

Select issues on Capital Gains & Other Incomes earned by Non-residents

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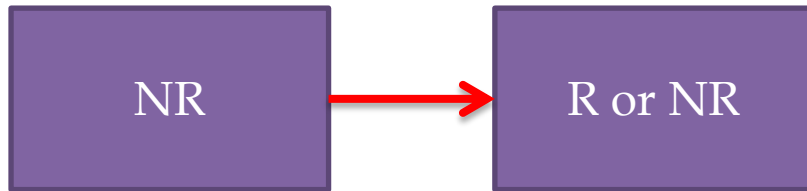
- ▶ Accrual & Deemed Accrual of Capital Gains in India
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Accrual and deemed accrual

Section 45 – Any profits or gains arising from the **'transfer'** of a capital asset

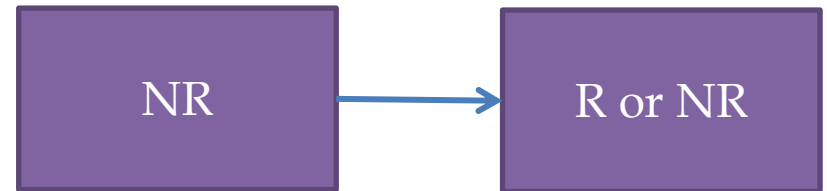
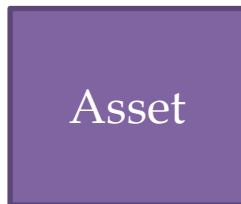
Sec 5: **Transfer** within India

Sec 9(1)(i): **Asset** within India



India

Outside India



Outside India

India



Do transfers include 'indirect' transfers?

Tax rates - Short-term Capital Gains

Type of asset	Rate of tax	As per provisions
Equity Shares; units of an equity-oriented fund; or unit of a business trust; on which STT is paid	15%	Section 111A
Capital assets other than those mentioned above including off-market sale of listed equity shares and units of equity-oriented fund	<ul style="list-style-type: none">▪ Slab rates for individual & HUF*▪ 40% for foreign companies▪ 30% for those not covered above	'Rates in force' as per Part I to the First Schedule of the relevant assessment year's Finance Act

- ▶ No marginal relief
- ▶ *No relief for NR senior or very senior citizens

Tax rates - Long-term Capital Gains

Type of asset	Applicable tax rates	As per provisions
Unlisted Securities (including shares of a non-public company - from AY 2017-18)	Up to AY 2012-13: 20% From AY 2013-14: 10% (Without giving effect to forex fluctuation adjustment and indexation benefit.)	Section 112(1)(c)(iii)
Listed securities (other than units) on which STT is not paid; or zero coupon bond	Lower of: 10% tax before availing indexation benefit; or	Proviso to Section 112(1)
	20% tax after availing indexation benefit.	Section 112(1)(c)(ii)
Listed securities on which STT is paid on transfer	Exempt from tax	Section 10(38)

► No marginal relief

Computation of Capital Gains for non-residents

- ▶ Full value of consideration received on transfer is to be reduced by the expenditure on transfer and the cost of acquisition or improvement – Section 48
- ▶ Forex Fluctuation Adjustment (FFA) – 1st proviso, Sec. 48
 - ▶ Capital gains shall be computed by converting the amount of sale consideration into the same foreign currency as was used at the time of purchase

Sr. No.	Particulars	In Rupees	Forex Rate @	In USD
a.	Cost	45,000	Rs. 45/\$	1,000
b.	Sale consideration	60,000	Rs. 60/\$	1,000
c.	Gain in respective currency (b - a)	15,000		Nil
d.	Taxable gain on account of application of FFA	Nil		

Computation of Capital Gains - Forex Fluctuation Adjustment

- ▶ FFA benefit - Capital gain in terms of foreign currency
- ▶ FFA applicable to
 - ▶ capital gains – short-term or long-term;
 - ▶ arising on transfer by a non-resident;
 - ▶ of shares or debentures of an Indian company;
 - ▶ purchased out of foreign currency.
- ▶ Forex rates as per Rule 115A – telegraphic transfer rate
- ▶ FFA and ‘Indexation benefit’ provisions mutually exclusive

Forex Fluctuation Adjustment - Issues

- ▶ Provision is mandatory in application
- ▶ What happens in case of appreciation?

Sr. No.	Particulars	In Rupees	Forex Rate @	In USD
a.	Cost	45,000	Rs. 45/\$	1,000
b.	Sale consideration	60,000	Rs. 30/\$	2,000
c.	Gain in respective foreign currency (b - a)	15,000		1,000
d.	Gain on account of application of FFA (USD 1,000 at Rs. 30)	30,000		
e.	Additional Gain taxable on account of <u>appreciation</u> in value of Rupee (d - c)	15,000		

- ▶ Intention to give relief from devaluation - CBDT circular
- ▶ Relief on appreciation only for Rupee denominated bonds of an Indian company - 4th Proviso to Section 48 - applicable from AY 2017-18

Forex Fluctuation Adjustment - Issues

- ▶ No relief for fluctuation from date of remittance till date of purchase
 - ▶ Rule 115A states rate as on day of acquisition, not remittance
- ▶ Provision applicable to Shares or debentures received as gifts or by way of inheritance
- ▶ NRO Deposits covered?
 - ▶ Foreign exchange utilised
 - ▶ Repatriability not an issue, but intention for repatriable investments
- ▶ Reinvestments
 - ▶ Forex rate of which date to be considered?
 - ▶ Gains earned in rupees to be adjusted?

