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Research

Taxing Offshore Indirect Transfers in India

May 2022

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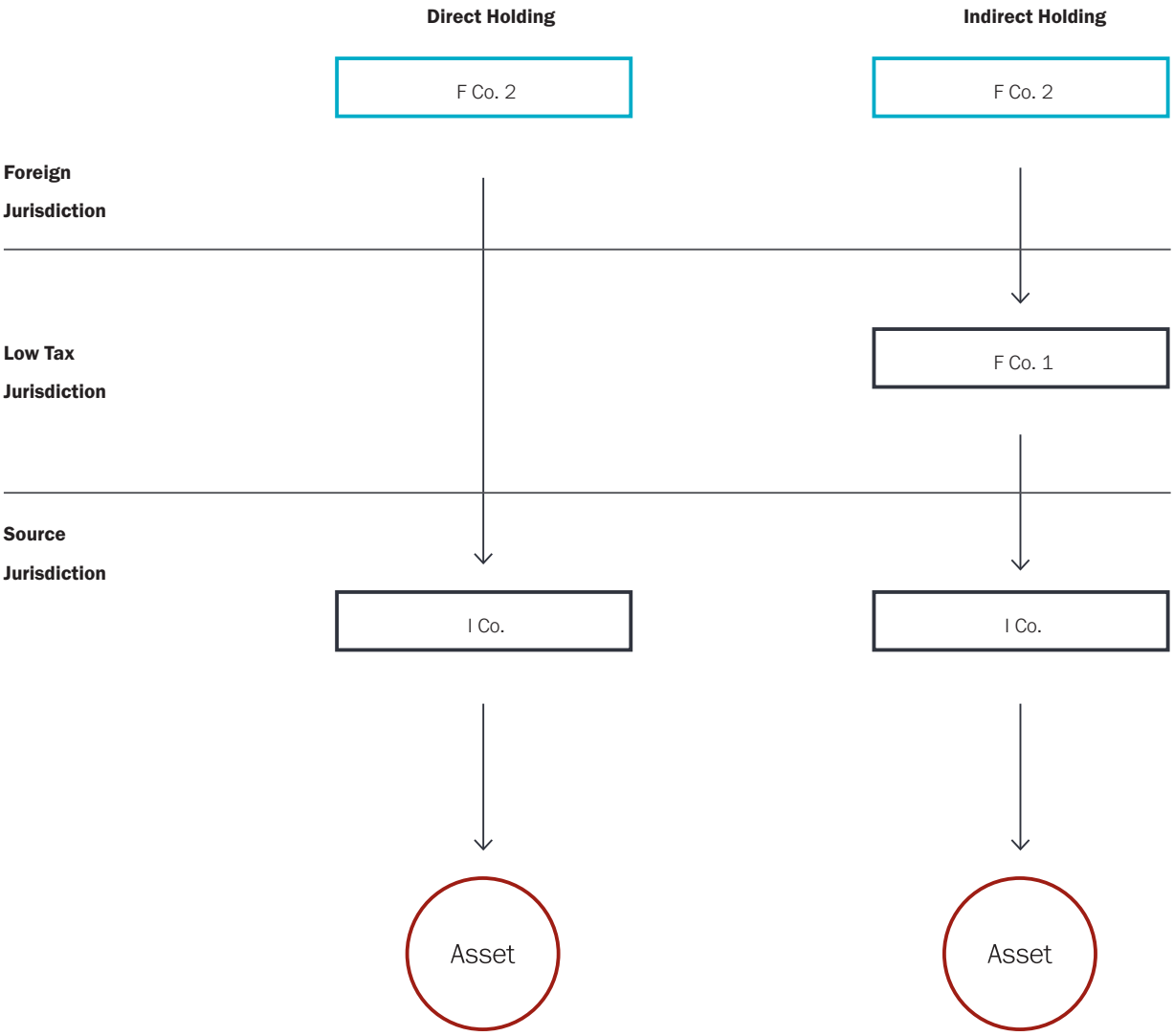
Contents

1. 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 realised in the jurisdiction where the asset is situated (**"Source Jurisdiction"**). 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

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

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 favour 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). 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.

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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 Uganda 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 undertake 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

2. 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.[8]

Further, any income or gain arising from the transfer of a capital asset is taxable under the head of capital gains.[9] Income arising from the transfer of any capital asset situated in India is deemed to accrue or arise in India.[10] 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.

