Nishith Desai Associates

LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI SILICON VALLEY BANGALORE SINGAPORE MUMBAI BKC NEW DELHI NEW YORK GIFT CITY

Research

Taxing Offshore Indirect Transfers in India

January 2025

 www.nishithdesai.com

Research

Taxing Offshore Indirect Transfers in India

January 2025

DMS Code: 115689.1

FT INNOVATIVE LAWYERS 2019
ASIA-PACIFIC WINNER

Ranked as the 'Most Innovative Indian Law Firm' in the prestigious FT Innovative Lawyers Asia Pacific Awards for multiple years. Also ranked amongst the 'Most Innovative Asia Pacific Law Firm' in these elite Financial Times Innovation rankings.

Disclaimer

This report is a copyright of Nishith Desai Associates. No reader should act on the basis of any statement contained herein without seeking professional advice. The authors and the firm expressly disclaim all and any liability to any person who has read this report, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance upon the contents of this report.

Contact

For any help or assistance please email us on **concierge@nishithdesai.com**
or visit us at **www.nishithdesai.com**.

Acknowledgements

Parul Jain
parul.jain@nishithdesai.com

Ipsita Agarwalla
ipsita.agarwalla@nishithdesai.com

Contents

Introduction 1

Taxation of Indirect Transfers under Indian Income Tax Act 4

Vodafone Case and Retrospective Amendments 5

Valuation Methodology 8

Exemptions and Issues related to Indirect Transfers 10

A. Exemption to FPIs 10

B. Dividend Exemption 10

C. Exemption to investment funds 10

D. Overseas Partnerships 11

E. Investment in Debt Instruments 11

F. M&A Exemptions 11

G. Exemption under Tax Treaty 13

H. Tax on the receipt of shares 17

Reporting obligations 18

Resolving Indirect Transfer tax disputes through Investment Arbitration 19

Removal of Retroactivity 20

International Scenario 21

Impact on documentation 22

Conclusion 23

Annexure 24

A. Extract of indirect transfer provisions 24

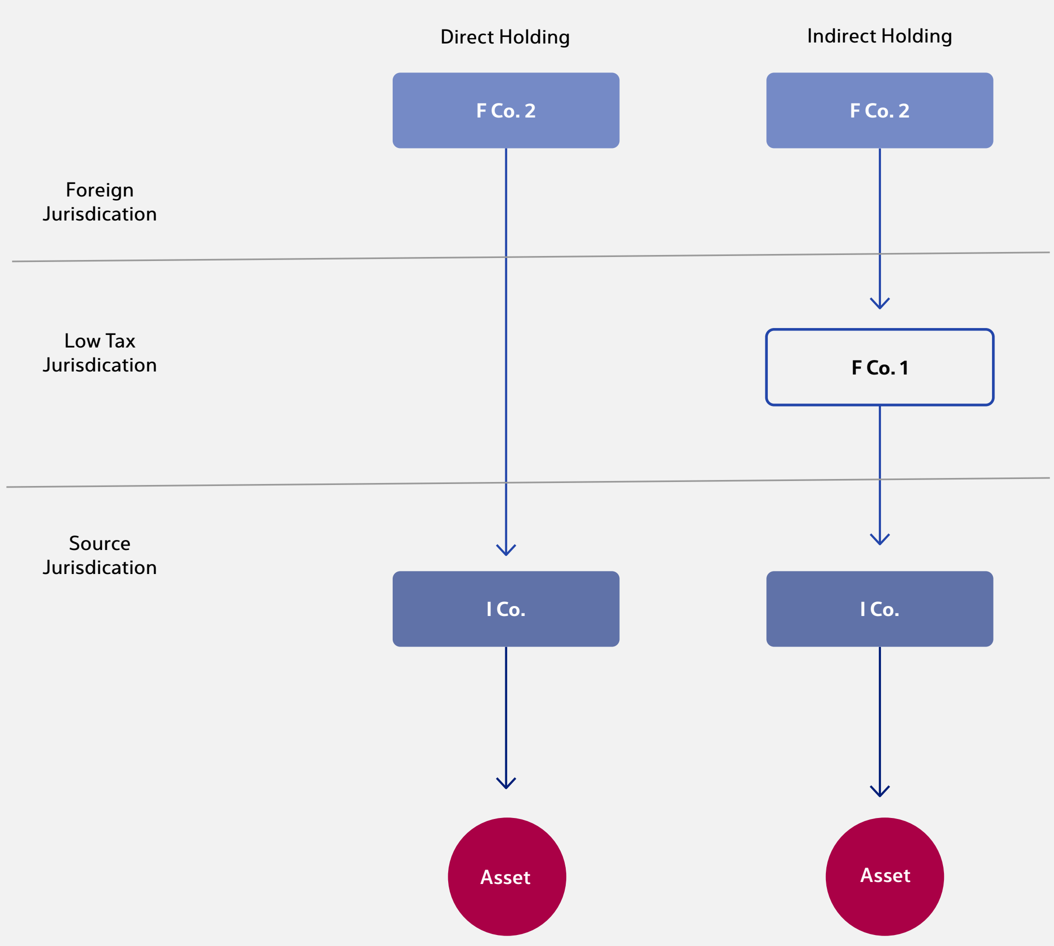
B. Meaning of transfer under ITA 27

Introduction

Exit from an investment is usually done by 'transferring' ownership of the asset.[1] The ownership of an asset may be direct or indirect (see figure 1). An indirect transfer of an asset takes place when an interest in an intermediate entity is transferred, effectively resulting in the transfer of control over an underlying asset situated in another jurisdiction **("Indirect Transfer")**.

In the below diagram, to effectuate an Indirect Transfer, F Co. 2 will transfer its holding in F Co. 1 to any other person. Hence, interest in the underlying asset in the source jurisdiction (shares of I Co. or Asset) gets (indirectly) transferred without any transaction occurring in the Source Jurisdiction.

Figure 1



For Indirect Transfer, the inherent issue is that contractually there is no transfer of the underlying asset. Hence there is no gain as such realized in the jurisdiction where the asset is situated **("Source Jurisdiction")**.

1 Section 2(47) of the Income Tax Act, 1961 extensively defines meaning of transfer for the purpose of capital gains.

The transfer is only of the share or interest of the entity that holds the asset (directly or indirectly), but that occurs in another jurisdiction, either in the jurisdiction of the residence of the seller or in a third jurisdiction. Hence, when the interest in the asset gets transferred, albeit indirectly, the Source Jurisdiction is deprived of the tax revenue arising out of such transfer.

The tax treatment of such Indirect Transfers has emerged as a contentious issue, particularly in developing countries. Developing countries often consider such transfer as a means to avoid capital gains tax in the country where the underlying asset is located. This issue reached global headlines due to transactions concerning Petrotech Peruana [2] and Zain International.[3]

China was one of the first countries which took action against indirect transfers based on the above-mentioned belief. China's approach to taxing such indirect transfer is essentially designed as an anti-avoidance measure. Prima facie, the transfer of shares of the foreign intervening entity by a non-resident to another non-resident is not subject to tax in China. However, this Indirect Transfer can be brought to tax if it fails the 'reasonable business purpose test', and the Chinese authorities consider that the transfer has no reasonable commercial purpose other than avoiding Chinese tax.[4] Australia also amended its income tax law in 2006 to tax Indirect Transfers. After the amendment, the transfer of an interest in Australian real property (indirectly) is also subject to capital gains tax.

The Indian tax authorities **("Revenue")** also considered offshore Indirect Transfers taxable under the provisions of the Income-tax Act, 1961 **("ITA")** in the Vodafone case.[5] The Revenue initiated high profile litigation on the basis that Vodafone had failed to withhold Indian taxes on payments made to the selling Hutch entity for the transfer of a share in a Cayman Island entity, which in turn was a holding company through various intermediate levels, of an Indian subsidiary. The Supreme Court of India **("SC")** held in favor of Vodafone that the transaction was not subject to tax under ITA and accordingly no Indian tax was required to be withheld on a transfer of offshore assets between two non-residents.[6]

Shortly thereafter, the Finance Act, 2012 introduced several amendments to undo the impact of the SC ruling. These included the insertion of a validation clause [7] which could enable the Revenue to deprive the SC ruling of its finality. Substantive amendments to the definitions of "capital asset" and "transfer", as well as an addition of Explanation 5 to section 9(1)(i) of the ITA, "clarifying" that an offshore capital asset would be considered to have its situs in India if it substantially derived its value (directly or indirectly) from assets situated in India. All of these amendments were enacted to take effect retroactively from 1962. Amendments were also introduced, with retroactive effect, to procedural provisions relating to withholding tax (Explanation 2 to section 195 of the ITA).