Sec 112 & Forex Fluctuation Adjustment

- ▶ Proviso to Section 112(1) states that where long-term gains are earned on sale of listed securities (other than units) or zero coupon bond, the tax rate applicable would be restricted to 10%
- ▶ Applicable on gains computed “before giving effect to the provisions of the second proviso to Section 48”, i.e., on gains earned before taking ‘indexation benefit’
- ▶ Dual benefit of FFA and 10% tax rate available?

Sec 112 & Forex Fluctuation Adjustment

Assessee's stand	Revenue's stand
<p>Indexation benefit is not availed on gains on which FFA is applied. Hence, lower tax rate of 10% is available.</p>	<p>Lower rate of 10% applies only to gains eligible for 'indexation benefit'. As gains subject to FFA are ineligible for 'indexation benefit' no relief of lower rate available.</p>
<p>Cairn UK Holdings Ltd. Del HC [2013] 38 taxmann.com 179:</p> <ul style="list-style-type: none">• Literal interpretation• No explicit stipulation in the Act.	<p>Cairn UK Holdings Ltd. AAR Delhi [2011] 12 taxmann.com 266 : Proviso the Section 112 applicable only if the assets sold are first qualified for indexation benefit.</p>
<p>Accordis Beheer B V [2016] 66 taxmann.com 164 (Mumbai - Trib.); Abbott Capital India Ltd. [2014] 46 taxmann.com 33 (Mumbai - Trib.) Timken France, In re [2007] 164 Taxman 354 (AAR); Compagnie Financiere Hamon, In re [2009] 177 Taxman 511 (AAR).</p>	<p>BASF Aktiengesellschaft vs. DDIT (293 ITR 1)</p>

Chapter XIA – Special provisions for NRIs

Assets covered	Incomes covered	Tax rate
'Specified assets' if purchased, acquired or subscribed to in convertible foreign exchange: a. Shares in an Indian company; b. Debentures in or deposits with an Indian company which is not a private company; and c. Specified Government securities.	a. Investment income which is defined as income derived from the specified assets, but excluding dividends referred to in Section 115O	20%
	b. Long-term capital gains	10%

- ▶ Most provisions are now not beneficial
- ▶ Only benefit for Long-term gains earned on listed securities (other than units) which are not traded on a stock exchange (not exempt under Sec10(38)) - as per Section 112(1)(c)(ii), such gains are taxable at 20% as compared to 10% under Section 115E.

Chapter XIIA - Issues

- ▶ Deposits of banking companies
 - ▶ Only public companies covered
 - ▶ Branches of Foreign companies not covered

- ▶ Short-term gains - investment income?
 - ▶ **Against - Sham L. Chellaram [2015] 54 taxmann.com 348 (Bombay)**
 - ▶ If we apply the definition of income as provided in Section 2 of the Act to the use of the word 'Investment Income' found in Section 115E, we would render the words 'Income by way of long term capital gain' therein redundant. This is not permissible in a taxing statute.
 - ▶ The words 'derived from' would normally indicate in case of shares, the dividend received on shares and not the sale of the shares.
 - ▶ Reverses Smt. Trishla Jain [1990] 34 ITD 523 (Delhi)
 - ▶ Upholds Sunderdas Haridas v. ACIT [1998] 67 ITD 89 (Mum.)

NRIs – Interest incomes

- ▶ Interest incomes earned by NRIs are taxable at normal rates
 - ▶ 20% under Chapter XIA
- ▶ Only NRO interest taxable
- ▶ NRE and FCNR interest exempt from tax
- ▶ NRE interest exempt if Non-resident under **FEMA**
 - ▶ Section 10(4)(ii)
- ▶ FCNR interest exempt if NR or RNOR under **Income-tax**
 - ▶ Section 10(15)(fa)

FCNR leveraged deposits

- ▶ Mr. A, NRI holds FCNR deposits from November 2013:
 - ▶ USD 3 million on which loan of USD 2.5 million taken from Singapore Bank
 - ▶ USD 5 million on which loan of USD 4.5 million taken from foreign branch of Indian Bank
 - ▶ Spread of around 3%
 - ▶ Returns to India in May 2015 and is FEMA and tax resident from date of return
- ▶ Issues:
 - ▶ Can he maintain FCNR deposits on return to India?
 - ▶ Can he repay overseas loans out of FCNR deposits on maturity?
 - ▶ Tax on interest income
 - ▶ Will deduction be allowed of interest paid on overseas loans?