8. Section 4 read with section 5 of ITA
9. Section 45 of ITA
10. Section 9(1)(i) of ITA

3. 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 [11], on the premise that such transaction was taxable in India. The SC rendered its decision[12] in favour 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.[13] 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 situate 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. [14]

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,[15] a set of amendments were introduced 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.

11. Section 195 of ITA
12. [2012] 341 ITR 1 (SC)
13. Brassard v. Smith [1925] AC 371, cited with approval by the SC in Vodafone 2012 (Radhakrishnan, J's judgement)
14. Article 142 of the Constitution of India
15. Finance Act, 2012

3. Vodafone Case and Retrospective Amendments

Importantly, these amendments were clarificatory and came into effect retrospectively from the introduction of the ITA i.e. April 1, 1962. 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.

4. Exemptions and Issues related to Indirect Transfers

I. Meaning of substantial

An Indirect Transfer is taxable in India when a share or interest in a foreign entity derives its value substantially from the assets situated in India. The word 'substantial' was not defined under the ITA for the purpose of Retroactive Amendments, and it could have been subject to different interpretations and a potential ground for litigation. In Copal Research Ltd.[16] , the Delhi HC interpreted 'substantially' as synonymous to 'principally', 'mainly' or 'at least majority'.

The Finance Act, 2015 added explanation 6 to section 9(1)(i) of the ITA which provides that a share or interest shall be deemed to derive its value 'substantially from assets located in India if the value of such assets:

i. exceeds the amount of INR 10 crore rupees (approx. USD 1.3 million); 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;

II. Small Shareholder exemption

The scope of Retroactive Amendments was so wide that even if a single share of a foreign company listed outside India was traded on an exchange it would be taxable under the ITA if such share derived substantial value from assets situated in India. There was no de minimis threshold in terms of value or percentage of shareholding transferred in the foreign jurisdiction. The Finance Act, 2015 introduced explanation 7 to section 9(1)(i) of the ITA which provides a threshold of 5% direct or indirect holding of the transferor in the company deriving its value from assets situated in India.

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.

Hiatus Period – For transactions between the financial years 2012 to 2015 [17], there remains a doubt whether the explanations 6 and 7 are prospective or retrospective in nature. An amendment in law is generally prospective unless specifically stated otherwise. The Authority for Advance Rulings (**"AAR"**) ruling [18] has held that the

16. [2015] 371 ITR 114 (Delhi). Also refer, In Re: Banca Sella S.p.A., AAR No. 1130 of 2011

17. The Retroactive Amendments come into effect on April 1, 1962, however, post 2021 Act, the retrospectivity aspect has been removed. Hence we have covered a period till 2012 (when Retroactive amendments came into effect) to 2015 (when Finance Act, 2015 amended Retroactive Amendments).

18. In re Copal Partners Ltd., AAR no.. 1555 to 1564 of 2013

explanations 6 and 7 must be given retrospective implementation on basis that they were clarificatory in nature and were inserted to address the genuine concern of taxpayers.

III. Institutional Investors

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 exempting Category I FPIs [19] from the application of indirect transfer provisions.[20] However, category II FPIs [21], private equity and venture capital investors are still subject to Indirect Transfer provisions.

A.Overseas Derivative Instruments (ODI's)

ODIs are used by investors and hedge funds to invest in the Indian stock market without registering with SEBI. ODI can be issued only by Category I FPIs. It is pertinent to note that by virtue of holding an ODI contract, the ODI holder does not hold any shares or interest in the FPI entity itself. Hence, considering that Indirect Transfer provisions get triggered on account of transfer of a share or interest in an overseas entity, and which share or interest derives value substantially from assets located in India, at the outset, any transfer of the ODI, or receipt of income linked to the underlying securities, should not result in a taxable event taking place in India.

IV. Dividend Exemption

The Central Board of Direct Taxes (**"CBDT"**) vide a circular [22] 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.

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19. "Category I foreign portfolio investor" generally includes:
(i) Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such Government and Government related investor(s);
(ii) Pension funds and university funds;
(iii) Appropriately regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker dealers and swap dealers;
(iv) Entities from the Financial Action Task Force member countries (subject to certain conditions).

