

Filing of an income-tax return mandatory for a foreign company even if the income is not taxable in India under the provisions of a DTAA

Fact :- The applicant is a company incorporated in and tax resident of the Netherlands. The applicant held shares in an Indian private limited company which it sold to two companies tax resident of Switzerland, resulting in capital gains to the applicant company.

Issues before the Authority for Advance Rulings ('AAR') :- Whether capital gains earned by the applicant on transfer of shares of the Indian company would be liable to tax in India as per the provisions of the Income-tax Act, 1961 ("the Act") and the Tax Treaty between India and The Netherlands? If the capital gain is not taxable in India, whether the applicant is required to file any return of income under section 139 of the Act? Whether the transfer of shares by the applicant would attract transfer pricing provisions under sections 92 to 92F of the Act? Whether the purchasers were liable to withhold tax at source under section 195 of the Act and if so, on what amount should the tax have been deducted?

Contentions of the Applicant

- The applicant submitted that since the shares of an Indian company were transferred, the situs of its shares would be in India. Therefore, under the provisions of section 5(2) read with section 9(1) of the Act, the capital gains accrues or arise/deemed to accrue or arise to the non-resident in India and hence taxable in India.
- The applicant further submitted that under section 90(2) of the Act, the applicant has an option to be governed by the provision of the India-Netherlands Tax Treaty, if they are more beneficial than the provisions of the Act.
- Per provisions of Article 13(5) of the India-Netherlands Tax Treaty, any capital gains arising from the sale of shares of an Indian company would be taxable in The Netherlands only, the state in which the transferor is a resident. Further the condition under Article 13(5) that gains from alienation of shares issued by an Indian company forming part of at least 10% interest in the capital stock of that Indian company can be taxed in India, if the transfer takes place to a resident of India, is not attracted as the shares in this case have been transferred to the purchasers who are residents of Switzerland.
- Regarding the transfer pricing adjustments, the applicant contended that as the said transfer of shares by the applicant is not liable to tax in India; the transfer pricing provisions would not apply.
- The applicant further submitted that section 195 of the Act would have no application as the capital gains on transfer of the said shares is not taxable in India and therefore, no tax was deductible at source.
- Regarding filing of return of income, the applicant contended that as the income of the non-resident company was not taxable in India; it is not under any obligation to file the return of income under section 139(1) of the Act, since the section was a machinery section that was triggered only when income was taxable in India. In doing so, the applicant relied upon similar interpretations made by the AAR in previous rulings in the cases of 1. Vanenburg Group B.V(289 ITR 464) 2. Dana Corporation,(321 ITR 178) and 3. Amiantit Intl. Holding Ltd., (322 ITR 678)

Contentions of the Revenue

- The Revenue conceded to the applicant's contention that in view of Article 13(5) of the India-Netherlands Tax Treaty, the taxability of the capital gains in this case would arise only in The Netherlands.

- The Revenue also conceded that the transfer pricing provisions of the Act would not be attracted as the sale and purchase of shares is between non-resident companies of The Netherlands and Switzerland.
- The Revenue further agreed that since there is no income chargeable to tax in India, there was no liability to deduct tax at source under section 195 of the Act.
- However, the Revenue differed with the applicant on the issue of filing of return of income and insisted that as per the provisions of section 139(1) of the Act, the applicant is liable to file an income-tax return in India.

Observations and Ruling of the AAR

- The AAR held three questions on this transaction i.e. i) non-taxability of capital gains in India, ii) non-applicability of transfer pricing provisions and iii) non-applicability of withholding tax provisions, in favour of the applicant.
- On the issue of filing of return of income, the AAR reviewed the provisions of section 139(1) of the Act and observed that while casting obligation to file return of income by a company, the legislature in its wisdom has omitted to include the expression “exceeded the maximum amount which is not chargeable to income-tax”.
- As per the third proviso to section 139(1), every company is required to file its return of income, whether it has an income or a loss. The applicant being a foreign company, is covered within the definition of a company under section 2(17) of the Act.
- The applicant did not dispute that the income arising from the sale of shares is liable to be taxed in India by virtue of section 5(2) of the Act, though no tax is actually paid in India. It is a different matter that by virtue of the Tax Treaty, the applicant is actually paying tax in The Netherlands. If the power to tax be granted it is difficult to appreciate the argument that when the resulting income is nil, there is no obligation to file return of income.
- Where it is not necessary for a non-resident to furnish return under section 139(1) of the Act, the statute has specifically provided so, as is the case under section 11 5AC(4) of the Act. Instead of causing inconvenience to the applicant, the process of filing of return would facilitate the applicant in all future interactions with the Income tax department.
- Based on the abovementioned observations, the AAR held that the applicant is required to file return of income under section 139(1) of the Act.

Conclusion

Capital gains on transfer of shares in an Indian company by a tax resident of The Netherlands to another nonresident are not be liable to tax in India under Article 13(5) of the India-Netherlands Tax Treaty. Indian transfer pricing provisions are not applicable on this transaction between the two non-residents as the income is not liable to tax in India. Further, as the income is not liable to tax in India, there is no obligation to withhold tax at source under section 195 of the Act. However, section 139(1) makes it mandatory for a foreign company to file an income-tax return in India when the income is liable to tax in India under the provisions of the Act but it is only under the provisions of the Tax Treaty that the resulting income is Nil.