FCNR leveraged deposits

- ▶ Issues:
- ▶ FCNR Deposits are Indian assets
- ▶ Can he maintain FCNR deposits on return to India?
 - ▶ FCNR deposits can be maintained till maturity
 - ▶ On maturity can be converted in to Resident Deposits or RFC account
- ▶ Can he repay overseas loans out of FCNR deposits on maturity?
 - ▶ In general, not allowed to repay overseas loans out of Indian funds
 - ▶ RFC account can be used to repay loans
- ▶ Tax on interest income at normal slab rates or 20% under Chapter XIIA
 - ▶ Exemption under Sec. 10(15)(fa) only for NR and RNOR
 - ▶ Taxable under the head 'income from other sources'

FCNR leveraged deposits

- ▶ Issues:
- ▶ Will deduction be allowed of interest paid on overseas loans?
- ▶ Interest paid on funds borrowed for earning income allowable as a deduction – Section 57(iii)
 - ▶ No deduction allowed under Ch. XIIA (benefit of 20%)
 - ▶ Interest paid outside India allowed only after TDS - Section 58(ii)
 - ▶ Interest on overseas loans by foreign lender not taxable in India
 - ▶ Unless paid by a resident for earning income from a source within India (Interest on Indian FCNR Deposits)
 - ▶ Therefore, interest paid taxable in India
 - ▶ Without TDS, interest paid not allowed as a deduction
 - ▶ Double whammy!
 - ▶ Interest earned taxable without deduction of interest paid!
 - ▶ Interest paid to branch of Indian bank
 - ▶ Payment to a resident covered under Sec. 194A
 - ▶ No tax to be deducted at source
 - ▶ Deduction allowed of expense made

Taxability of FII's

- ▶ Governed by Sec 115AD
 - ▶ Code in itself

Type of asset	Short-term Gains	Long-term Gains
Equity shares or units of an equity-oriented fund, on which STT is paid, i.e., which are sold on the stock exchange	15%	Exempt u/s. 10(38)
Capital assets other than those mentioned above. Off-market sale of listed equity shares and units of equity-oriented fund are also covered here	30%	10%

- ▶ Short-term gains on which STT is not paid taxable at 30% vis-à-vis 40%
- ▶ Computation to be done without 1st & 2nd provisos to Sec 48
- ▶ No tax to be deducted from capital gains - u/s. 196D

Taxability of FIIs - Issues

- ▶ MAT applicability – yes, no, yes, confused!
 - ▶ FIIs view - not required to maintain accounts, 115JB inapplicable
 - ▶ Castleton Investment Limited followed by Revenue
 - ▶ Finance Act 2015 provided relief for incomes earned by FIIs
 - ▶ Only if MAT rate is higher than rate prescribed under Sec. 115AD
 - ▶ Notices issued for past matters
 - ▶ Press Release and instructions for not raising past matters
 - ▶ AP Shah Committee appointed
 - ▶ Recommended complete inapplicability to FIIs /FPIs
 - ▶ Finance Bill 2016 provides relief for all **foreign companies**
 - ▶ Not having a PE in India if coming from a treaty country; or
 - ▶ Does not need to register under the Companies Act
 - ▶ Retrospective amendment from AY 2001-02

Taxability of FIIs - Issues

- ▶ Capital Gains vis-à-vis Business Income
- ▶ Huge controversy set to rest by Finance Act 2015
 - ▶ Change in definition of Capital Asset – Section 2(14)
 - ▶ Covers securities held by FII
 - ▶ Taxation of gains on derivatives
 - ▶ Derivatives are covered within the definition of ‘securities’ mentioned in Section 115AD - Platinum Asset Management Ltd.
- ▶ Taxability under Treaty?
 - ▶ Characterisation of income under Treaty separate from characterisation of income under Act?
 - ▶ India-USA & India-UK refer to “capital gains”
- ▶ Fund Manager exemption under Section 9A
 - ▶ Impractical on account of several conditions
 - ▶ POEM?

