

**BEFORE THE AUTHORITY FOR ADVANCE RULINGS
(INCOME TAX)**

22nd Day of March, 2012

PRESENT

Mr Justice P.K. Balasubramanyan (Chairman)

Mr. V.K.Shridhar (Member)

A.A.R. No. P of 2010

Name & address of the applicant : **A**

Commissioner Concerned : Director of Income-tax
(International Taxation)
Mumbai

Present for the applicant : Mr. Ravi Sharma, Advocate

Present for the Department : Mr. G.C. Srivastava, Advocate

R U L I N G

[By Justice P.K. Balasubramanyan]

The applicant is a company incorporated in India in the year 1953 under the Companies Act of 1913. It is a closely held Public Limited Company. 48.87 % of its share are held by 'A'(USA), 25.06% by 'A'(Mauritius), 27.37% by company 'A' (S), Singapore and 1.76% by the general public. On 15.6.2010, the Board of Directors of the applicant has passed a resolution proposing a scheme of buy-back of its shares from existing shareholders in accordance with Section 77A of the Indian Companies Act.

2. 'A' (Mauritius) which holds 25.06% of shares in the applicant and incorporated on 6.4.2001 in Mauritius, proposes to accept the offer of buy-back. It acquired the shares in the applicant during the period 2001 to 2005 for Rs.280 per share on the first occasion and Rs 320 per share on the subsequent occasions. It is in that context that the applicant approached this Authority for Advance Ruling as to whether the capital gains that may arise, is chargeable to tax in India in the context of the Double Taxation Avoidance Convention between India and Mauritius and whether it will have the obligation to withhold tax in terms of Sec 195 of the Indian Income-tax Act.

3. In its comments accompanying the letter dated 31.1.2011, the revenue raised the contention that there was a previous buy-back in the year 2008 and on a return of income filed by 'A' (M) which sold back some of its shares, the question was pending before the assessing officer and hence the entertaining of the application was barred by clause (i) of

the proviso to section 245R(2) of the Act. In the letter dated 28.3.2011 it was contended that the whole of the transaction was designed to avoid payment of tax in India. This Authority did not specifically overrule the contention based on clause (i) of the proviso presumably because the transaction of 2008 though similar in nature, was a different transaction and hence that clause was not attracted. As regards the objection based on clause (iii) of the proviso, this Authority overruled the objection then raised based on the ultimate control said to be vesting in the American Company, but with a rider that it can look whether question of avoidance at a later stage, of the circumstances warranted it. Thus this Authority allowed the Application under Sec 245R(2) of the Act to give a ruling on the following questions:-

- (1) Whether on the stated facts and in law, the capital gains arising to 'A' (M), a tax resident of Mauritius, pursuant to the tendering of shares of 'A' (the applicant) under the buy-back scheme of the applicant would be Exempt from taxation in India, having regard to the provisions of paragraph 4 of Article 13 of the India-Mauritius Tax Treaty?
- (2) If the answer to question No.1 is affirmative then whether, on the stated facts and in law the applicant is required to withhold tax on the remittance of the buy-back proceeds to 'A'(M)?

4. It is argued on behalf of the applicant that a buy-back is a legally recognized transaction and that the buy-back proposed is strictly in terms of

section 77 of the Companies Act. In view of section 46A of the Income-tax Act, and the amendment of the definition of Dividend under that Act, there cannot be any doubt that what would be generated would be capital gains. Under paragraph 4 of the DTAC between India and Mauritius such gains are taxable only in Mauritius. It is, therefore, submitted that the questions may be ruled in favour of the applicant.

It is argued on behalf of the Revenue that the hearing of the application is barred by clause (i) of the proviso to Section 245R(2) of the Act. It is submitted that there was an identical buy-back in the year 2008 and on an application being made by the applicant under section 195(2) of the Act it was directed that tax had to be withheld. The applicant had withheld the tax and remitted it. Subsequently, 'A' (M) had filed a return of income claiming Nil liability and the question whether the income was taxable in India was pending before the Assessing Officer when the applicant filed the above application under section 245Q of the Act. The identical question was hence pending adjudication before an income-tax authority when this Authority was approached by the applicant. Senior counsel for the applicant met this by pointing out that the objection had already been overruled either expressly or impliedly when this Authority allowed the application under section 245R(2) of the Act and that in any event the earlier was a different transaction and hence there was no bar as has been held by this Authority on a number of occasions.

5. We find some force in the contention of counsel for the Revenue that the question pending before the Authority was an identical one. We have in this case already overruled the objection either expressly or

impliedly when we allowed the application under section 245R(2) of the Act. Moreover, this Authority has been taking the view that if the transaction is different the bar is not attracted. We do not think it necessary in this case to reconsider the question. Hence, we overrule the objection.

