

Whether Transfer Pricing Provisions are Applicable when No Income is Chargeable to Tax – Recent Rulings Analysed



With introduction of various amendments in Finance Bill 2012, the ambit of Transfer Pricing (TP) provisions has been widened by expanding the definition of international transactions, defining intangible property, including business transaction *i.e.* restructuring or reorganisation with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, loss or assets of such enterprises, etc. Further, the repercussions of non-compliance of TP provisions have been made onerous in the form of increased penal consequences. Accordingly, it becomes pertinent to re-visit the position with regard to applicability of TP on certain transactions, and its related compliances in the light of the amendments suggested under the Finance Bill, 2012 and recent Authority of Advance Rulings (AAR) for the same. The purpose of this article is to highlight the discussion with respect to applicability of transfer pricing provisions where no income is chargeable to tax as laid down in the recent ruling in case of *Castleton Investment Limited vs. Director of Income-tax AAR*¹.



CA. Dhinal Ashvinbhai Shah

(The author is a member of the Institute. He can be reached at citax@icai.org)

The AAR, a quasi-judicial body which gives advice on tax matters in advance of the actual transaction, has recently held that the transfer pricing rules would apply even if the capital gains are not liable to tax in India under the India-Mauritius tax treaty. However, the AAR had taken a view previously on the same issue where it stated that TP provisions are not applicable where no liability to pay tax exists. The AAR is not deterred from taking a contrary view if it is convinced that the earlier view is not correct. The theory of precedents does not have strict application to the AAR. It is bound only by the decisions of the Supreme Court.

¹ *Castleton Investment Limited v. Director of Income-tax AAR 999 of 2010*

Castleton Investment Limited vs. Director of Income-tax AAR.

Facts:

- The applicant is a company incorporated in Mauritius in the year 1993 and is a tax resident of Mauritius. It is a part of Glaxo Smithkline group of companies (GSK group).
- The applicant acquired 3.77% of the paid up share capital of Galxo Smithkline Pharmaceuticals Limited (GSKPL), an Indian company, in the year 2004.
- Glaxo Smithkline (Pte) Limited, Singapore (GSK) is also a part of GSK group. As a part of global reorganisation of the group businesses, the applicant proposed to transfer the shares of GSKPL held by it to GSK. The transfer is for cash consideration at fair market value.
- The transfer of shares is proposed to be off the market and not through a recognised stock exchange, without attracting securities transaction tax.
- The applicant has no office, employees or agents in India and hence, there is no permanent establishment in India.

Issues raised before the AAR:

- Whether capital gains arising from transfer of shares of GSKPL by the applicant to GSK would be subject to tax in India?
- If the transfer of shares by the applicant to GSK is not taxable, whether the provisions of Section 92 to 92F of the Income-tax Act, 1961 (Act) relating transfer pricing would be applicable?
- Whether the sale consideration receivable by the applicant should suffer any withholding tax as per Section 195 of the Act?
- If the transfer of shares of GSKPL is not taxable in India, whether the applicant is required to file any return of income under Section 139 of the Act?
- Whether the provisions of Section 115JB of the Act shall be applicable to the applicant?

Ruling of the AAR

Capital gains tax

- As per Article 13(4) of the Double Tax Avoidance Convention (DTAC) between India and Mauritius, by invoking Section 90(2) of the Act, the capital gains that would arise would not be chargeable to

In *Castleton Investment Limited vs. Director of Income-tax AAR*, it was ruled that in a case when an option is exercised to opt for benefits under a DTAC, then the question would arise whether the gain is taxable in this country and if yes, to what extent. The question of chargeability to tax would arise only at a later stage. The application of Section 92 cannot be kept at bay by jumping to the second stage straight away. The AAR has taken the view that whether ultimately the gain or income is taxable in the country or not, Sections 92 to 92F would apply if the transaction is one coming within those provisions.

tax in India. The argument that unless the applicant is actually taxed in Mauritius or is liable to be actually taxed on the capital gains that would arise in Mauritius, the DTAC is attracted since a DTAC can apply only when there is actual taxation in two countries, though may sound attractive cannot be accepted.

- Though the view was taken by this Authority in *Cyril Eugene Pereira, In re*² that unless there is real double taxation, the DTAC cannot be invoked, the said view was disapproved by the Supreme Court in *UOI vs. Azadi Bachao Andolan*³. Hence, the AAR relying upon the ruling of Supreme Court of India in case of *Azadi Bachao Andolan*³, held that the applicant can claim exemption under the beneficial provisions of India-Mauritius DTAC on capital gains arising on transfer of shares.