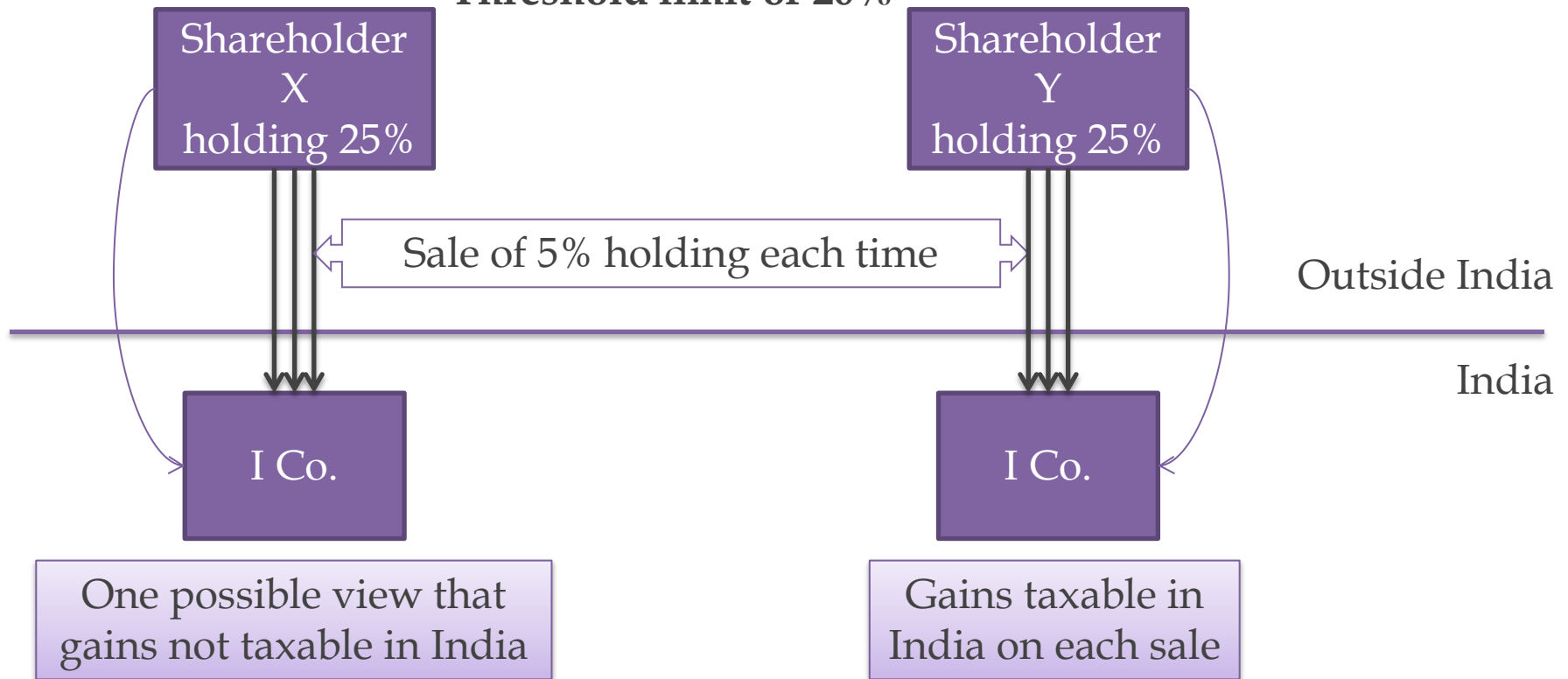
Capital Gains under DTAA

- ▶ Article 13 of the OECD and UN Models
- ▶ Basic Rule - Gains taxable where alienator is resident - COR
- ▶ Taxability based on types of assets sold
- ▶ Shares exceeding certain percentage of investee company - Article 13(5) – UN Model
 - ▶ If X, resident of Country A, sells share of an Indian company I Co., and such shares exceed a certain minimum percentage in I Co., then India can tax such gains. Country A can also tax the gains.
 - ▶ Shares can be held ‘directly or indirectly’
 - ▶ Ratio to be seen at any time during the 12 month period preceding such alienation

Article 13(5) – Variation in wording

Shares 'representing' threshold limit vs. Shares 'forming part of' threshold limit

Threshold limit of 20%



Gains should be taxable in India under both types of wordings

Capital Gains under DTAA

- ▶ Article 13(5) Absent in OECD Model & in DTAAAs with Mauritius, Singapore, etc.
- ▶ Covered in alienation of 'Other property' - Article 13(6)
 - ▶ Taxable in COR, India does not get right to tax
 - ▶ Used for double non-taxation under Mauritius, Singapore DTAAAs

Capital Gains under Mauritius DTAA

- ▶ Capital Gains on sale of shares taxable only in Mauritius
 - ▶ No tax on capital gains in Mauritius
 - ▶ Benefit of double non-taxation
- ▶ Flip flop treatment by Government
- ▶ Circular 789 upheld by SC in Azadi Bachao Andolan
 - ▶ Aditya Birla Nuvo
 - ▶ Vodafone Intl. BV
 - ▶ Sanofi Pasteur Holding SA
- ▶ Change imminent?
 - ▶ Possibly through revision in DTAA

Capital Gains under Singapore DTAA

- ▶ Capital Gains taxable only in Singapore, not in India
 - ▶ Singapore does not tax capital gains
 - ▶ Double non-taxation
 - ▶ Applicable only till India-Mauritius DTAA provides similar relief
- ▶ Limitation of Benefits clause
 - ▶ Benefit of Singapore treaty not available if

Test 1

'Affairs' of Singapore resident are arranged with the primary purpose to take advantage of treaty

The case of entities not having bona fide business shall be covered by clause (1)

OR

Test 2

Shell/Conduit Co. - any legal entity with negligible or nil business operations or with no real and continuous business activities carried out in Singapore