6. Learned Counsel for the Revenue then argued that this was a transaction designed to avoid payment of tax in India. He submitted that after the introduction of Section 115-O of the Act with effect from 1.4.2003, the applicant had not declared or paid any dividend to its shareholders. It had allowed the reserves to grow substantially and was now transferring it to 'A' (M) to take over under the DTAC between the two countries and avoid payment of any tax on the sum transferred out of the country. He pointed out that if dividends had been declared and paid as was done prior to 1.4.2003 the applicant would have been forced to pay dividend distribution tax and the ruse adopted was with a view to avoid that tax payment. He submitted that this Authority had not closed the doors on this question while allowing the application under section 245R(2) of the Act and the question may now be considered.

7. Learned counsel sought to meet this contention by submitting that this Authority had already overruled this contention while allowing the application under section 245R(2) of the Act and it is not open to the Revenue to raise this contention all over again. He submitted that buy-back of shares was sanctioned by law and there was no justification in going behind the transaction or to question the motive for the transaction or to question its bona fides. He also submitted that it was for the Board of Directors of the Company to decide on whether dividend was to be paid or

not and the decision taken by the Board in that behalf was a bona fide and valid decision. Taking advantage of legal and permissible means to arrange one's affairs cannot be characterized as a scheme for avoidance of tax.

8. We may observe some of the other relevant aspects. Though a buy-back was offered in the year 2008 and now, neither 'A' (USA), nor 'A' (S) accepted the offer. According to the Revenue, this was because the gain on buy-back would have been taxable at the hands of those entities under the India -USA DTAC and conditionally under the India-Singapore DTAC. The India-Mauritius DTAC did not make the gain taxable in India and it was not taxed in Mauritius. The acceptance of the offer by 'A' (M) alone on both occasions, was therefore significant. The public held only 1.76% of the shares and even if some of them had accepted the offer, there was no significant change in the holdings.

9. 'A' (Mauritius) is a wholly owned subsidiary of 'A' (Hong Kong). It was established to undertake offshore business activities as a corporate investment vehicle. 'A' (H) makes adequate funds available to it as and when investment directions for offshore business activities are taken. Until 14-3-2004, the immediate holding company of 'A' (M) was 'A' (UK) Limited, a company incorporated in Hong Kong. From 15-3-2004, the immediate holding company is 'X' International Corporation-Asia Private Limited, a company incorporated in Singapore. The ultimate holding company is 'X' Corporation, a company incorporated in the State of Delaware, USA.

It is in this context that the Revenue contended that since the control and management of 'A' (M) was with 'X' Corporation USA, the treaty that should govern the present transaction, is the India-USA DTAC. According to it, the place of management of 'A' (M) lies in USA only.

10. Dividend was being distributed by the applicant to its shareholders until 1.4.2003. With effect from 1.4.2003, Section 115-O of the Act in its present form was introduced. This obliged the applicant to pay a tax on distributed profits. The applicant, if it had paid dividends, would have incurred this liability to pay tax. The applicant did not pay any dividend after 1.4.2003. It allowed its reserves to accumulate. The reserve has grown from Rs.(1) crores as in March, 2003 to Rs.(3) crores in March, 2008 and to Rs.(4) crores in March, 2010. In the year 2008, the applicant offered a buy-back of shares. Neither the shareholder US 'A' nor the shareholder 'A' (S) accepted the offer. In fact, their shareholding remained and remains constant from the year 1998 till the year 2009-2010. The offer of buy-back was accepted only by 'A' (M). It is the case of the Revenue that it is only under the India-Mauritius DTAC that capital gains is totally not taxable in India, and that is the reason why the offer is being accepted only by 'A' (M) among the major shareholders. The general public held only 1.76% of the shares and it is not clear whether anyone among them has chosen to accept the offer. The contention of the Revenue is that what would have been payable as tax on distribution of profits in India, is now evaded and the fund transferred out of the country under the guise of a buy-back of shares. This amounts to clear avoidance of tax in India. A scheme has been devised for such avoidance.

11. It is argued on behalf of the Revenue, that what is devised is a colourable transaction and the authorities under the Act and the courts are free not to accept them. It was submitted that even going by the decision in Azadi Bachao Andolan, the Mc Dowell principle will apply and hence the present proposed transaction may be ignored and it may be held that the payment is taxable as dividend under the Income-tax Act read with the India-Mauritius DTAC. This Authority is reminded of the development of the law from Ramsay to Vodafone in this context.

12. On behalf of the applicant it is reiterated that the application having been allowed under section 245R(2) of the Act, inspite of an objection of similar nature being raised, it was no more open to the Revenue to raise this objection. Even otherwise, the applicant is entitled to arrange its affairs in such a manner that it lightens the burden, by choosing a legal means available to it and that arrangement cannot be characterized as scheme for avoidance of tax. In any event, in view of the amended definition of dividend under the Act, the receipt cannot be taxed as dividend. It is only capital gains attracting Section 46A of the Act and paragraph 4 of Article 12 of the India-Mauritius DTAC.

