BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX) NEW DELHI

25th Day of February 2010

P R E S E N T

Mr. Justice P.V. Reddi (Chairman)
Mr. J. Khosla (Member)

AAR No. 818/2009

Name & address of the applicant	:	KSPG Netherlands Holding B.V. Czaar Peterstaat 229 1018 PL Amsterdam
Commissioner concerned	:	Director of Income Tax (International Taxation), Mumbai
Present for the Applicant	:	Mr. Nishith Desai, Advocate Mr. Bijal Ajinkya, Advocate Mr. Mahesh Kumar, Advocate Mr. Huzefa Tavawalla, Advocate Mr. Vivek Narayanan, Representative of applicant
Present for the Department	:	None

R U L I N G

(By Hon'ble Chairman)

1. In this application, filed u/s 245Q(1) of the Income-tax Act, 1961 (hereinafter referred to as 'IT Act'), the following facts are stated:

The applicant is a company incorporated in the Netherlands, with its registered office in Amsterdam. The copy of certificate of incorporation of the applicant shows that it was incorporated on 11th August, 2008.

PG India is a private limited company (Pierburg India) incorporated in India under the Companies Act, 1956 on 26th October, 2006 and is the wholly owned subsidiary of the applicant.

The applicant and PG India are part of the Kolbenschmidt Pierburg group which has extensive manufacturing operations in Europe, North America, South America and Asia catering to

> the global market for superior automobile components. In order to meet the increased capital requirements connected with PG India's expansion plans, the applicant has made significant investments into PG India.
>
> The applicant expects to receive income in the form of dividends declared and distributed by PG India.
>
> The applicant may also realize capital gains through a sale of portion or all of its shares in PG India to another non-resident company.
>
> PG India may also consider a buy-back of its shares by the applicant. Consequent to the buy back, PG India would continue to be the wholly owned subsidiary of the applicant.

1.1. Initially, Pierburg GmbH was the holding company of Pierburg India in November, 2008. It sold the entire shareholding in Pierburg India to the applicant for a valuable consideration of Rs.10 crores. Consequentially, the applicant which is a Netherlands company became 100 per cent shareholder and the holding company of Pierburg India. The applicant made substantial investments in Pierburg India. The applicant seeks advance ruling on the following four questions"

> 1. Whether, on the facts and in the circumstances of the case, KSPG Netherlands Holding B.V (hereinafter referred to as the 'applicant) would be liable to tax in India on the dividends received by it from its wholly owned subsidiary, Pierburg India Private Limited (hereinafter referred to as "PG India") as per the provisions of the Income-tax Act, 1961 (hereinafter referred to as "IT A")?
>
> 2. Whether, on the facts and in the circumstances of the case, the applicant would be liable to tax in India on the capital gains that may accrue from the transfer of shares in PG India to another non-resident as per the provisions of the Convention between the Government of Republic of India and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to

taxes on income and on capital (hereinafter referred to as "India-Netherlands Treaty")?

3. Whether, on the facts and in the circumstances of the case, the transferor would be liable to tax in India on the capital gains that may accrue from a buyback of shares by its wholly owned Indian subsidiary, PG India as per the provisions of the ITA?

4. Whether, on the facts and in the circumstances of the case, the applicant would be liable to tax in India on the capital gains that may accrue from a buyback of shares by its wholly owned Indian subsidiary, PG India as per the provisions of the India-Netherlands Treaty?

1.2. In the course of hearing, the learned counsel for the applicant has stated that question no. 4 need not be decided and it may be treated as not pressed.

Question No.1

2. It relates to exigiblity of tax under the Income-tax Act in respect of dividends received by the applicant from its wholly owned subsidiary Pierburg India Pvt. Ltd. By virtue of section 9(1)(iv) of the IT Act, a dividend paid by an Indian company outside India is deemed to be taxable income. However, in view of section 10(34) of the Act, the income by way of dividends referred to in section 115-O of the Act is liable to be excluded from the total income of the previous year of any person. Section 115-O reads thus:

(1) *Notwithstanding anything contained in any other provision of this Act and subject to the provisions of this section, in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) on or after the 1st day of April, 2003 whether out of current or accumulated profits shall be charged to additional Income-tax (hereafter referred to as tax on distributed profits) at the rate of fifteen percent."*