---

2 Ecopetrol Columbia and Korea National Oil Corp. purchased shares of a Houston based company whose major asset was Petroech Peruana, a company incorporated in Peru and engaged in oil production, from another Delaware incorporated company. The potential loss of tax revenue for Peru was estimated to be around USD 482 million.

3 A Dutch company purchased shares of Zain Africa BV (also a Dutch company) which owned Uganda based Mobile phone operator Celtel Ugan- da Ltd., from Zain International BV (another Dutch company). Although the supreme judicial authority of Uganda ruled in favour of revenue authorities, the issue still remains unresolved and is pending under Mutual Agreement Procedure as provided under the relevant tax treaty.

4 An offshore indirect transfer fails the 'reasonable business purpose test', if all of the following conditions are satisfied: (1) the foreign holding company is located in a jurisdiction where the effective tax rate is significantly low, or where offshore income is not taxed; (2) the asset directly transferred derives at least 75% (directly or indirectly) of its value from Chinese taxable property; (3) at least 90% of the total assets or income of the foreign holding company is based (directly or indirectly) on investment or income from China; (4) the overseas enterprise does not under- take substantive functions and risks, and; (5) the tax consequences of the indirect transfer in the foreign country is lower than the Chinese tax payable, had the sale was made directly.

5 Vodafone International Holdings B.V. v. Union of India [2012] 341 ITR 1 (SC).

6 It is important to note that at the time of Vodafone ruling the ITA did not had statutory General Anti-Avoidance Measure ("GAAR") (which has been brought into effect from April, 2017). The SC applied judicial GAAR, however the threshold to tackle transactions designed to avoid taxation in India, has now reduced with statutory GAAR.

7 Section 119 of the Finance Act, 2012.

These provisions are collectively referred to as **"Retroactive Amendments"** and have been discussed in detail in this paper. However, the government's efforts were thwarted when international investment tribunals ruled against India's attempt to impose a retrospective tax on such transfers. Considering the mounting pressure on the government from foreign investors and the need for foreign investment to sustain a post-pandemic recovery, the government through the 2021 Act (defined later) did away with the retrospective application of Indirect Transfer tax provisions.

Taxation of Indirect Transfers under Indian Income Tax Act

Under the Indian Income-tax Act, 1961 **("ITA")**, an Indian resident is taxed on its global income (residence-based taxation) whereas a non-resident is taxed only on the income which is derived from a source in India (source- based taxation) i.e. income which is received or deemed to be received in India and income which accrues, arises or is deemed to accrue or arise in India.[1]

Further, any income or gain arising from the transfer of a capital asset is taxable under the head of capital gains.[2] Income arising from the transfer of any capital asset situated in India is deemed to accrue or arise in India.[3] Hence, if the capital asset is situated in India it is irrelevant whether the transferor is resident or non-resident for the purpose of taxation under the ITA.

However, in an Indirect Transfer, there is a transfer of an interest in an entity that is located in a foreign jurisdiction and such transfer may occur between two non-residents. Hence though the underlying asset is situated in India, in contractual terms the transfer is of a share or interest in a company that is registered outside India.

The subsequent parts of this paper deal with the legislative history of Indirect Transfer in India and are followed by other nuances.

1 Section 4 read with section 5 of ITA.

2 Section 45 of ITA.

3 Section 9(1)(i) of ITA.

Vodafone Case and Retrospective Amendments

Hutchinson group had invested in the Indian telecom business in 1992 by entering into a joint venture **("JV")** with an Indian entity. It held its interest in the JV through a Cayman Island-based company CGP, which itself was a wholly-owned subsidiary of Hutchinson Telecommunication International Limited **("HTIL")**, another Cayman Island-based company. In 2007, HTIL agreed to sell its share in CGP to Vodafone International BV, a tax resident of the Netherlands. Through this transfer, Hutchinson's group stake in the Indian JV got indirectly transferred to Vodafone.

Revenue raised demand against Vodafone for not withholding taxes at the time of payment of sale consideration to the seller[1], on the premise that such transaction was taxable in India. The SC rendered its decision[2] in favor of the taxpayer and held that transfer of the solitary CGP share was not taxable in India.

As per the principle of lex situs, the transfer of moveable property is governed by the law of the country in which such movable property is situated. In the case of transfer of shares, the situs is considered to be in the jurisdiction where the shares could be effectively dealt with i.e. where the shareholders' register is maintained.[3] One of Revenue's contentions in Vodafone was that instead of the "look at" approach, the "look through" approach should be adopted, thereby treating the transfer of the share of a foreign company as the transfer of the share of an Indian company. This argument was not accepted by the SC as it would have rendered the phrase 'capital asset situates in India' in section 9(1)(i) of the ITA nugatory. It was further remarked that the question of adopting the 'look through' approach is a matter of policy and if intended to be adopted, it must be expressly provided in the statute.

The government was averse to losing the substantial revenue in the present case and several other similar transactions by different companies, as the judgment had become the law of the land.[4]

A review petition was also filed in the same matter. However, it did not yield any favourable results for the Revenue. Finally, in the forthcoming Union Budget,[5] a set of amendments were introduced (retroactively effective from April 1, 1962) to tax Indirect Transfers under the framework of the ITA —

1. Explanation 4 to section 9(1)(i) – A clarificatory amendment that the expression 'through' shall mean and include 'by means of', 'in consequence of' or 'by reason of', thereby making express inclusion of 'look through approach' in the ITA.
2. Explanation 5 to section 9(1)(i) – A deeming fiction to clarify that any share or interest in a foreign company or entity which derives its value, directly or indirectly, 'substantially' from assets situated in India, shall be deemed to be 'capital asset situate in India'.
3. Explanation 2 to section 2(47) – A clarificatory amendment that 'transfer' includes the creation or disposing of any interest in any asset in any manner whatsoever (i.e. directly, indirectly, absolutely, conditionally, voluntarily, involuntarily) by way of an agreement entered into in India or outside India or otherwise.

1 Section 195 of ITA.

2 [2012] 341 ITR 1(SC).

3 Brassard v. Smith [1925] AC 371, cited with approval by the SC in Vodafone 2012 (Radhakrishnan, J's judgement).

4 Article 142 of the Constitution of India.

5 Finance Act, 2012.

These amendments were intended to empower the government to tax Indirect Transfers and to an extent invalidate the decision of the SC in Vodafone on scope and purpose of section 9 and 195 of the ITA.

Pursuant to introduction of Indirect Transfer provisions by the Finance Act, 2012, several issues arose due to lack of clarifications under law. Subsequently, the Finance Act, 2015 **("FA, 2015")** made several clarificatory amendments to the Indirect Transfer provisions.

A. Threshold for Substantiality

Explanation 6 to Section 9(1)(i) introduced by FA, 2015 provides that a share or interest of a foreign company or entity shall be deemed to derive its value substantially from assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets (i) exceeds INR 100 million **("de minimis threshold")**; and (ii) represents at least 50% of the value of all the assets owned by the foreign company or entity. The value of the assets shall be the fair market value **("FMV")** of such asset, without reduction of liabilities, if any, in respect of the asset.