13. It is true that while allowing the application under section 245R(2) of the Act for giving a ruling, this Authority did not accept the plea of avoidance then put forward. At the same time, this Authority did not shut the door fully on the question. This Authority stated:

“Just because the ultimate holding company of the transferor is ‘X’ Corporation, USA, it would not ipso facto label the transaction to be prime facie designed for avoidance of tax. At the same time, we may clarify that the hands of this Authority are not tied to take up the issue, if later on, the transaction is proved to be designed for avoidance of tax.”

The objection now raised by the Revenue, is not the same as that raised earlier. Moreover, the order makes it clear that if later on adequate material is available to hold that the transaction is designed for avoidance of tax, it could be considered. On the terms of the order, it cannot be said that the consideration of the objection now raised by the Revenue is barred.

14. That apart, a plea that a transaction is colorable or that it is devised as a scheme for avoidance of tax, is a plea that has to be considered while giving a ruling under Section 245R(4) of the Act. According to us, it is a fundamental objection, which if upheld, would disentitle the applicant to a ruling or the ruling he has sought on a set of facts put forward. There is always a duty in this Authority to see whether there has come into existence a devise or scheme for avoidance of tax, before pronouncing on the taxability or otherwise of that transaction. This follows from the long line of judicial precedents which it is unnecessary to reiterate.

15. In this case, there is no dispute that no dividend had been paid to any of the shareholders after 1.4.2003 on which date Section 115-O of the Act was introduced in its present form. The accumulation in the reserves was allowed to be increased considerably. It may be noted that the major

shares are held by the 'A' group and only 1.76% of shares are outstanding with the general public. The payment of dividend in the normal course by a company making profits, would have meant that the applicant would have been obliged to pay tax on distribution of profits to its shareholders. Instead of distributing the dividend on the basis of profits that accrued, the applicant allowed the reserves to grow. The proposed buy-back, if followed up, would mean that considerable sums would be repatriated to 'A' (M) in Mauritius without the tax on the distributed profits being paid, by resort to paragraph 4 of Article 13 of the DTAC between India and Mauritius. In this context, it is significant to note that neither 'A' USA nor 'A' (S) accepted the offer of buy-back, obviously because in the case of one it would have been taxable in India as capital gains and in the case of the other, its taxability would have depended on certain conditions being fulfilled, whereas under the India-Mauritius DTAC, capital gains is totally out of the Indian tax net. There was no proper explanation on the part of the applicant as to why no dividends were declared subsequent to the year 2003 when the company was regularly making profits and when dividends were being distributed before the introduction of Section 115-O of the Act in its present form. We are, therefore, satisfied that the proposal projected before us of buy-back is a scheme devised for avoidance of tax. In fact, it is a colorable device for avoiding tax on distributed profits as contemplated in Section 115-O of the Act.

16. It is true that if the receipt in the hands of 'A' (M) is treated as capital gains, it would be Section 46A of the Act that will be attracted and by the force of paragraph 4 of Article 13 of the concerned DTAC, the receipt

would not be taxable in India. But in view of our finding that the transaction of buy-back proposed to be resorted to, is a colorable transaction, the question is whether the amount would not be taxable as dividend in terms of Section 2(22) of the Act as amended with effect from 1.4.2003. When the proposed transaction is found to be colorable, it is not a transaction in the eye of law and once it is ignored as such, the arrangement can only be treated as a distribution of profits by a company to its shareholders which does not attract Section 115-O of the Act. Dividend in terms of the definition includes any distribution by a company of accumulated profits to its shareholders. The exemption is only in respect of a genuine buy-back of shares. On our finding that the proposed buy-back is colourable, the distribution in question will satisfy the definition of dividend under the Act and consequently taxable as such. Under Article 10, paragraph 2 of the DTAC, dividend paid by a company which is a resident of India, to a resident of Mauritius, may also be taxed in India, according to the laws of India but subject to the limitation contained therein,. It may also be noticed that the payment in question, would also satisfy the definition of dividend in paragraph 4 of Article 10 of the DTAC between India and Mauritius. We are of the view that the proposed payment would be taxable in India in terms of paragraph 2 of Article 10 of the DTAC between India and Mauritius.

17. In the light of the reasoning and conclusion as above, we rule on question no. 1 that the amount that would be payable by the applicant to 'A' (M) would be taxable in India in terms of Article 10 of the DTAC between India and Mauritius. On question no. 2, we rule that the applicant is

required to withhold tax on the proposed remittance of the proceeds to 'A'
(M).

18. Accordingly, the ruling is pronounced on this, the 22nd day of
March, 2012.

Sd/-

(V.K. Shridhar)

Member

Sd/-

(P.K. Balasubramanyan)

Chairman