2.1. Thus, as contended by the applicant, under section 115-O, PG India would be liable to pay tax on the distribution of profits by way of dividends to the applicant @ 15 per cent. However, such dividends received by the applicant (shareholder of PG India) would not be taxable in its hands under the IT Act. This legal position admits of no doubt and in fact it has not been disputed by the Revenue in its comments. In the comments furnished by the Revenue, it has been fairly stated as follows:

> **4.1.3.** Further, once the Indian company PG India Pvt. Ltd. has paid the dividend Distribution Tax, the dividend received either by the Netherlands company KSPG Netherlands Holding B.V., or the ultimate holding company in Germany, Kolbenschmidt Pierburg A.G., would not be liable to tax in India in terms of the express provisions of Section 10(34) of the Income-tax Act.
>
> **4.1.4.** This position, however, is subject to change in case any amendments are made in the relevant provisions of the Income-tax Act.

2.2. The first question is, therefore, answered in the negative.

Question No.2

3. The applicant seeks to invoke para 5 of Art.13 of the India-Netherlands Treaty[1] in support of its contention that capital gains tax cannot be levied and collected by the Indian Tax authorities under the Income-tax Act, 1961. Art.13 of the Treaty provides for taxation of

[1] Convention…….

gains from the alienation of capital assets. Para 5 of Art.13 which is relevant for our purpose is extracted below:

> *"5. Gains from the alienation of any property other than that referred to in paragraphs 1,2,3 and 4, shall be taxable only in the State of which the alienator is a resident.*
>
> *However, gains from the alienation of shares issued by a company resident in the other State which shares form part of at least a 10 per cent interest in the capital stock of that company may be taxed in the other State if the alienation takes place to a resident of that other State. However, such gains shall remain taxable only in the State of which the alienator is a resident if such gains are realized in the course of a corporate organization, reorganization, amalgamation, division or similar transaction, and the buyer or seller owns at least 10 per cent of the capital of the other."*

3.1. It is the case of the applicant that the exception provided in the second part of para 5 is not attracted in a case of transfer of shares to a non-resident. Therefore, even if the quantum of shares transferred exceed 10% of the capital stock of PG India, the second condition for triggering the exception, namely, the alienation to a resident of India, is not satisfied. Thus, according to the applicant, the substantive part of Art.5 governs the present case. We find substance in the plea taken by the applicant.

3.2. It is beyond dispute that the applicant is a resident of the Netherlands within the meaning of Art.4 (i) of the Treaty. The applicant is entitled to invoke the benefit of the provisions in the Treaty notwithstanding the provisions of the Income-tax Act, 1961 on the same subject. Section 90(2) of the IT Act recognizes this principle. It lays down that in relation to the assessee to whom the

Agreement (Treaty) applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. The opening sentence of para 5 of Art.13 mandates that the gains from the alienation of any property (other than that referred to in the following paragraphs) are liable to be taxed only in the State of which the alienator is a resident. Property in the form of shares is not excluded from the purview of the above opening provision in para 5. That being the position, the Govt. of India is precluded from subjecting to tax the gains on account of transfer of shares of the Indian company to a non-resident. This clear legal position is not in dispute. However, the Revenue contends that "the beneficial owner of capital gains arising out of the transactions, if and when undertaken, would be the German company" and accordingly the provisions of the India-Germany DTAA would be applicable in which case the capital gains can be taxed in India. It is submitted on behalf of the Revenue that Kolbenschundt Pierburg AG is the ultimate holding Company of the Indian Company and it is that Company which has beneficial ownership in the shares of the Indian Company sought to be transferred. The Revenue further avers that till November 2008, Pierburg GMBH (German Company) was the immediate holding Company, but, the applicant (Netherlands Company) incorporated on 6th November 2008 became the immediate holding company of the Indian company. In this background, it is alleged by the Revenue that

"the interpolation of the Netherlands' Company as recently as 6th November, 2008 is a part of the scheme for the avoidance of liability to tax on capital gains". We find it difficult to accept the contention of the Revenue. Assuming that the concept of beneficial ownership which finds specific mention in Articles 10 to 12 of the Treaty (relating to dividends, interest, royalty and FTS), can be transposed into Art.13, we find no factual or legal basis to hold that the German Company is the real beneficial owner of the shares and the capital gains that would accrue. The transferor i.e. the Netherlands Company though a subsidiary of the aforementioned Germany Company is a distinct legal entity having its own board of directors and management systems. The glaring fact which is to be taken note of in this context is that the applicant which was incorporated towards the end of 2008 made significant investments in the Indian Company. It is stated that from September 2009 onwards, it invested nearly 17 million Euros (110 crores) in Pierburg India. It is seen from the facts stated by the applicant that the applicant had initially acquired the shares of the Indian Company from Pierburg GMBH at a price determined as per the evaluation guidelines prescribed under the Foreign Exchange Management Act, 2000. The substantial investments it has made was with a view to broaden the capital base of the Indian company, as stated by the applicant. The implied suggestion of the Revenue that the applicant is a sham entity or a