Deemed to be a Shell/Conduit Co. if its op expenses are < 2L SGD p.y. in last 24 months

Deemed not to be a Shell/Conduit Co. if it is listed in Singapore; and if its op expenses are >= 2L SGD p.y. in last 24 months

Capital Gains under Cyprus DTAA

- ▶ Similar benefits on capital gains as India-Mauritius DTAA
 - ▶ No tax payable in India on sale of shares in an Indian company
- ▶ CBDT has notified Cyprus as “Notified Jurisdictional Area” u/s. 94A from 1/11/2013
 - ▶ All parties shall be treated as AEs and TP provisions will apply
 - ▶ Additional documentation to be maintained
 - ▶ Any payment *on which tax is deductible at source* will be liable for TDS as per rates under the Act or 30%, whichever is higher.
- ▶ Impact on capital gains?
 - ▶ Sec 94A does not deny treaty benefits
 - ▶ Deduction at higher rate only on ‘sum chargeable to tax’
 - ▶ As no tax on capital gains, 30% rate not applicable
 - ▶ However, transaction will be scrutinised thoroughly
- ▶ Section 94A constitutional validity upheld by Madras HC
 - ▶ T. Rajkumar v. UOI [2016] 68 taxmann.com 182

Capital Gains under Other DTAA's

▶ UK & USA DTAA's

- ▶ Taxable in both countries as per domestic law

▶ Netherlands DTAA

- ▶ Gains from shares taxable only in Netherlands
- ▶ If Dutch company holds at least 10% of Indian Co. gains taxable in India
 - ▶ Only if sale happens to Indian Resident
 - ▶ If sale happens to NR, then gain taxable only in Netherlands
- ▶ Gain taxable only in Netherlands if realised in course of corporate organisation, reorganisation, amalgamation, division, etc., and buyer or seller owns at least 10% of the other co.'s capital
 - ▶ Not every transaction is reorganisation
 - ▶ Buyback held not to be a reorganisation
 - ▶ *Accordis Beheer B V* [2016] 66 taxmann.com 164 (Mumbai - Trib.)

REITs and InVITs - Structure

- ▶ Modern Structure for investment in Real Estate
 - ▶ REITs – Completed Projects
 - ▶ InVITs – Completed and ongoing Projects
- ▶ SEBI Regulations applicable
- ▶ Foreign Investment possible – FEMA amendment
 - ▶ (A.P. DIR Series Circular No. 63, 21.04.2016)
- ▶ Parties to structure
 - ▶ Sponsor – Project Developer
 - ▶ Business Trust – Trust for pooling investments
 - ▶ SPV – Operates Infrastructure projects
 - ▶ Investors – Includes Financial Institutions & Retail Investors



REITs and InVITs – Taxability

Exclusive transactions under Business Trust

▶ Sponsor

- ▶ Transfer of SPV Securities held to Business Trust – Not taxable – Holding Period of securities = SPV + Trust
- ▶ Sale of units to Financial Institutions and Stock Exchange – Taxable as Capital Gains

▶ SPV

- ▶ Project profits – Normal Corporate tax – May get 80IA and other tax reliefs
- ▶ Dividend to Business Trust – DDT
- ▶ Interest on debt securities – Allowable expenditure

REITs and InVITs – Taxability

► Business Trust

Type of Income	Taxable	References
Dividend	Exempt	U/s. 10(34)
Capital Gains	Yes	Normal Provisions
Interest from SPV	Exempt	U/s. 10(23FC)
Rent	Exempt	U/s. 10(23FCA)
Others (FD Interest, etc.)	Yes	Maximum Marginal Rate