Between 2012 to 2016, in the absence of a statutory definition of 'substantially' under the ITA, the Indirect Transfer provisions were subject matter of scrutiny in several cases. Prior to the amendments by FA, 2015, cases such as Copal Research Limited,[6] GEA Refrigeration Technologies GmBh,[7] Banca Sella S.p.A,[8] had uniformly held that 'substantially' appearing in Explanation 5 to Section 9(1)(i) of the ITA means at least 50% interest in Indian assets. Further, the AAR has held that amendments made to the Indirect Transfer provisions by FA, 2015 are retroactive in nature.[9] This AAR ruling provides some measure of certainty in respect of transactions consummated prior to the amendments undertaken by FA, 2015

B. Date for Determining Valuation

The amendments made by FA, 2015 state that typically, the end of the accounting period of the foreign entity preceding the date of transfer shall be the 'specified date' i.e. the relevant date of valuation. However, in a situation when the book value of the assets on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer, then the specified date shall be the date of transfer.

C. Apportionment of Gains

Explanation 7 to Section 9(1)(i) introduced by FA, 2015 provides inter alia that the gains arising on transfer of a share or interest deriving, directly or indirectly, its value substantially from assets located in India will be taxed on a proportional basis based on the assets located in India vis-à-vis global assets. Rule 11UC provides for the determination of income attributable to assets in India.

6 DIT v. Copal Research Limited (2014) 371 ITR 114 (Delhi HC).

7 In Re: GEA Refrigeration Technologies GmBh (2018) 401 ITR 115 (AAR).

8 The decision of Delhi High Court has been stayed by the Supreme Court.

9 In Re: A and Others, decision dated March 18, 2020, AAR Nos. 1555 to 1564 of 2013.

Essentially, Rule 11UC provides for apportionment of income from indirect transfer basis the ratio between the FMV of the assets located in India and FMV of all assets of the foreign entity as computed according to Rule 11UB of the ITR.

D. Exemptions

The amendments made by FA, 2015 also state that the indirect transfer provisions shall not be applicable in the following circumstances:

1. Where the transferor of shares of or interest in a foreign entity, along with its related parties does not hold (i) the right of control or management; and (ii) the voting power or share capital or interest exceeding 5% of the total voting power or total share capital in the foreign company or entity directly holding the Indian assets **("Holding Co")**.
2. Where the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly, then the exemption shall be available to the transferor if it, along with related parties, does not hold (i) the right of management or control in relation to such company or entity; and (ii) any rights in such company which would entitle it to either exercise control or management of the Holding Co or entitle it to voting power exceeding 5% in the Holding Co.

Listed Securities — Indirect Transfer provisions are also applicable on transactions in respect of listed securities taking place on offshore exchanges (subject to the 5% threshold). The intent behind the Indirect Transfer provisions was to tax the transfer of 'control' over the assets situated in India. Further, the transactions on the stock exchanges are generally regulated. While in most cases the small shareholder may help exempt income arising from such indirect transfers, nonetheless there may be situations (eg cases of promoter holdings exceeding 5%) whereby even a transfer on an overseas stock exchange may trigger tax in India. In such situations, it may be practically impossible for the purchaser of securities on the Indian stock exchange to withhold appropriate taxes. Hence, a specific exemption concerning listed securities should have been provided in addition to the small shareholder exemption already existing in law.

Valuation Methodology

As discussed above, the Indirect Transfer provisions are triggered if the share or interest of the foreign company derives substantial 'value' from assets in India. Therefore, one has to compare the 'value' of share of the foreign company vis-à-vis the value of the assets in India through which such foreign company derives substantial (>50%) value.

The Central Board of Direct Taxes **("CBDT")** has notified rules prescribing the method of computation of FMV of assets (Rule 11UB).

A. Valuation of Indian Asset (A)

Rule 11UB of the Income-tax Rules, 1962 **("ITR")** provides valuation standards to be adopted for calculating FMV of assets situated in India where such asset is the shares of a listed company, shares of an unlisted company, interest in partnership firm or association of person, or any other interest.

In case of unlisted shares of an Indian company, Rule 11UB provides that the FMV shall be determined by a merchant banker or accountant in accordance with any internationally accepted valuation methodology for valuation of shares on arm's length basis as increased by the liability, if any, considered in such determination.

B. Valuation of Assets of Foreign Company (B)

The valuation of assets of the foreign company depends upon whether the transfer of share or interest of the foreign entity is between connected persons or not.

Transfer between connected persons

FMV of all the assets of the foreign company is determined as a sum of A: fair market value of the foreign company or the entity as on the specified date as determined by a merchant banker or an accountant as per the internationally accepted valuation methodology and B: Book value of the liabilities of the company or the entity as on the specified date as certified by a merchant banker or an accountant.

Transfer between unconnected persons

FMV of all the assets of the foreign company is determined as a sum of A: Market capitalization of the foreign company or entity computed on the basis of the full value of consideration for transfer of the share or interest and B: Book value of the liabilities of the company or the entity as on the specified date as certified by a merchant banker or an accountant

In case where the value of Indian assets (A) is more than 50% of the value of all assets of foreign company (B), Indirect Transfer provisions will be triggered. In transactions wherein foreign entities have Indian assets it is important to check whether the 50% test is being met or not to see applicability of Indirect Transfer provisions. Considered from perspective of a non-resident, the valuation rules are complicated and cumbersome.

Importantly, the FMV has be assessed on the 'specified date' which is the end of the accounting period of the foreign entity preceding the date of transfer unless the book value of foreign company increases by 15% from the end of the accounting period till the date of transfer.

Rule 11UB merely helps in assessing whether Indirect Transfer provisions are being triggered or not. In case where the Indirect Transfer provisions are triggered, capital gains will have to be computed as per section 48 of the ITA. As per section 48 of the ITA, capital gain is computed by deducting the cost of acquisition from the consideration received on account of transfer of capital asset **("FVC")**.

Section 50CA of the ITA deems the FMV of unlisted share to be the FVC for determination of capital gains, in case where the FVC is less than the FMV. While section 50CA does not explicitly cover shares of foreign company, in case where Indirect Transfer provisions are triggered, FVC is determined on basis of FMV of share of the foreign company as per Rule 11UA of the ITR.

In offshore transactions wherein Indian subsidiaries are involved, buyers often ask for valuation report for getting comfort on their withholding tax obligations.

Exemptions and Issues related to Indirect Transfers

A. Exemption to FPIs

Indirect Transfer provisions have had significant impact on the offshore funds industry. The investment structure in the case of a typical Foreign Portfolio Investor **("FPI")** is a multi-tier structure consisting of individual investors, participatory noteholders, feeder funds etc. located in various jurisdictions, pooling their capital with the main FPI being registered with Securities and Exchange Board of India **("SEBI")**. The FPI itself is an entity taxable in India under ITA read with the relevant tax treaty. The non-resident investors of an FPI will (indirectly) hold underlying assets in India and any transfer by FPI would trigger liability in hands of each layer of such investor, making such income taxable at two or more levels.

Under the Finance Act, 2017 (read with Finance Act, 2020) a clarificatory amendment was introduced providing that Indirect Transfer provisions will not be applicable to transfers of asset held by non-resident by way of investment, directly or indirectly, in a Category I FPI under the SEBI (FPI) Regulations, 2019.

B. Dividend Exemption

The CBDT vide a circular[1] has clarified that payment or declaration of dividend outside India by a foreign company which derives its value substantially from assets situated in India is not subject to Indirect Transfer provisions.

However, there is lack of certainty over distributions that arise out of redemption of shares made from accumulated profits of the holding vehicle to the parent company. A view may be taken that redemptions should not be scrutinized under Explanation 5 of Section 9(1)(i) of the ITA since Section 2(22) of the ITA (which defines the term "dividend") includes distributions by way of any "capital reduction" and provides that "dividend" includes any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits, whether the such accumulated profits have been capitalized or not. However, this position suffers from ambiguity since Section 46A of the ITA treats purchase of its own shares by an Indian company to be a transaction that is subject to capital gains and does not consider such purchases to be a form of dividend distribution.

C. Exemption to Investment Funds

Concerns were raised by non-residents investing in India through multi-tier investment structures, that on account of Indirect Transfer provisions such non-residents may suffer multiple taxation of the same income at the time of subsequent redemption or buyback.

