members of the company. During the pendency of the petition before the CLB, the Assessee and the company entered into a Settlement Agreement on 23 January 2014. In accordance with the agreement, the Assessee received an amount of INR 3.3 crore as full and final settlement on a condition that the Assessee will relinquish all his rights, title, interest and entitlement in respect of registration of the sweat equity shares.

In its return of income, the assessee reported the aforesaid amount as long-term capital gains. During assessment, the Assessing Officer ('**AO**') rejected the claim of the Assessee and taxed the settlement amount received under Section 17(3)(iii) of the Act as '*profit in lieu of salary*' on account that (i) TDS was deducted on the said amount under section 192, (ii) the claim was emanated from employer-employee relationship and (iii) since the shares were not registered in the Assessee's name, therefore amount received was on cessation of employment.

Before the Delhi High Court, the High Court stated that upon reading the clauses of the Settlement Agreement, the consideration received was concerned with the unconditional and irrevocable relinquishment of the Assessee's right to seek and enforce registration of the shares and also in respect of all other claims which could have been raised by the Assessee in respect of the shares. The Court noted that the consideration would not qualify as '*profits in lieu of salary*' since the conditions of clause (iii) of Section 17(3) were not met.

[*Akash Poddar* v. *ACIT* – TS-572-HC-2024(DEL)]

Discretionary compensation received for diminution in ESOP value is taxable as Perquisite under Section 17(2)(vi)

In the given case, the Assessee was an employee of Flipkart Internet Private Limited (‘**FIPL**’), an Indian-incorporated company and a wholly owned subsidiary of Flipkart Market Place Private Limited (‘**FMPL**’), a Singapore-based entity. FMPL, in turn, was a wholly owned by Flipkart Private Limited Singapore (‘**FPS**’). FPS had implemented Flipkart Stock Option Scheme, 2012 (‘**FSOP, 2012**’) under which employees’ stock options (‘**ESOPs**’) were granted to either the employees or any person approved by the Board.

In 2023, FPS announced compensation of USD 43.67 per share in view of the divestment of its stake in the PhonePe business. Pursuant to this, the Assessee received compensation of INR 2.09 crore in respect ESOPs of FPS held by him under the FSOP, 2012. The TDS under Section 192 of the Act was deducted on the same. The Assessee requested for a ‘Nil’ certificate of tax deduction at source by claiming that the compensation received qualified as capital receipt. However, the said application was rejected by the Tax officer.

Aggrieved by the same, the Assessee filed a Writ petition before the Madras High Court. The Court held that the compensation in question is taxable as ‘Salary’ under clause (vi) of Section 17 of Act. The Court noted that the term ‘specified security’ includes the securities offered under such plan or scheme. The expression *‘value of any specified security... transferred directly or indirectly by the employer ... free of cost or at concessional rate to the assessee’* in clause (vi) is wide enough to encompass the discretionary compensation paid to ESOP holders to compensate for the potential or actual diminution in value thereof.

The Court also noted that ESOPs do not fall within the ambit of Section 2(14) of the Act and are consequently not capital assets. It was thus held that the compensation received was not a capital receipt. It was noted that unlike the facts of judicial precedents, ESOPs are not a source of revenue or profit-making apparatus. ESOPs are contractual rights that may qualify as actionable claims or chose in action. Further, in the absence of any contractual right to receive the compensation in question, it cannot be said that a non-existent right was relinquished.

[*Nishithkumar Mukeshkumar Mehta* v. *DCIT* – TS-582-HC-2024(MAD)]

Faceless mechanism applicable on reassessment proceedings of international taxation cases

In this case, a writ petition was filed by the petitioner before the Bombay High Court wherein the petitioner challenged notice issued under Section 148A(b), order passed under Section 148A(d) and consequential notice issued under Section 148 of the Act. The petitioner contended that the faceless mechanism as specified under Section 151A read with the provisions of Section 144B of the Act was not followed with regard to the above-mentioned notices and orders which were issued/ passed by the Jurisdictional Assessing Officer ('**JAO**').

The High Court discussed the orders issued by Central Board of Direct Taxes under Section 119 of the Act and referred to the decision of *Hexaware Technologies Limited* v. *ACIT*[4] and *CapitalG LP* v. *ACIT*[5] and thereafter the decision given by the Telangana High Court in the case of *Sri Venkataramana Reddy Patloola* v. *DCIT*[6] held in favour of the petitioner. The High Court held that the notices were issued by the JAO which fell outside the purview of faceless mechanism and thus were illegal and without jurisdiction.

[*Abhin Anilkumar Shah* v. *ITO-Int. Tax* – TS-647-HC-2024(BOM)]

Shares subscribed from foreign remittance is 'Capital Account Transaction' and no income accrued in India

In this case, the Assessee was a Fund managed by Tosca Fund Asset Management, LLP ('**petitioner**') which was a Foreign Company based under the laws of Cayman Islands. The Assessee was registered as Foreign Institutional Investor ('**FII**')/Foreign Portfolio Investor ('**FPI**') with SEBI in India. During AY 2019-20, the Assessee received foreign inward remittances of INR 137.48 crore for subscribing securities on the stock exchange of India and accordingly purchased shares in India.

The petitioner did not file any return of income of India. Consequently, reassessment proceedings were initiated alleging that in the absence of return of income, the source of income of the above investment remained unexplained. The AO passed order under Section 148A(d) of the Act holding that it was a case fit for reopening assessment. This is because no documentary proof was submitted by the Assessee with regard to the source

[4] (2024) 464 ITR 430
[5] TS-647-HC-2024(BOM)
[6] 2024 SCC Online TS 1792

of investment made and there was a discrepancy between the share price disclosed by the Assessee and as per the exchange rate on the date of purchase of shares.

The petitioner filed a writ petition before the Hon'ble Delhi High Court. The High Court quashed the notices/ orders on the basis that the subscription of share capital in India would undoubtedly be a 'Capital Account Transaction'. Since the funds remitted in India were used for subscription of securities, no income was earned by the petitioner in AY 2019-20.

Further, the High Court noted that the order passed under Section 148A(d) was related to the discrepancy in the share price, however this was not the matter of the notice initially issued under Section 148A(b) of the Act. Thus, the High Court by placing reliance on the decision given by the co-ordinate bench in the case of *Banyan Real Estate Fund Mauritius* v. *ACIT* [TS-566-HC-2024(DEL)], held that revenue cannot take fresh ground while passing the order under Section 148A(d) of the Act.

[*Tosca Master* v. *DCIT Circle 3(1)(1), (Int. Tax)* – TS-583-HC-2024(DEL)]

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