REITs and InVITs – Taxability

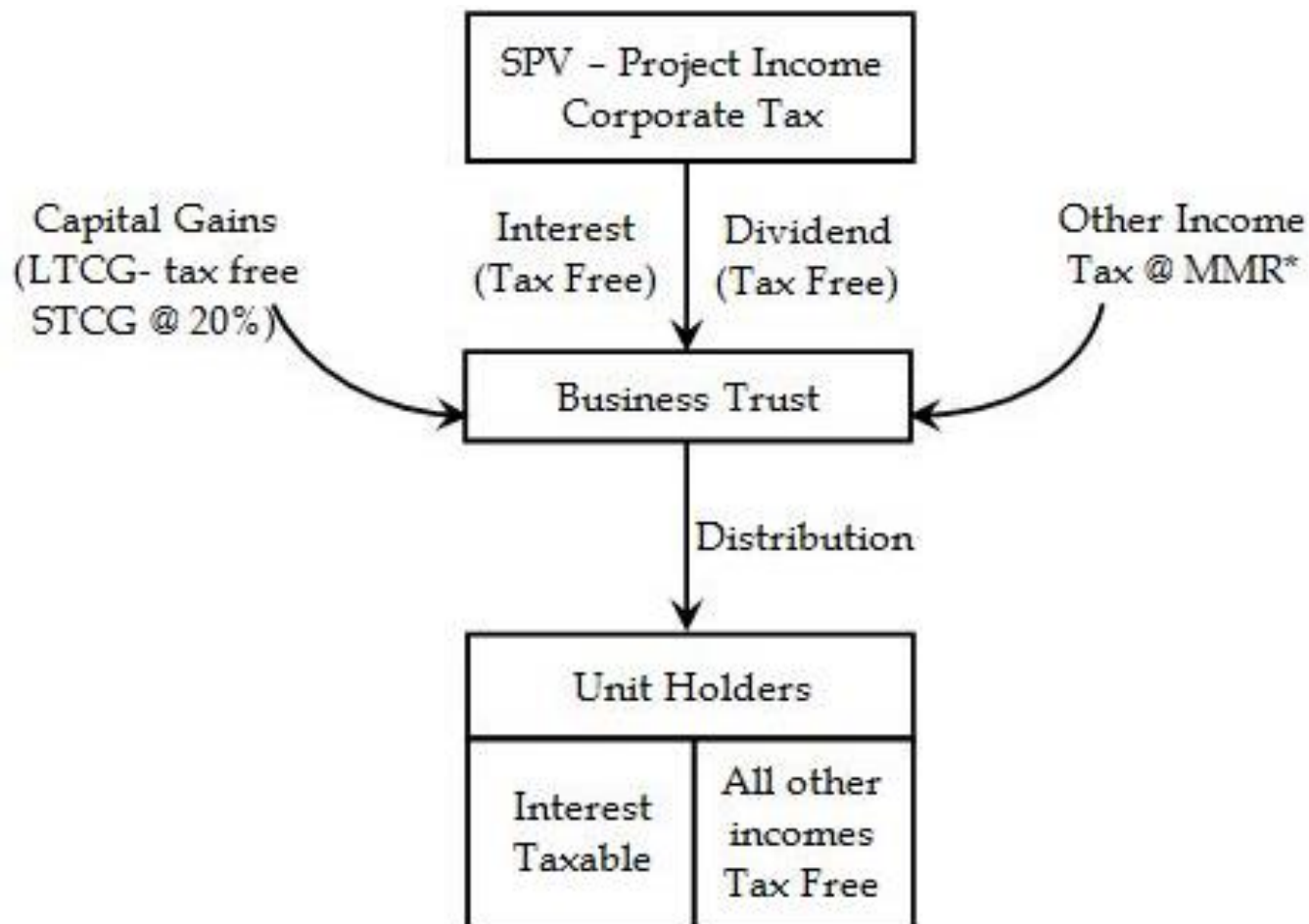
▶ Investor

▶ Interest component

Residential Status of Investor	Tax Rate	TDS Rate
Non-resident	5%	5%
Resident	Rates-in-force	10%

▶ Capital Gains – Normal Provisions

REITs / InVITS Flow of Incomes & Taxability



*MMR - Maximum Marginal Rate of tax

Taxability in IFSCs

- ▶ Tax incentives for IFSC provided in Finance Bill 2016
- ▶ LTCG is exempt irrespective of payment of STT if transaction is in Foreign Currency
- ▶ MAT for units in IFSC @ 9% as compared to current 18.5% if all its income is in Convertible Foreign Currency
- ▶ No DDT to be paid by units located in IFSC if all its income is in Convertible Foreign Currency
- ▶ No STT and CTT on transactions in Foreign Currency
- ▶ No stamp duty in GIFT for capital market activities

Tax on GDRs/ADRs/Bonds

- ▶ FCCB /FCEB Schemes provide certainty for tax
- ▶ Indian Company to obtain approval from shareholders for issue of bonds/ GDRS/ ADRs in foreign currency and traded in overseas exchange
- ▶ Can be issued to Non-residents / Resident employees
- ▶ Taxation of Dividend (other than under Section 115-O); Interest & Long-term capital gains @ 10% - Sec. 115AC
- ▶ TDS Provisions - 196C - Rate of 10% for above incomes

Tax on GDRs/ADRs/Bonds

- ▶ Capital gains related to GDRs:
- ▶ On trading in GDRs
 - ▶ No tax, provided that the transaction is outside India between two non-residents – Sec. 47(viia) & Scheme
 - ▶ Transaction in India – LTCG – 10%; STCG – normal provisions
- ▶ On redemption of GDR into underlying share
 - ▶ No tax – Tax only when the converted shares are sold
- ▶ After redemption
 - ▶ Section 115AC continues to apply if shares held by NR
 - ▶ On sale of underlying shares on stock market in rupees general provisions of the Act would apply – Sec. 115AC not applicable
- ▶ Applicability of treaty
 - ▶ Treaty between India and Country of Overseas Depository Bank till GDRs are held by ODB
 - ▶ Treaty between India and country of NR on redemption of GDRs

