

## Tax Hotline

July 24, 2008

### SUN'S DEFAULT UNDER TRANSFER PRICING NOT TO AFFECT TREATY ENTITLEMENT

The Income Tax Appellate Tribunal (Mumbai Bench) recently pronounced its order in the appeal filed by the Income Tax Department ("Revenue") in the case of DDIT v. M/S Sun Chemicals B.V. ("Sun Chemicals") concluding that a default by a non-resident relating to the Indian transfer pricing regulations does not disentitle such non-resident from claiming the benefits under a tax treaty.

Sun Chemicals is a company incorporated in Netherlands and is a leading supplier of graphic arts products. It had acquired the shares of Coates of India Ltd. in two tranches on April 20, 2000 and on June 29, 2001. These shares were subsequently sold by Sun Chemicals on September 21, 2001. While there was a long term capital loss in relation to the shares acquired on the earlier date, there was a short term capital gain earned from the transfer of shares acquired on June 29, 2001. The net capital loss declared by Sun Chemicals in the return filed was Rs. 1,51,67,050/-.

Subsequently questions arose regarding the calculation of the transfer price at an arm's length price as the shares were acquired from an associate enterprise and the Assessing Officer determined that there was a short term capital gain of Rs. 15,06,11,574/- by taking the cost of the shares as Rs. 73/- per share as compared to Rs. 113.19 per share paid by Sun Chemicals. Further, the Assessing Officer denied Sun Chemicals the benefit under the India-Netherlands Double Tax Avoidance Agreement ("Treaty"). If the Treaty were applied, as per Article 13(5) of the Treaty the capital gains arising in the hands of Sun Chemicals would only be taxable in Netherlands and the same would not be taxed in India.

#### Facts in Picture



#### CONTENTIONS OF THE REVENUE

It was the Revenue's contention that Treaty benefits should not be allowed to Sun Chemicals on the ground that the definition of 'tax' as per the Treaty<sup>1</sup> shall not include any amount which is payable in respect of any default or omission in relation to the taxes to which the Treaty applies. This imposes a responsibility on Sun Chemicals to disclose its correct income and not resort to default/omission while determining the tax. The Revenue submitted that Sun Chemicals has, by not disclosing the fact of purchase of shares from an associate enterprise, and secondly, by not disclosing the arms length price in respect of the purchase transaction has resulted in contravention of section 92C of the ITA. Therefore the benefit of the Treaty is not available to Sun Chemicals. The Revenue, making another point to support their stand, pointed out that under the provisions of the Treaty, benefit can be availed by honest and tax compliant entities only.

#### CONTENTIONS OF SUN CHEMICALS

The counsel for Sun Chemicals contended that Sun Chemicals is entitled to the benefit of the Treaty in terms of section 90(2) of the ITA as laid down by the Supreme Court in the Azadi Bachao Andolan case<sup>2</sup>. The ruling in the case of Vanenburg Group B.V. vs. Commissioner of Income-tax<sup>3</sup> was also relied upon. It was contended that (i) no capital gains arises to a resident of Netherlands on the transfer of shares in the course of business re-organisation; (ii) since no capital gains arises in India, Sun Chemicals is not required to file the return of income in India; and (iii) since the transfer pricing provisions contained in the Income Tax Act, 1961 ("ITA") are machinery in nature, the same would not apply to Sun Chemicals in absence of taxable income in India.

#### THE RULING

The tribunal held that the default or omission are restricted to those which are related to tax and therefore, scope of default or omission cannot be extended to default or omission qua the provisions relating to the determination of total income of Sun Chemicals, including the determination of the arms length price under the ITA. The tribunal also rightly

## Research Papers

### Life Sciences 2025

June 11, 2025

### The Tour d'Horizon of Data Law Implications of Digital Twins

May 29, 2025

### Global Capability Centers

May 27, 2025

## Research Articles

### 2025 Watchlist: Life Sciences Sector India

April 04, 2025

### Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

## Audio

### CCI's Deal Value Test

February 22, 2025

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025

upheld the fact that the words 'default or omission in relation to taxes' in the definition of the term 'tax' would include any amount of interest payable by the taxpayer. Thus, it was concluded that the default or omissions relating to the provisions of section 92 to 92F of the ITA are not covered by the default or omission mentioned in Article 3(d) of the Treaty and consequently the appeal of the Revenue stood dismissed.

While the tribunal has concluded in favour of Sun Chemicals to the extent that the Treaty shall be applicable in the present case, and has also taken a correct interpretation of the term 'tax', it has not considered the issue regarding whether transfer pricing provisions can be applied at the time of acquisition of shares in the first place. It was contended by Sun Chemicals before the Assessing Officer that the acquisition of shares is outside the purview of the transfer pricing provisions, as profit or loss arises from the sale of shares and not from acquisition. This aspect is important especially since Section 92(3) of the ITA specifically provides that transfer pricing provisions shall not apply in the event they result in reducing the income chargeable to tax. In the current case, the shares were acquired at a price much above the arm's length price, and such a downward revision of the price would have resulted in the lower capital gains in the hands of the seller from whom Sun Chemicals had purchased the shares. However, the tribunal has not given its observations on this, and the issue regarding the applicability of transfer pricing provisions for a purchaser at the time of acquisition of shares still remains ambiguous. In the context of the burgeoning Indian economy, where investments in Indian companies are being made at high premium, this could have an effect on the tax implications at the time of sale of such investments, especially in cases where the investments are not being made through tax favorable jurisdictions.

**- Shreyas Jhaveri, Mansi Seth & Parul Jain**

1 Article 3(d) of India-Netherlands Treaty: "the term: tax means the Indian tax or the Netherlands tax, as the context requires, but shall not include any amount which is payable in respect of any default or omission in relation to the taxes to which this Convention applies or which represents a penalty imposed relating to those taxes."  
2 263 ITR 706.

3 159 Taxman 219.

**DISCLAIMER**

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.