1 Circular No. 4 of 2015.

The CBDT issued circular in 2017[2] clarifying that Indirect Transfer provisions will not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in 'specified funds'. Specified Funds inter-alia include Category-I/ II Alternate Investment Funds **("AIFs")**, Venture capital funds etc. Further, such exemption is only available if capital gains tax has been paid at the Indian level at the time when the AIF divests shares of the Indian company. CBDT has clarified that the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India.

D. Overseas Partnerships

In the case of companies, a shareholder may be distributed dividends or there may be a redemption of shares (capital reduction) by the company, or the investor may also sell its shares. However, in the case of partnerships, a partner may simply retire. In such situations, there is no 'transfer'[3] as such and payments made by the partnership may be characterized as the distribution of capital and profits to the partner by the partnership firm. Hence, it may be argued that in the case of overseas partnership firms which derive their value from underlying Indian assets, A change in the partnership interest / distribution of profits of the partnership should not attract indirect transfer provisions.

E. Investment in Debt Instruments

In case of issuance of debt instruments by an overseas entity whose shares / interest derive value substantially from India, it can be argued that subscription to and subsequent transfer of such debt instruments does not give rise to applicability of Indirect Transfer provisions since these instruments do not confer any interest in the overseas entity per se, the interest if at all is with respect to receipt of interest and premium amounts linked to the debt instrument. Nonetheless, in case the debt instruments functions like quasi equity eg in case of convertible debentures, or interest coupon tied to profits of the issuer entity, it may be difficult to argue non -applicability of the Indirect Transfer provisions upon transfer of such debt instruments.

F. M&A Exemptions

There are several situations where structuring / re-organization may result in an Indirect Transfer of assets in India. Such re-organization could be as a result of internal group structuring by way of a merger or demerger. Indian assets may also be indirectly transferred due to structuring / acquisitions at an offshore level. For example, in case where an offshore company with an Indian subsidiary is being acquired by way of a reverse triangular merger,[4] the offshore mergers may trigger Indirect Transfer provisions. In case where Indirect Transfer provisions are triggered, the buyer will be under an obligation to withhold tax.

2 Circular No. 28 of 2017, dated November 7, 2017.

3 Section 2(47) of the ITA.

4 A reverse triangular merger is a type of acquisition where a company creates a subsidiary to buy another company, and then merges the subsidiary into the acquired company. The acquired company then becomes the subsidiary of the acquiring company.

Representations and warranties will also have to be accordingly documented and negotiated. The ITA provides certain exemptions from applicability of Indirect Transfer provisions in case of certain re-organizations.

I. Exemptions in the hands of the amalgamating company / demerged company

Transfer of a capital asset by an amalgamating (merging) company to an amalgamated (merged) company in a scheme of amalgamation (merger) is exempt in the hands of the amalgamating company if the amalgamated company is an Indian company.[5] In case both the amalgamating company and the amalgamated company are foreign companies, similar exemption is available in the hands of the amalgamated company[6] if the transfer is of shares of an Indian company, and the following conditions are satisfied –

At least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company.

Such transfer does not attract capital gains tax in the amalgamating company's country of incorporation.

Both the above exemptions apply in case of direct transfers. However, The FA, 2015 provided a similar exemption to the foreign amalgamating company in case the transfer is of shares of a foreign company which substantially derive their value from assets situated in India.[7]

Further, in the case of demerger of a foreign company whose shares derive substantial value from assets situated in India, an exemption was introduced for the demerged company[8], subject to satisfaction of the above two conditions.

II. Exemption in the hands of the shareholders

In case the amalgamated company is an Indian company and the shareholder of the amalgamating company receives shares of the amalgamated company in consideration of the transfer of shares held by him in the amalgamating company, the transaction would be an exempt transfer.[9] However, there is no exemption in the hands of the shareholders of the amalgamating company if the amalgamated company is not an Indian company. Hence, the transfer of a capital asset being shares of a foreign amalgamating company which derives its value from assets situated in India in pursuance of the scheme of amalgamation could be liable to tax in India in the hands of the shareholder of the amalgamating company in absence of a specific exemption.

5 Section 47(vi) of the ITA.

6 Section 47(via) of the ITA.

7 Section 47(viab) of the ITA.

8 Section 47(vicc) of the ITA.

9 Section 47(vii) of the ITA.

G. Exemption under Tax Treaty

As a general rule capital gains arising out of the sale of shares is taxable only where the alienator is resident.[10] However, in case such share derives its value from immovable property situated in another contracting state, such state also has the right to tax gains on alienation of shares.[11] Further, the UN Model Tax Convention **("MTC")** also provides the source state the right to tax gains on the alienation of shares of a company (which does not derive its value from the immovable property) resident in that State, subject to certain ownership threshold[12] to be satisfied by alienator at any time during 365 days preceding such alienation. [13]

Although the UN MTC is wider than OECD MTC, it is pertinent to note that for the source country to apply Article 13(5), the company whose share is transferred should be a resident of the source country, which is generally not the case in a typical Indirect Transfer structure. In an Indirect Transfer structure, the company whose share is transferred is resident in A jurisdiction, the alienator may be resident in B jurisdiction and the underlying asset (or share) be situated in C jurisdiction. Hence, the situation may fall under Article 13(6), which is a residuary clause, giving the sole right to the contracting state of which the alienator is resident. Hence, instead of jurisdiction C, jurisdiction B may get the right to tax such gains in the absence of a specific 'look through' approach qua residency in article 13(5) of the UN MTC.

Interpretation of Indirect Transfer provisions in tax treaties by Indian Judiciary

Despite several clarifications issued by the CBDT, the indirect transfer transactions continue to remain one of the most litigated issues in India. One heavily litigated issue is the availability of tax treaty benefits for indirect transfers.

The Andhra Pradesh High Court dealt with one of the first cases wherein the issue of claiming benefit under tax treaty on indirect transfer was examined. The Andhra Pradesh High Court in case of *Sanofi Pasteur Holding SA*[14] held that tax treaty provisions will prevail over the Indirect Transfer provisions introduced in the ITA. The impugned transaction was between three French entities wherein a French buyer was acquiring shares of a French company which held an Indian company (the transfer took place prior to May 28, 2012). It was the contention of tax authorities that the impugned transaction was a pre-ordained scheme to avoid Indian tax liability. The Andhra Pradesh High Court held that since the transaction in question fell the within the purview of Article 14(5) of the India-France tax treaty, the taxing rights with respect to capital gains lay exclusively with France. The tax authorities had filed a special leave petition against such order before the Supreme Court of India. However, after the enactment of the 2021 Act, the matter was withdrawn.[15]

The Mumbai ITAT in *Sofina SA*[16] noted that while the indirect transfer provisions contained in Explanation 5 to Section 9(1)(i) of the ITA may contemplate a 'see-through' approach, Article 13(5) of the India-Belgium tax treaty does not permit a 'see-through' approach. The Mumbai ITAT noted that in the absence of a deeming fiction in the India-Belgium tax treaty like the deeming fiction in Explanation 5, the said deeming fiction cannot be read into the provisions of the tax treaty.

10 Article 13(1) of OECD Model Tax Convention and UN MTC.

11 Article 13(4) of OECD MTC and UN MTC.

12 To be decided between members of each treaty.

13 Article 13(5) of the UN MTC.

14 Sanofi Pasteur Holding SA v. DoR [2013] 257 CTR 401 (AP).

15 https://economictimes.indiatimes.com/industry/banking/finance/retro-tax-i-t-department-withdraws-sanofi-appeal-from-supreme-court/articleshow/91875989.cms?from=mdr.

16 Sofina SA v. ACIT, decision dated March 5, 2020, ITA No.7241/Mum/2018.

Accordingly, it was held that a transfer of shares of a Singapore company by a Belgian resident which derived value from India was not taxable in India under India-Belgium tax treaty. The Mumbai ITAT placed reliance on the ruling of the Andhra Pradesh High Court in Sanofi.