Taxability of FVCIs

- ▶ Investment in Domestic Venture Capital Companies or Domestic Venture Capital Funds
 - ▶ Pass through status to DVCCs and DVCFs
 - ▶ Section 10(23FB)
- ▶ Provisions of TDS will not apply
- ▶ Income taxable on accrual basis
- ▶ Tax rates as per normal provisions
- ▶ Unlike FIIs, benefit of special rates of tax is not available
- ▶ Tax Efficient Jurisdictions – Treaty benefit available

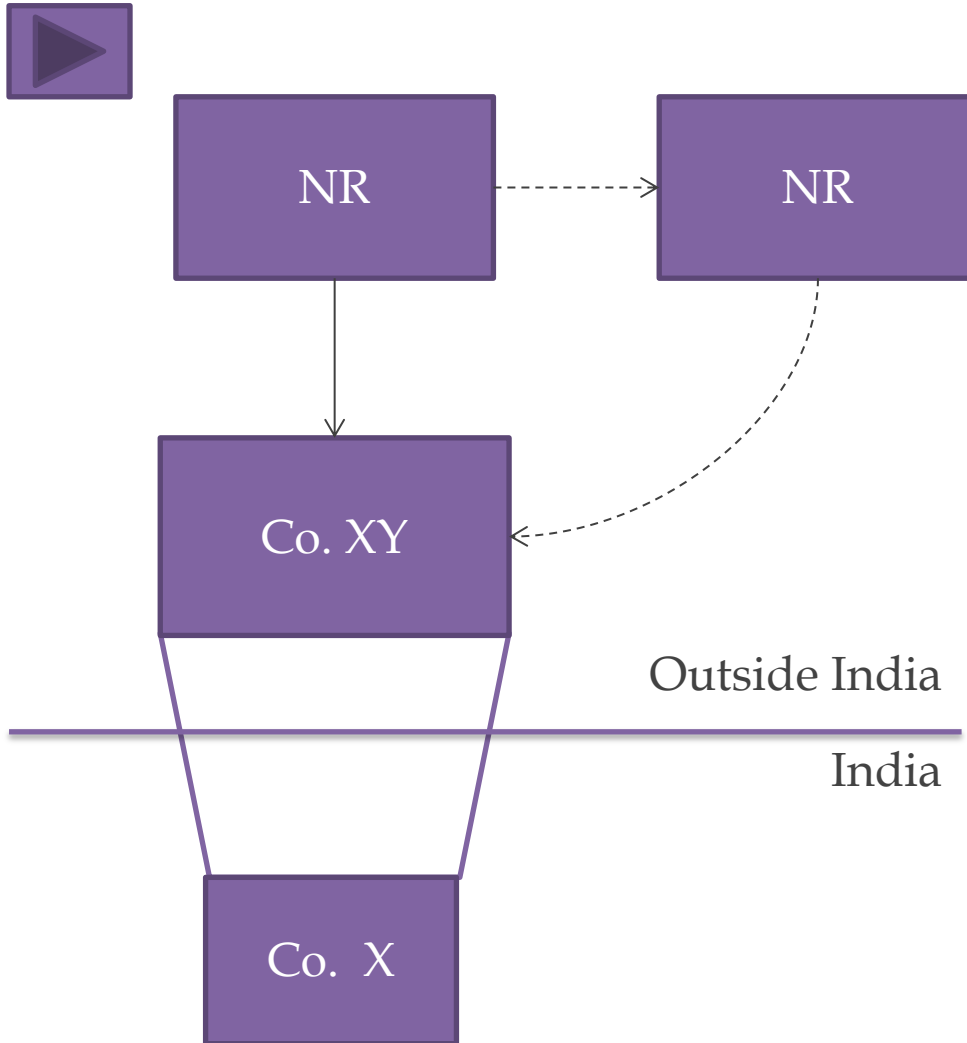
Taxability of QFIs

- ▶ Should be Non-resident as per FEMA and Income-tax
- ▶ Excludes FIIs and FVCIs
- ▶ To be operated through Qualified Depository Participants (Financial Intermediary registered with SEBI)
- ▶ Tax to be computed as per General Provisions
- ▶ Unlike FIIs, benefit of special rates of tax is not available
- ▶ QDPs act as agents or representative assessee of QFIs
- ▶ QDPs should ensure deduction of withholding taxes