20. Explanation to 3rd proviso to section 9(1)(i) of the ITA.

21. "Category II foreign portfolio investor" generally includes all the investors not eligible under Category I foreign portfolio investors such as –
(i) appropriately regulated funds not eligible as Category-I foreign portfolio investor;
(ii) endowments and foundations;
(iii) charitable organisations;
(iv) corporate bodies;
(v) family offices;
(vi) Individuals;
(vii) appropriately regulated entities investing on behalf of their client, as per conditions specified by the SEBI from time to time;
(viii) Unregulated funds in the form of limited partnership and trusts;

22. Circular No. 4 of 2015

V. Redemption or buyback of shares

There could be situations in multi-tiered investment structures, where interest or share held indirectly by a non-resident in a 'specified funds' [23] is redeemed in a holding entity outside India in consequence of the transfer of shares or securities held in India by the specified funds, the income of which have been subject to tax in India. In such cases, the application of Indirect Transfer provisions on redemption of share or interest in the upstream entity may lead to multiple taxation of the same income. The CBDT vide a circular has clarified that Indirect Transfer provisions are not applicable in such situations, provided that the income accrues or arises from or in consequence of the transfer of shares or securities held in India by the specified funds and such income is already chargeable to tax in India.[24]

Hence, the redemption of an interest in an offshore fund should not be subject to tax in India, but the transfer of interest by one limited partner of a fund to another limited partner may be subject to tax as per the Indirect Transfer provisions.

However, there is a lack of certainty over distributions that arise out of redemption of shares/interest made from **accumulated profits** of the holding vehicle to the parent company. A position can be taken that such transaction is dividend, being distribution by way of any "capital reduction"[25] , however, there is an ambiguity in this position as section 46A[26] of the ITA treats such transaction subject to capital gains and not deemed dividend, whereas section 2(22) of the ITA regards payment made to a shareholder on account of reduction of capital as dividend to the extent that the distributing company possesses accumulated profits.

VI. Overseas Partnerships

In the case of companies, the investment amount can be recouped either by payment of dividend or redemption of shares / interest (capital reduction) by the company, or the investor may also sell its shares. However, in the case of partnerships, an old partner may simply retire. In such situations, there is no 'transfer' [27] as such and payments made by the partnership may be characterised 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.

VII. 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

23. Specified funds include Investment Fund as defined in clause (a) of Explanation 1 to section 115UB of the ITA, and Venture Capital Company and Venture Capital Fund, as defined respectively in explanation to section 10(23FB) of the ITA.
24. Circular No. 28 of 2017
25. Please refer section 2(22)(d)
26. Section 46A of the ITA levies capital gain tax on consideration received by shareholders on the buyback of shares by the company. As per the provision, capital gain taxed will be levied on the difference between cost of acquisition and value of consideration received by the shareholders subject to section 48 of the ITA.
27. Section 2(47) of the ITA

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.

VIII. M&A Exemptions

A. 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.[28] In case both the amalgamating company and the amalgamated company are foreign companies, similar exemption is available in the hands of the amalgamated company [29] 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.

The Finance Act, 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. [30]

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 [31], subject to satisfaction of the above two conditions.

B. 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.[32] 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 being shares of a foreign amalgamating company which derive their 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.

28. Section 47(vi) of the ITA
29. Section 47(via) of the ITA
30. Section 47(viab) of the ITA
31. Section 47(vicc) of the ITA
32. Section 47(vii) of the ITA

IX. 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.[33] 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.[34] 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 [35] to be satisfied by alienator at any time during 365 days preceding such alienation. [36]

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 a residuary clause, giving the sole right to the contracting state where 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

It is a settled proposition that a unilateral amendment in a domestic law will not amend the tax treaty automatically. Hence even after the introduction of explanation 5 to section 9(1)(i) in the ITA, the taxpayers can take benefit of the tax treaty, which as observed above does not address taxation of Indirect Transfers. We have provided here an analysis of three different cases wherein it was held that the Indirect Transfer transaction was not liable to be taxed in India as per the relevant tax treaty.

Case	Relevant Treaty Article	Interpretation
Sanofi Pasteur Holding SA v. Department of Revenue, Ministry of Finance Karnataka High Court W.P. Nos. 14212 of 2010 and 3339 & 3358 of 2012	India France DTAA – Article 14 4. 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. 5. 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.

33. Article 13(1) of OECD Model Tax Convention and UN MTC
34. Article 13(4) of OECD MTC and UN MTC
35. To be decided between members of each treaty
36. Article 13(5) of the UN MTC

4. Exemptions and Issues related to Indirect Transfers

In re, GEA Refrigeration Technologies GmbH AAR, New Delhi AAR No. 1232 of 2012	India Germany DTAA – Article 13 4. Gains from the alienation of shares in a company which **is a resident of a Contracting State** may be taxed in that State. 5. 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.
Sofina S.A. v. Assistant Commissioner of Income-Tax ITAT, Mumbai IT Appeal No. 7241 of 2018	India Belgium Treaty – Article 13 4. 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. 5. 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. 6. 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.