Most recently, the Delhi High Court in the Tiger Global case[17] allowed a Mauritian taxpayer to claim benefit under the India-Mauritius tax treaty on transfer of shares of a Singapore company (deriving value from Indian assets). The Delhi High Court held that the capital gains were not taxable in India due to the grandfathering benefit provided under Article 13(3A) of the India-Mauritius tax treaty. The Court primarily relied on the tax residency certificate held by the taxpayer and the satisfaction of the limitation of benefit clause to conclude that the taxpayer should be granted benefit under the India-Mauritius tax treaty.[18] We have elaborated further on impact of this decision below.

Case	Relevant Treaty Article	Interpretation
Sanofi Pasteur Holding SA **v. Department of Revenue, Ministry of Finance ("Sanofi")** **Karnataka High Court** **W.P. Nos. 14212 of 2010 and 3339 & 3358 of 2012**	India France DTAA – Article 14 Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that Contracting State. For the purposes of this provision, immovable property pertaining to the industrial or commercial operation of such company shall not be taken into account. Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.	It was observed that Article 14(4) adopts the "see through" approach (with respect to companies deriving value from immovable property) by incorporating "directly or indirectly". However, with respect to Article 14(5) it was observed that where shares of a company which is a resident of France are transferred (representing a participation of more than 10% in such entity) the resultant capital gain is taxable only in France. Even where the underlying value of such shares is located in the jurisdiction of the other contracting State (India), this fact was considered to be irrelevant under DTAA provisions.
In re, GEA Refrigeration Technologies GmbH **AAR, New Delhi** **AAR No. 1232 of 2012**	India Germany DTAA – Article 13 Gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State. Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident.	In the present case the gains arose out of alienation of shares of a German resident company (which held certain Indian assets), by German shareholders. Hence the transaction was held to be taxable in Germany only.

17 [2024] 165 taxmann.com 850 (Delhi).

18 The decision of Delhi High Court has been appealed before the Supreme Court by tax authorities.

Tiger Global International II Holdings and Ors. v. AAR ("Tiger Global"I **Delhi High Court** **W.P.(C) No. 6764 of 2020, 6965 of 2020 and 6766 of 2020**	India Mauritius DTAA – Article 13 3A. Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State. 3B. However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated; 4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.	The High Court noted that the intention of Article 13(3A) is to ring-fence all acquisitions which had taken prior to April 1, 2017. Since the taxpayers had acquired the shares in the Singapore company prior to April 1, 2017, the transfer was protected under Article 13(3A)
Sofina S.A. v. Assistant Commissioner of Income- Tax **ITAT, Mumbai** **IT Appeal No. 7241 of 2018**	India Belgium Treaty – Article 13 Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. Gains from the alienation of shares other than those mentioned in paragraph 4, forming part of a participation of at least 10 per cent of the capital stock of a company which is a resident of a Contracting State may be taxed in that State. Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.	The Mumbai bench of Income Tax Appellate Tribunal ("ITAT") provided its observations in line with the Sanofi judgment. It was observed that Article 13(4) envisages a "see through" approach, however it is restricted to only immovable property. The transfer in the present case was of shares of a company resident in Singapore, hence it did not meet the essential requirement of Article 13(5) and accordingly the transaction was held to be covered under Article 13(6) and taxable in laws of Belgium where the alienator was resident.

Most tax treaties entered by India have a paragraph which grants India the right to tax capital gains arising from transfer of shares of an Indian company. In an Indirect Transfer where shares of a company which is not resident in India are transferred, courts have held that such income could not be taxable in India. It is interesting to note that the language in the treaty provides that such income may be taxed in the respective contracting state. However, the treaty does not restrict India from taxing such income. Hence, an argument could be made by tax authorities that such income could also be taxed in India since the treaty does not restrict India from taxing such income (counterargument could be that tax treaties would not envisage to provide India (being resident country) taxing right in such situations).

However, this right will only be available with India in case of transfer between the foreign entity based in the same jurisdiction and not two different jurisdictions.

For example, the relevant extract of Article 13 dealing with Capital Gains in the India Singapore tax treaty (and most others) is as follows (emphasis supplied):

> *4. [***]*
>
> *[4A. Gains from the alienation of shares acquired before 1 April 2017 in a company which is a resident of a Contracting State shall be taxable only in the Contracting State in which the alienator is a resident.*
>
> *4B. Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxed in that State.*
>
> *4C. However, the gains referred to in paragraph 4B of this Article which arise during the period beginning on 1 April 2017 and ending on 31 March 2019 may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State.*
>
> *5. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4A and 4B of this Article shall be taxable only in the Contracting State of which the alienator is a resident.]*

Article 13(4B) gives Singapore a right to tax gains arising from the sale of shares of the Singapore target. However, importantly, this article does not take away India's right to tax the gains. Thus, there is a risk that revenue authorities may argue that in the case of Singapore-Singapore-India transactions, Article 13(4B) applies, and not Article 13(5). However, in the case of Singapore – Mauritius – India transactions, Article 13(5) should clearly apply (which categorically restricts India's right to tax). Article 13(4B) would not apply since the Mauritius target would not be a resident of Singapore / India, which is one of the Contracting States under the India Singapore tax treaty. However, this issue is yet to be examined by the Indian Courts.

Interestingly, while the Delhi High Court ruled in favour of taxpayer, it did not comment on applicability of the residuary clause (Article 13(4)) of the India-Mauritius tax treaty. The decision merely provides benefit in cases wherein shares were acquired prior to April 1, 2017. If one were to read Article 13(3A) closely, it may be possible to argue that Article 13(3A) is not applicable to indirect transfer situations to begin with. This is because Article 13(3A) grandfathers acquisition of shares of Indian company by resident of Mauritius prior to April 1, 2017. While the decision by Delhi High Court lays down important principles for claiming benefit under tax treaty, in context of indirect transfer, the controversy on whether tax treaty benefit can be claimed or not still remains open.

H. Tax on the Receipt of Shares

The ITA also provides for provisions for tax on receipt of a property (including shares) on the recipient, if such property is received without consideration or for a consideration which is less than the FMV of the property.[19]

Further, section 5 read with section 4 of the ITA taxes the total income of the non-resident person which is

a. Received or deemed to be received in India or

b. Accrue or arises or is deemed to accrue or arise in India.

To determine whether the non-resident recipient of shares could be liable to pay tax under the ITA in India, first the income should fall within the scope of total income.

At the outset, the receipt of shares in the hands of the recipient cannot be considered **"to be received or deemed to be received in India"**. For income to be **"received or deemed to be received in India"** the receipt of the shares needs to be in India. While the Indirect Transfer provisions deem the offshore share (deriving its value from the Indian asset) to be situated in India, however, that does not imply that the receipt of the share takes place in India. According to the doctrine of **lex situs,** the receipt of the shares should be where the corporate actions regarding such receipt are taken and the agreements are signed. Therefore, at the outset, the income arising from receipt of overseas shares at lower than their fair value should not fall in the first category.

Consequentially, to analyze whether the income **"accrues or arises"**, deeming fiction created under section 9 of the ITA need to be referred which include interpretation of section 9(1)(viii) and section 9(1)(i) of the ITA.

Section 9(1)(viii) deems payments made by resident to non-resident outside India to accrue or arise in India. Thus, from plain reading of the provision, presence of a resident is quintessential, and mere receipt of payment by a non-resident is not covered under section 9 of ITA. Further, no deeming provision has been created for transaction between non-residents to be treated as income accruing or arising in India.

Section 9(1)(i) states that **"all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India."** Here in Explanation 4 to section 9(1)(i) of the ITA defines "through" to include "by means of", "by reasons of", "in consequence of". This explanation expands the applicability of the provision. On the basis of this expanded scope, the Revenue may argue that even the income accruing to the recipient of the shares could be brought within the tax brackets. However, this argument of the Revenue should not sustain as the explanation will also have to be interpreted in the context of section 45 of the ITA. Section 45 of the ITA taxes gains arising from the transfer of shares only in the hands of the 'transferor'. Thus since the general taxability of gains from selling of shares is in the hands of transferor and not recipient, the scope of explanation cannot be stretched unreasonably so as to bring recipient of shares within the ambit of section 9(1)(i) of the ITA. Therefore, the receipt of shares (below FMV) by a non- resident recipient should not be taxable in India.