Taxability of Offshore Funds

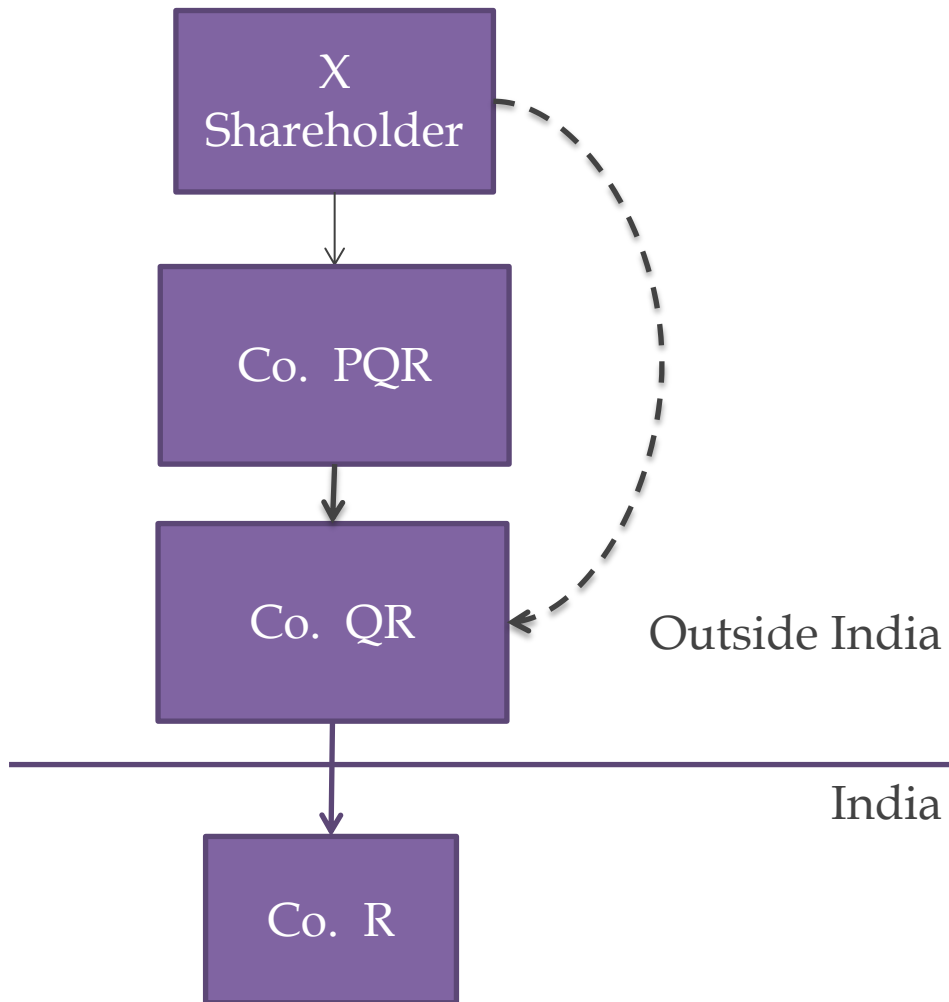
- ▶ “Overseas Financial Organisation”
- ▶ Should have an arrangement for investment in India with PSBs, Public Financial Institutions or Mutual Fund as per section 10(38)
- ▶ LTCG on sale of MG units – 10%
- ▶ Benefit redundant on exemption under Sec 10(38)
- ▶ Following benefits or deductions are not available
 - ▶ Foreign Exchange Fluctuation Adjustment
 - ▶ Inflation Adjustment
 - ▶ Expenses
 - ▶ Chapter VI-A

Indirect transfers - provision



- ▶ Explanation 5 to Section 9(1)(i):
 - ▶ **An asset or a capital asset**
 - ▶ being any share or interest
 - ▶ in a company or entity
 - ▶ registered or incorporated
 - ▶ outside India
 - ▶ **shall be deemed to be and**
 - ▶ shall always be deemed to have been
 - ▶ **situated in India,**
 - ▶ if the share or interest derives,
 - ▶ directly or indirectly,
 - ▶ its value **substantially**
 - ▶ from the assets located in India
- ▶ Retrospective amendment

Indirect transfers – ‘transfer’ not necessary



- ▶ Co. PQR is liquidated
- ▶ Shareholder X receives shares in Co. QR on liquidation
- ▶ Substantial value in Co. QR's shares due to investment in Co. R
- ▶ Shares of Co. QR deemed to be in India
- ▶ Section 46(2) applies
 - ▶ No transfer u/s. 45



Indirect transfers – DTAA relief

- ▶ Section 9(1)(i) not a non-obstante clause
- ▶ Section 90(2) applies wherever DTAA beneficial
- ▶ Sanofi Pasteur Holding SA
 - ▶ Groupe Industrial Marcel Dassault, In re
- ▶ Vodafone South Ltd.
 - ▶ Implications?

TDS u/s. 195

- ▶ Deduction on capital gain or on gross sum
 - ▶ Transmission Corporation - 239 ITR 587 (SC)
 - ▶ GE India Technology Centre - 193 TAXMANN 234 (SC)
 - ▶ Karnataka High Court in Samsung Electronics overruled
 - ▶ Few Bangalore ITAT decisions have not applied GE India correctly
 - ▶ Instruction No. 2/2014 – default only in respect of appropriate proportion chargeable to tax
- ▶ Can the payer himself determine the amount of tax to be deducted at source?
 - ▶ GE India Technology Centre
 - ▶ Approaching the tax officer u/s. 195(2) not mandatory.
- ▶ If not taxable, Section 206AA not applicable
- ▶ TRC required if DTA Benefit availed

Thank you!

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