In all of the above three treaties, the relevant article provides that income from the transfer of shares of a company resident in a contracting state **may be taxed** in such contracting state. 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 that such income could also be taxed in India since the treaty does not restrict India from taxing such income.

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.

In another recent ruling in the matter of **Tiger Global** [37], the AAR rejected the assessee's applications seeking a ruling on the taxability of capital gains arising from sale of shares of a Singapore entity (which derived substantial value from an Indian company) under India-Mauritius tax treaty, on the basis that the arrangement was a pre-ordained transaction created for the purpose of tax avoidance in India. The application was rejected in the admission stage itself and it was observed that exemption from capital gains tax on sale of shares of a company not resident in India (Singapore resident in present case) was never intended to be provided under the original as well as the revised India-Mauritius DTAA (thus observing that tax treaties are not meant for avoiding tax on indirect transfer). The ruling certainly creates a cloud over availability of DTAA benefits, however it has been challenged by the applicant and is currently pending before the Delhi High Court.[38]

XI. GAAR and Treaty Shopping

The General Anti Avoidance Rule (**"GAAR"**) was introduced in the ITA by Finance Act, 2012 [39] but its implementation was deferred a few times. It was finally brought into effect from 1st April 2017. GAAR gives very broad powers to revenue authorities which include denial of tax benefits and even re-characterisation of transaction if such transaction arise out of 'impermissible avoidance agreements'.

In order to avail treaty protection, foreign companies may set up one or more entities in their own or a foreign jurisdiction. For instance, a Singapore based entity may incorporate a subsidiary in Singapore or Mauritius to hold the shares of the Indian company. In future, the shares of the foreign subsidiary company can be sold, to actually transfer the underlining Indian company, and avail the treaty benefit to avoid indirect transfer tax in India.

37. In re, Tiger Global International II Holdings AAR No. 4, 5 & 7 of 2019
38. Writ Petition (Civil) No. 6764 of 2020
39. Chapter X-A of ITA

In situations where the Revenue believes that the entity has been incorporated with the mere aim of obtaining treaty benefits, it may deny the treaty benefits in light of GAAR and Principle Purpose Test (**"PPT"**) in the treaty.[40]

The recent Tiger Global ruling and challenge of Sanofi judgment in SC suggest that the Revenue may chase down other Indirect Transfer cases too. Further with the introduction of GAAR and PPT, the defence of tax treaty will not be available with the assessee as GAAR has an overriding effect over the treaties and PPT denies treaty benefits. Hence, substance in an arrangement must be reflected clearly to avoid unnecessary litigation.

XII. 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. [41]

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."** Herein 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.

40. PPT allows tax authorities to disallow the application of treaty benefits, if the application of those benefits was one of the principal purposes of an arrangement or transaction

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

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.

5. Compliances and Reporting

I. Valuation Methodology

Explanation 5 to section 9(1)(i) makes reference to the value of share or interest in a foreign company or entity. The term 'value' is also subject to various interpretations – whether book value or Fair Market Value (**"FMV"**), whether gross assets or net assets should be considered for determining value, whether physical as well as intangible assets are to be included and at what time value needs to be determined.

The Finance Act, 2015 provides that FMV of the shares or interest would be calculated based on gross assets (including intangible assets), i.e. without reduction of liabilities in respect of the assets. Further, the Central Board of Direct Taxes (**"CBDT"**) notified[42] certain rules prescribing the method of computation of FMV of assets situated in India.

Rule 11UB [43] 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. Further Rule 11UC [44] provides mechanism for determining income attributable to assets located in India, arising out of Indirect Transfer, as required under section 9(1)(i) of the ITA. The date for determining valuation (**"specified date"**) should be the last date of the accounting period (in which the transfer occurred) of the foreign company. However, in a situation where 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 date of the accounting period (as per the balance sheet) preceding the date of transfer, the specified date shall be the date of transfer.

Further, for the purpose of applying substantial threshold, calculation of value of assets without excluding the liabilities creates artificial difference between companies employing debt in their operations and the companies which may not do so.

II. 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 Income Tax Rules, 1962 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. [45]

42. Notification No. 55 of 2016, dated June 28, 2016.
43. Income Tax Rules, 1962
44. Income Tax Rules, 1962
45. 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.

5.Compliances and Reporting

Pertinently, these reporting obligations have been put solely on the Indian entity, and not on foreign companies or entities actually dealing with the transfer of shares. 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.