19 Section 56(2)(x)(c) of the ITA.

Reporting Obligations

A. Reporting

Section 285A of the ITA provides for certain reporting compliances with respect to Indirect Transfers. The obligation for the reporting is on the Indian entity based of which the foreign entity derives its value in terms of explanation 5 of section 9(1)(i) of the ITA.

In this regard, Rule 114DB of the ITR specifies that the reporting of transaction in respect of transfer of shares of or interest in a foreign entity (which derives its value from assets situated in India) needs to be done within 90 days of the end of the financial year, however where there is change in management or control of the Indian entity, the reporting should be done within 90 days of the transaction. Additionally, the Indian entity is also required to maintain information pertaining to shareholding, financial statements, valuation report amongst other details for 8 years from the date of the transaction. Failure to comply with this reporting compliance invites penalty under the ITA.[1]

In multiple cases involving transfer of shares between foreign entities, the Indian entity may not have any knowledge or information about the deal within the stipulated time period. Further, there may not be any obligation on the non – resident transacting parties to inform the Indian entity about the transfer of shares occurring outside India. Also, various details regarding the transaction could be kept confidential from the Indian company, creating practical hurdle in reporting them. Further, there is also lack of clarity whether the reporting compliances need to be followed, when there is treaty exemption on taxability of indirect transfer in India.

In addition to above, the seller is required to file Form CT along with its income-tax return. Form 3CT has to be duly signed and verified by an Indian accountant providing the basis of the apportionment in accordance with the formula and certifying that the income attributable to assets located in India has been correctly computed.

1 Section 271GA of the ITA provides for a penalty of 2% of the value of the transaction if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern and 5 lakhs in other cases.

Resolving Indirect Transfer Tax Disputes through Investment Arbitration

Vodafone had obtained a favorable judgment from the SC, still the tax demand was revalidated by the Retroactive Amendment. Instead of challenging the Retroactive Amendments before the courts of India, Vodafone considered the arbitration route available under the Bilateral Investment Treaty **("BIT")** between India and Netherlands.

India initially opposed the proceedings by stating that "disputes relating wholly or mainly to taxation are excluded from the scope of the India – Netherlands BIT". However, in September 2020, the international arbitral tribunal passed an award against India, reportedly for violation of the fair and equitable treatment standard under the India – Netherlands BIT. The obligation to provide 'fair and equitable treatment' includes guarantees such as providing stable and predictable legal framework to foreign investors, following due process while modifying the legal framework that might potentially impact foreign investors, adopting measures in a transparent and non- arbitrary manner, among others.

The withholding tax obligation is not a primary tax liability but a procedural obligation put in place to ensure ease of recovery of taxes. Vodafone in present matter was buyer of the assets, hence there was no primary tax liability on it and only withholding obligation was there. This fact coupled with Retroactive Amendments were introduced in a hasty manner, could be the plausible reasons the Arbitral Tribunal ruled in favour of Vodafone.[1]The decision has been a major setback for the Revenue and is a reminder for the government that foreign investors in addition to remedies under domestic law, also have certain safeguards in international law. This award negates India's position that tax disputes do not come under the ambit of investment treaties. As a general principle the tax matters do not come under the ambit of an investment treaty, however one could argue that these matters are tax related investment dispute and not purely tax disputes. After facing few claims arising out of BITs between 2011 - 2016, India unilaterally terminated several BITs in 2016. India has also introduced a Model BIT in 2016 to serve as the foundation to re-negotiate treaties. In the recent treaties which India has signed with Belarus and Brazil, specific exclusion for taxation measures has been made from the scope of BIT.

In another matter, Cairn group of the UK has obtained a favourable ruling from the Permanent Court of Arbitration **("PCA")** at The Hague under the India-UK BIT. The dispute related to gains arising out of internal group restructuring with regard to the retrospective amendment. The Indian court ruled against Cairn[2] 47 and instead of further appealing before higher judicial body in India, Cairn approached the PCA under the India – UK BIT. The PCA ruled in favour of Cairn with an award of around USD 1.2 Billion and Cairn also filed few cases in foreign courts for enforcement of award.[3]These cases have now been settled based on the changes brought about by the 2021 Act (discussed below).[4]

1 Complete text of the award in this matter was not released in public domain.

2 Cairn UK Holdings Ltd. v. Deputy Commissioner of Income-Tax 56 ITR(T) 595 (Delhi - Trib.).

3 https://www.businesstoday.in/current/economy-politics/cairn-threatens-to-seize-indian-assets-overseas-to-collect-14-billion-arbitration-award/story/429153.html.

4 Please refer our detailed analysis of the Vodafone arbitration here (https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Vodafone-Holdings-B.V.-versus-Republic-of-India.pdf) and the Cairn arbitration here (https://www.nishithdesai.com/SectionCategory/33/Research-and-Articles/12/57/CapitalMarketsHotline/4393/15.html).

However, despite adverse awards, the Indian government has still maintained the position that tax is completely a sovereign matter and it is not included in scope of BITs. For the foreign investors it is still not an easy road as both the Vodafone award and the Cairn award have already been challenged by the Indian government in the court of Singapore[5] and Hague[6] respectively.

Removal of Retroactivity

The Indirect Transfer provisions were amended by the Taxation Laws (Amendment) Act, 2021 **("2021 Act")** to remove the retrospectivity from them. The 2021 Act makes following changes in the Indirect Transfer provisions:[7]

- **An embargo on future tax demands:** The 2021 Act provides that the Indirect Transfer provisions would not apply to income accruing or arising as a result of an Indirect Transfer undertaken prior to May 28, 2012. The 2021 Act has added a proviso to explanation 5 to section 9(1)(i) of the ITA for non-application of Indirect Transfer provisions on (i) assessments or reassessments initiated under specified sections, (ii) orders passed enhancing a tax assessment or reducing a refund and (iii) orders passed deeming a person to be an assessee-in- default for not withholding taxes in respect of indirect transfers prior to May 28, 2012.
- **Nullification of tax demands raised:** The 2021 Act also provides that demands raised for indirect transfers of Indian assets made prior to May 28, 2012 shall be nullified, subject to fulfilment of the following conditions by the person in whose case such demand has been raised:
  - Withdrawal or an undertaking for withdrawal of appeal filed before an appellate forum or a writ petition filed before a High Court or the Supreme Court of India;
  - Withdrawal or an undertaking for withdrawal of any proceedings for arbitration, conciliation or mediation initiated by such person such as under a bilateral investment treaty; and
  - Furnishing of an undertaking waiving their rights to seek or pursue any remedy or any claim in relation to such income whether in India or outside India.
- **Refund of amounts paid:** The 2021 Act also provides that the Government shall refund the taxes paid in cases where the application of Indirect Transfer provisions is being withdrawn due to fulfilment of the conditions mentioned above. However, no interest, cost or damage shall be paid by the Government on such refund of taxes.

The 2021 Act saw moves towards settlement of quite a few cases including the Revenue withdrawing its petition in Supreme Court over taxability in the case of Sanofi Pasteur & others, and reports regarding the Indian Government being in talks with Vodafone Group Plc and Cairn Energy Plc to settle long-running tax disputes with them arising from the Indirect Transfer provisions.[8]

5 https://www.business-standard.com/article/companies/india-challenges-vodafone-arbitration-award-plans-the-same-in-cairn-case-120122401064_1.html.

6 https://www.business-standard.com/article/companies/india-challenges-1-2-bn-cairn-award-says-never-agreed-on-tax-arbitration-121052300482_1.html.

7 CBDT has notified the rules for implementing the amendment made by the Amendment Act through press release dated October 02, 2021.

8 https://www.bloomberg.com/news/articles/2021-08-09/vodafone-cairn-in-talks-to-settle-tax-row-india-official-says.