conduit company deliberately set up to avoid the tax liability relating to capital gains is wholly misconceived. It would be presumptuous to predicate that the gains accruing to the applicant by the transfer of shares held in the Indian company would not enure to the benefit of the applicant or will not enter into the profit and loss account of the applicant or that the gains will be just passed on to the ultimate holding company (i.e. German company), dictated by its mandate. It is not possible to assume that the applicant would merely act as a conduit to syphon off the gains to the ultimate holding company by means of a colorable device contrary to its corporate status and the stake in the Indian company. It is of course open to the tax authorities to look to the facts at the time of transfer, but, on principle and in the light of the facts stated and substantiated in this application, we cannot reach the conclusion that the beneficial ownership in the gains resulting from the transfer of shares is vested with the ultimate holding company i.e. German company. As stated earlier, we find no reason and no basis to characterize the proposed transaction as a mere device to avoid the capital gains tax by unlawful means.

3.3. In the comments furnished on behalf of the Revenue, it is pointed out that no details are available now and therefore the question cannot be adjudicated at this stage. We do not think that in the absence of details such as the number of shares, the

consideration and the name of the non-resident transferee, this Authority shall desist from giving a ruling on the legal issue. Not much turns out from these details. However, we would like to observe that at the time of transfer, the applicant shall furnish information to the Department. Of course, the Revenue is bound by this ruling and observations made herein in making any inquiry at that stage.

We are, therefore, of the view that the answer to Question No.2 should be in the negative and the applicant is not liable to pay the tax on capital gains by virtue of the opening sentence of Art.13.5 of the Treaty.

Question No.3

4. The applicant relies on Section 47(iv)(b) of the IT Act and submits that the transfer of capital assets by a company to its subsidiary would not be regarded as a transfer for the purposes of Section 45 if the transfer is made to a wholly owned subsidiary and the subsidiary is an Indian company. It is submitted that both these conditions are satisfied and therefore the buy-back of shares of Pierburg India which continues to be the Indian subsidiary of the foreign company (applicant-Company) will not be chargeable to capital gains tax under the IT Act. However, for the reasons stated in the following para, we refrain from giving a ruling on this aspect.

4.1. The relevant part of the definition of 'advance ruling' contained in Section 245N reads thus:

> *"a determination in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or proposed to be undertaken by a non-resident".*

4.2. The transaction of buy-back of shares as and when it takes place, would be an altogether different transaction from the transfer of shares embraced within Question No.2. The transferee will be PG India whereas in the transaction falling under Question No.2, the transferee is a non-resident entity. The buy-back is within the volition and decision of PG India which is not the case in regard to Question No.2. Moreover, the buy-back of shares is not something which is integrally connected with the first transaction resulting from the investments it made in the Indian company. We are of the view that the applicant has to make a separate application at the appropriate time. It would not be proper and appropriate to give an advance ruling on the 3rd question in this application. We uphold the contention of the Revenue in this regard and decline to answer this question.

5. We pause here to say that in regard to Qn.No.2 also, the Revenue has raised the contention that the contemplated transfer is neither a proposed transaction much less a transaction already undertaken, we find no force in such argument. We agree with the applicant's submission that it is closely linked to the investments already made and to be made by the applicant and the question

cannot be characterized a hypothetical one. We say so especially for the reason that the expression 'arising out of' a transaction is wide in its scope and can reasonably encompass the disposal of shares as it cannot be isolated and dissociated from the applicant's stake in India having regard to substantial investments it made.

Accordingly, the ruling is given and pronounced on this the 25th day of February, 2010.

Sd/-	**Sd/-**
(J.Khosla)	**(P.V. Reddi)**
Member	**Chairman**

F.No. AAR/818/2009 dated …….

This copy is certified to be a true copy of the Order and is sent to:

1. The applicant
2. The Director of Income-tax (International Taxation), Mumbai

(Batsala Jha Yadav)
Addl. Commissioner of Income-tax, AAR