6. Resolving Indirect Transfer tax disputes through Investment Arbitration

Vodafone had obtained a favourable 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.[46]

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 [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.[48] These cases have now been settled based on the changes brought about by the 2021 Act (discussed below). [49]

46. Complete text of the award in this matter was not released in public domain.
47. Cairn UK Holdings Ltd. v. Deputy Commissioner of Income-Tax 56 ITR(T) 595 (Delhi - Trib.)
48. https://www.businesstoday.in/current/economy-politics/cairn-threatens-to-seize-indian-assets-overseas-to-collect-14-billion-arbitration-award/story/429153.html
49. 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).

6. Resolving Indirect Transfer tax disputes through Investment Arbitration

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[50] and Hague [51] respectively.

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

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

7. Removal of Retroactivity

Recently, 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:[52]

- **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 withdawing its petition in Supreme Court over taxability in the case of Sanofi Pasteur & others, and reports regarding the Indian Governmen 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.[53]

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.

52. CBDT has notified the rules for implementing the amendment made by the Amendment Act through press release dated October 02, 2021
53. https://www.bloomberg.com/news/articles/2021-08-09/vodafone-cairn-in-talks-to-settle-tax-row-india-official-says

8. 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.

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). Recently, The Platform for Collaboration on Tax has released a toolkit on taxation of Indirect Transfers[54] , 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.

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

9. Impact on Tax indemnities

Tax indemnity clauses are becoming quite common in cross border Private Equity/Venture Capital and M&A deals (**"cross border deals"**). Indemnity is provided for any breach of warranty or a representation made by a party in an agreement.

The existence of a tax treaty significantly reduces exposure of such tax in India. With the introduction of GAAR difference between tax evasion and tax planning has been minimised. With the potential denial of treaty benefits, lot of uncertainty may prevail at the time of entering into a cross border deal. Hence the buyer may seek significant protection in terms of indemnity.

When negotiating tax indemnities, the buyer mainly seeks protection from any demand raised with respect to withholding tax liability. Section 195 of ITA casts a liability on even a non – resident paying to another non – resident which typically occurs in an Indirect Transfer. The liability under section 195 is however confined to only the amount chargeable to tax under the ITA read with the tax treaty. However, given the complex structure in an Indirect Transfer and uncertainty with respect to treaty relief, determining chargeability to tax in India is not an easy task. From the buyer's perspective, there exists a dilemma whether to withhold taxes on payment of consideration to the seller. The buyer should seek representations from the seller with respect to specific issues such as tax residency, tax residency certificate (**"TRC"**) and Form 10F, adequate substance in the transaction, legal opinion (for bona fides purpose) etc. to get some certainty, as in case of any breach of such representation, the seller would be liable to indemnify the buyer. Further, the tax authorities can also be approached to get more certainty under section 195 and/or 197. [55]

The Finance Act, 2021 has introduced a new reassessment scheme under the ITA. Before the amendment, a special time period of 16 years was provided for reopening of assessment in case the income escapes assessment in relation to an asset situated outside India. Vide the Finance Act, 2021 the limitation period for reopening assessment has been reduced to 3 years from the end of the relevant assessment year.[56] This is a welcome move and it will reduce time period for indemnity and help in reducing costs for obtaining tax liability insurance.

55. The Finance Bill of 2021 has overhauled the AAR mechanism for obtaining Advance Rulings and has introduced Board of Advance Rulings ("BAR"), which is yet to operationalise. Even the Board of Advance Rulings can be approached to ascertain taxability of a transaction, however given the time consideration involved in determination of the application by the tax authorities, approaching BAR may not be practical.

56. The limitation period is 10 years from the end of the relevant assessment year in case the assessing officer has in his possession books of account or other documents or evidence which reveal that the income chargeable to tax, represented in the form of asset, or expenditure in respect of a transaction or in relation to an event or occasion, or an entry or entries in the books of accounts, which has escaped assessment amounts to or is likely to amount to INR 50 lakhs or more for that year.

10. Conclusion

The Indirect Transfer provisions were introduced in the ITA with an intent to overcome the SC decision. The initial provisions were criticised 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. Transactions undertaken post May 2012 may also be litigated on treaty eligibility.

Annexure

I. 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—

   ii. exceeds the amount of ten crore rupees; and

   iii. 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;"

Annexure

II. 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]

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

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

vi. 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"

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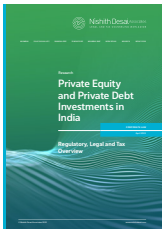

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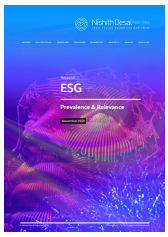

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