The 2021 Act is a welcome amendment, however, there remain certain incongruities. First, it provides no relief to taxpayers that have paid tax demands raised for indirect transfers undertaken prior to May 28, 2012 without contesting its applicability. Second, the Act provides that taxpayers who have paid the tax demand in dispute and are now withdrawing their appeal / arbitration proceeding, will be issued refunds of the taxes without any interest, thereby, disregarding provisions of Section 244A of the ITA. The provision for refund under Section 244A is an equitable provision seeking to compensate a taxpayer for unjustly denying them the use of their funds, in the same manner as the Government levies interest on delayed payments by the taxpayer. A refusal to pay this due to a taxpayer, baked into a legislation, can set a dangerous precedent. Further, given the time value of money and decrease in exchange rates, merely refunding the tax amount may not recover the loss faced by the taxpayers.

International Scenario

As observed in Part I, fixing tax leakages due to use of Indirect Transfer structures is an issue not limited to India only. Several other developing countries have been adopting different mechanisms to overcome the revenue loss. The issue of Indirect Transfers came into the public domain before the Base Erosion and Profit Shifting **("BEPS")** project was undertaken by the OECD. However, despite being a subject matter of international tax policy, the BEPS project did not address issues related to Indirect Transfers.

Independently, different nations have adopted mechanisms to tax income from Indirect Transfers. Chinese authorities introduced Circular 689 in early 2010 to lay emphasis on the substance over form approach and aims to deny tax benefits for transactions which are tax-abusive. It gives the Chinese tax authorities' rights to invoke the GAAR to disregard one or more intermediate holding companies, if their existence serves no commercial purpose except the avoidance of tax liabilities, thus in effect, treating the indirect sale as a direct disposition of the Chinese company or investment.

After the Petrotech case,Peru passed a legislation to tax Indirect Transfers under domestic law. A 50% threshold in terms of substantial value of assets and 10% threshold for the amount of shareholding/interest to be transferred were put in as safeguards. The Uganda Revenue Administration imposed capital gains tax, amounting to US$85 million on Zain International BV, a Dutch company, transferring shares of another Dutch company (owning the Kampala-registered mobile phone operator) to Bharti Airtel International BV, a Dutch subsidiary of Indian multinational. On appeal, the Uganda's Appeal Court held that Uganda has the jurisdiction to assess and tax the offshore seller of an indirect interest in local assets.

With respect to immovable property, both the UN MTC, along with the OECD MTC (post the 2017 revision) allocate the primary taxing right to the country where the immovable property is located, irrespective of the residence of the company or entity which owns such property as per Article 13(4). UN MTC goes a step ahead to cover Indirect Transfers arising other than from immovable property as per Article 13(5). However, its scope is restricted not a sufficient to ensure source taxation in case of Indirect Transfers (as discussed in Sanofi, GEA and Sofina above). The Platform for Collaboration on Tax has released a toolkit on taxation of Indirect Transfers[1], giving recognition to the concerns of source countries. In the report two models have been suggested for taxation of Indirect Transfers —

1. Taxing the Local Resident Asset-Owning Entity under a Deemed Disposal Model – Under this model the taxpayer is not the entity disposing of the shares but the entity which directly owns the assets.
2. Taxing the Non-resident Seller – It is similar to the model adopted by India post the 2012 amendment.

The report recognized that countries are responding to the issues they have encountered in respect of offshore indirect transfers in very different ways. The report concluding by noting that a more uniform, coordinated and coherent approach to the taxation of offshore indirect transfers, where countries choose to tax them, can make a substantial contribution to coherence in international tax arrangements and enhanced tax certainty.

1 https://www.taxplatform.org/sites/pct/files/publications/PCT_Toolkit_The_Taxation_of_Offshore_Indirect_Transfers.pdf.

Impact on Documentation

As discussed above, Indirect Transfer provisions have to be examined in can of offshore transfers wherein foreign companies have India assets. Where Indirect Transfer provisions are triggered, the seller will have to discharge capital gains tax in India. While the primary obligation is on the seller, the buyer has the obligation to withhold tax. Unlike a direct transfer, in case of indirect transfer typically the form of share sale agreement is as per standards in foreign country. Such agreement should be carefully reviewed to determine relevant additions to be made from Indian tax perspective.

As a condition precedent to the transaction, the buyer should ensure that there is a valid valuation report obtained under Rule 11UB and Rule 11UA, seller has a valid tax residency certificate (in case where treaty benefit is sought) etc. Representations from each shareholder of the foreign company whose shares are being transferred the seller should be obtained. These representations should inter-alia include representation on residency, period of holding, nature of holding (whether capital asset or stock in trade) etc. It is also standard for buyer to ask for tax opinions wherein tax treaty benefit is being claimed. In case where Indirect Transfer is being triggered and buyer has to withhold tax, the buyer should obtain a capital gains tax computation on basis of which withholding should be done.

Conclusion

The Indirect Transfer provisions were introduced in the ITA with an intent to overcome the SC decision. The initial provisions were criticized for not being drafted properly, wherein they covered several unintended transactions.

Even after various rounds of clarifications and amendments under the ITA, the taxation of Indirect Transfers still remains an area which needs more certainty. The Retroactive Amendments, were never a welcomed measure, especially considering the impact on investor confidence. Although given the significant stake involved, the government has put in relentless efforts to chase down Indirect Transfers. Yet it is not at the winning end, given the foreign arbitral awards. With the 2021 Act, the dust may get settled with respect to transactions occurring before May 2012, and although one could question the timing of the 2021 Act, in any case, it is a welcome move and would boost investor confidence and tax certainty in future. However not all dust is settled regarding Indirect Transfer provisions especially in relation to claiming benefit under tax treaty. All eyes now lay towards the Supreme Court of India to decide this issue in the Tiger Global case.

Annexure

A. Extract of Indirect Transfer Provisions

Section 9: Income deemed to accrue or arise in India

"9(1) The following incomes shall be deemed to accrue or arise in India :

i. all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India

Explanation 5 — For the removal of doubts, it is hereby clarified that 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:

Provided that nothing contained in this Explanation shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in a Foreign Institutional Investor as referred to in clause (a) of the Explanation to section 115AD for an assessment year commencing on or after the 1st day of April, 2012 but before the 1st day of April, 2015:

Provided further that nothing contained in this Explanation shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category–I or Category–II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 74 [prior to their repeal], made under the Securities and Exchange Board of India Act, 1992 (15 of 1992):

Provided also that nothing contained in this Explanation shall apply to an asset or a capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992):

Provided also that nothing contained in this Explanation shall apply to —

i. an assessment or reassessment has been made under section 143, section 144, section 147 or section 153A or section 153C; or

ii. an order has been passed enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154; or

iii. an order has been passed deeming a person to be an assessee in default under sub-section (1) of section 201; or

iv. an order has been passed imposing a penalty under Chapter XXI or under section 221

in respect of income accruing or arising through or from the transfer of an asset or a capital asset situate in India in consequence of the transfer of a share or interest in a company or entity registered or incorporated outside India made before the 28th day of May, 2012 and the person in whose case such assessment or reassessment or order has been passed or made, as the case may be, fulfils the specified conditions, then, such assessment or reassessment or order, to the extent it relates to the said income, shall be deemed never to have been passed or made, as the case may be

Provided also that where any amount becomes refundable to the person referred to in fifth proviso as a consequence of him fulfilling the specified conditions, then, such amount shall be refunded to him, but no interest under section 244A shall be paid on that amount

Explanation.—For the purposes of fifth and sixth provisos, the specified conditions shall be as provided hereunder:—

i. where the said person has filed any appeal before an appellate forum or any writ petition before the High Court or the Supreme Court against any order in respect of said income, he shall either withdraw or submit an undertaking to withdraw such appeal or writ petition, in such form and manner as may be prescribed;

ii. where the said person has initiated any proceeding for arbitration, conciliation or mediation, or has given any notice thereof under any law for the time being in force or under any agreement entered into by India with any other country or territory outside India, whether for protection of investment or otherwise, he shall either withdraw or shall submit an undertaking to withdraw the claim, if any, in such proceedings or notice, in such form and manner as may be prescribed;

iii. the said person shall furnish an undertaking, in such form and manner as may be prescribed, waiving his right, whether direct or indirect, to seek or pursue any remedy or any claim in relation to the said income which may otherwise be available to him under any law for the time being in force, in equity, under any statute or under any agreement entered into by India with any country or territory outside India, whether for protection of investment or otherwise; and

iv. such other conditions as may be prescribed

Explanation 6.—For the purposes of this clause, it is hereby declared that—

a. the share or interest, referred to in Explanation 5, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if, on the specified date, the value of such assets—

    i. exceeds the amount of ten crore rupees; and

    ii. represents at least fifty per cent of the value of all the assets owned by the company or entity, as the case may be;

b. the value of an asset shall be the fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in such manner as may be prescribed;

c. "accounting period" means each period of twelve months ending with the 31st day of March:

Provided that where a company or an entity, referred to in Explanation 5, regularly adopts a period of twelve months ending on a day other than the 31st day of March for the purpose of—

i. complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or

ii. reporting to persons holding the share or interest,

then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:

Provided further that the first accounting period of the company or, as the case may be, the entity shall begin from the date of its registration or incorporation and end with the 31st day of March or such other day, as the case may be, following the date of such registration or incorporation, and the later accounting period shall be the successive periods of twelve months:

Provided also that if the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist;

d. "specified date" means the—

   i. date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest; or

   ii. date of transfer, if the book value of the assets of the company or, as the case may be, the entity on the date of transfer exceeds the book value of the assets as on the date referred to in sub-clause (i), by fifteen per cent.

Explanation 7.— For the purposes of this clause,—

a. no income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the Explanation 5,—

   i. if such company or entity directly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, neither holds the right of management or control in relation to such company or entity, nor holds voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, of such company or entity; or

   ii. if such company or entity indirectly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, neither holds the right of management or control in relation to such company or entity, nor holds any right in, or in relation to, such company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India, nor holds such percentage of voting power or share capital or interest in such company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

b. in a case where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity referred to in the Explanation 5, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed;

c. "associated enterprise" shall have the meaning assigned to it in section 92A;"

B. Meaning of Transfer under ITA

Section 2: Definitions

(47) transfer", in relation to a capital asset, includes,—

i. the sale, exchange or relinquishment of the asset ; or

ii. the extinguishment of any rights therein; or

iii. the compulsory acquisition thereof under any law ; or

iv. in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment ;] [or]

v. the maturity or redemption of a zero coupon bond; or]

vi. any transaction involving the allowing of the possession of any immovable property to be taken or retained inpart performance of a contract of the nature referred to in section 53A4 of the Transfer of Property Act, 1882 (4 of 1882) ; or

vii. any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immov-able property.

Explanation 1.—For the purposes of sub-clauses (v) and (vi), "immovable property" shall have the same meaning as in clause (d) of section 269UA.]

Explanation 2.—For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India"

About NDA

At Nishith Desai Associates, we have earned the reputation of being Asia's most Innovative Law Firm — and the go-to specialists for companies around the world, looking to conduct businesses in India and for Indian companies considering business expansion abroad. In fact, we have conceptualized and created a state-of-the-art Blue Sky Thinking and Research Campus, Imaginarium Aligunjan, an international institution dedicated to designing a premeditated future with an embedded strategic foresight capability.

We are a research and strategy driven international firm with offices in Mumbai, Palo Alto (Silicon Valley), Bengaluru, Singapore, New Delhi, Munich, and New York. Our team comprises of specialists who provide strategic advice on legal, regulatory, and tax related matters in an integrated manner basis key insights carefully culled from the allied industries.

As an active participant in shaping India's regulatory environment, we at NDA, have the expertise and more importantly — the VISION — to navigate its complexities. Our ongoing endeavors in conducting and facilitating original research in emerging areas of law has helped us develop unparalleled proficiency to anticipate legal obstacles, mitigate potential risks and identify new opportunities for our clients on a global scale. Simply put, for conglomerates looking to conduct business in the subcontinent, NDA takes the uncertainty out of new frontiers.

As a firm of doyens, we pride ourselves in working with select clients within select verticals on complex matters. Our forte lies in providing innovative and strategic advice in futuristic areas of law such as those relating to Blockchain and virtual currencies, Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Ed-Tech, Med-Tech and Medical Devices and Nanotechnology with our key clientele comprising of marquee Fortune 500 corporations.

The firm has been consistently ranked as one of the Most Innovative Law Firms, across the globe. In fact, NDA has been the proud recipient of the Financial Times–RSG award 4 times in a row, (2014-2017) as the Most Innovative Indian Law Firm.

We are a trust based, non-hierarchical, democratic organization that leverages research and knowledge to deliver extraordinary value to our clients. Datum, our unique employer proposition has been developed into a global case study, aptly titled 'Management by Trust in a Democratic Enterprise,' published by John Wiley & Sons, USA.

Research@NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our "Hotlines". These Hotlines provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our NDA Labs dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research papers and disseminate them through our website. Our ThinkTank discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we now have established an exclusive four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. Imaginarium AliGunjan is a platform for creative thinking; an apolitical ecosystem that connects multi-disciplinary threads of ideas, innovation and imagination. Designed to inspire 'blue sky' thinking, research, exploration and synthesis, reflections and communication, it aims to bring in wholeness — that leads to answers to the biggest challenges of our time and beyond. It seeks to be a bridge that connects the futuristic advancements of diverse disciplines. It offers a space, both virtually and literally, for integration and synthesis of knowhow and innovation from various streams and serves as a dais to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research publications.
Please feel free to contact us at **research@nishithdesai.com**.

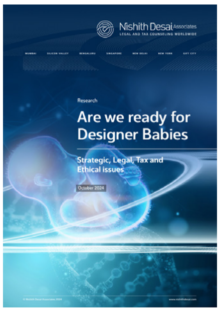
Recent Research Papers

Extensive knowledge gained through our original research is a source of our expertise.

October 2024

Unmasking Deepfakes

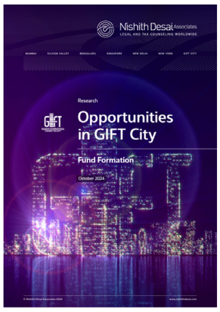
Legal, Regulatory and Ethical Considerations



October 2024

Are we ready for Designer Babies

Strategic, Legal, Tax and Ethical issues



October

Opportunities in GIFT City

Fund Formation

August 2024

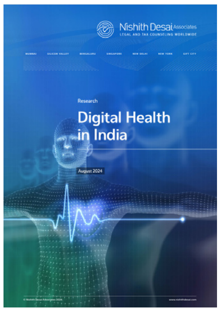
Telemedicine in India

The Future of Medical Practice

August 2024

Clinical Trials and Biomedical Research in India

Legal and Regulatory Framework



August 2024

Digital Health in India

For more research papers click here.

Nishith Desai Associates
LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI

93 B, Mittal Court, Nariman Point
Mumbai 400 021, India

Tel +91 22 6669 5000
Fax +91 22 6669 5001

SILICON VALLEY

220 S California Ave., Suite 201
Palo Alto, California 94306, USA

Tel +1 650 325 7100
Fax +1 650 325 7300

BANGALORE

Prestige Loka, G01, 7/1 Brunton Rd
Bangalore 560 025, India

Tel +91 80 6693 5000
Fax +91 80 6693 5001

SINGAPORE

Level 24, CapitaGreen,
138 Market St,
Singapore 048 946

Tel +65 6550 9855

MUMBAI BKC

3, North Avenue, Maker Maxity
Bandra–Kurla Complex
Mumbai 400 051, India

Tel +91 22 6159 5000
Fax +91 22 6159 5001

NEW DELHI

13-H, Hansalaya Building,
15, Barakhamba Road, Connaught Place,
New Delhi -110 001, India

Tel +91 11 4906 5000
Fax +91 11 4906 5001

NEW YORK

1185 Avenue of the Americas, Suite 326
New York, NY 10036, USA

Tel +1 212 464 7050

GIFT CITY

408, 4th Floor, Pragya Towers,
GIFT City, Gandhinagar,
Gujarat 382 355, India

Taxing Offshore Indirect Transfers in India

ndaconnect@nishithdesai.com