Applicability of transfer pricing provisions

- According to the applicant, Section 92 of the Act can be applied only to a transaction chargeable to tax under the Act. Since the transaction in question is not chargeable to tax in India in view of Article 13(4) of the DTAC, Section 92 of the Act is not attracted. The applicant relied on the earlier Rulings of this Authority in *Praxair Pacific Limited*⁴ and in *Vanenburg Group BV*⁵.
- Without resort to provisions of Sections 92 to 92F of the Act, the capital gains from an international transaction cannot be determined. Only on determining whether capital gains have

² *Cyril Eugene Pereria, In re* 239 ITR 650

³ *UOI v. Azadi Bachai Andolan* [2003] 263 ITR 706 (SC)

⁴ *Praxair Pacific Limited v. DIT* 326 ITR 276 (AAR)

⁵ *Vanenburg Group BV v. CIT* 289 ITR 464 (AAR)

arisen, would the question arise whether the gain is chargeable to tax or not under the Act. Clearly, in cases governed by the Act alone, they would be chargeable to tax. In a case when an option is exercised to opt for benefits under a DTAC, then the question would arise whether the gain is taxable in this country and if yes, to what extent. The question of chargeability to tax would arise only at a later stage. The application of Section 92 cannot be kept at bay by jumping to the second stage straight away. The AAR has taken the view that **whether ultimately the gain or income is taxable in the country or not, Sections 92 to 92F would apply if the transaction is one coming within those provisions.**

Applicability of withholding tax

- About the applicability of withholding tax is concerned, the AAR has held that as per *GE Technology Centre P. Ltd. vs. CIT*⁶, in cases where there is no chargeability to tax under the provisions of the Act, there will be no obligation to withhold.

Filing of return of income

- As regard the filing of return of income is concerned, the applicant argued that since the income is not taxable in India, there is no obligation on the applicant to file a return of income under Section 139 of the Act. The AAR has observed that Section 139 insists that every person, being a company, firm or a person other than, a company or firm, if its or his total income exceeds the maximum amount which is not chargeable to income-tax, has to file a return of income. A company which is entitled to claim the benefit of a DTAC might have an income

exceeding the maximum amount which is not chargeable to tax under the Act. On the language of Section 139 of the Act, such a person is bound to file a return of income. When a person claims the benefit of a DTAC, that person is invoking Section 90(2) of the Act to do so. In other words, a person earning an income that is chargeable to tax under the Act, has to make a claim by invoking Section 90(2) of the Act for getting the benefit of a DTAC. So even if he would be entitled to seek relief under the DTAC, he has to seek it and that would be during the consideration of his return of income or at best while filing his return. If so, the obligation under Section 139 of the Act cannot simply disappear merely because a person may be entitled to claim the benefit of a DTAC. The AAR has held that the applicant will have an obligation to file return of income under Section 139 of the Act.

Applicability of MAT provisions

- As regards the applicability of minimum alternate tax (MAT), the AAR has observed that Section 115JB of the Act on its wording makes no distinction between a resident company and a non-resident company. Prima facie, it applies to all companies. The definition of a company in Section 2(17) of the Act means an Indian company or any company incorporated by or under the laws of a country outside India. As per AAR ruling in the case of *Niko Resources*⁷, Section 115JB of the Act would apply to the foreign company also.

AAR observations with respect to transfer pricing provisions in various other rulings

Regarding the applicability of TP provisions, the AAR had held, in various previous rulings, which stated that TP provisions would not apply in the absence of liability to pay tax. We have analysed the same as under:

Praxair Pacific Ltd vs. DIT⁴

- In the present case, the applicant was a tax resident of Mauritius. It was proposing to transfer its equity share in Jindal Praxair to its wholly owned subsidiary company, Praxair India. The consideration for the proposed transfer is stated to be determined on the basis of cost.
- The issues raised before the AAR were with

In the case of *Castleton Investments Limited*, the AAR has emphasised on the statutory applicability of TP provisions, and has held that these provisions do not automatically become inapplicable if there is no liability to pay tax. Yet, at the same time, the AAR appreciates that applying the TP provisions may not eventually be fruitful, i.e. if capital gains itself are not liable to tax, then the arm's length determination thereof, even if undertaken, would have no revenue consequences.

⁶ *GE Technology Centre P. Ltd. v. CIT* 327 ITR 456 (SC)

⁷ *Niko Resources Limited* 234 ITR 828 (AAR)

respect to taxability of the capital gains earned and whether TP provisions with respect to Section 92 to 92F would be applicable on the said transaction.

- The AAR applied the principles laid down in *Azadi Bachao Andolan* and observed that the applicant would not be subject to tax in India on the capital gains arising from the proposed transaction in India.
- Further the AAR observed that in absence of liability to pay tax on the capital gains under the DTAC, **the TP provisions would not be attracted and the applicant is not liable to comply with the same.**

Vanenburg Group BV vs. CIT⁵

- In the present case, the applicant was a tax resident of Netherlands. It was proposing to transfer its equity share held in Cordys India to its wholly owned subsidiary, Cordys Holding BV, Netherlands.
- The issues raised before the AAR were with respect to taxability of the capital gains earned, whether TP provisions would be applicable on the said transaction, whether the applicant was liable to file a tax return under the provisions of Section 139 of the Act.
- The AAR observed that as per provisions of the DTAC entered into between India and Netherlands capital gains released in the course of a reorganisation, amalgamation, division etc, such gains would be taxable only in the State in which the alienator is resident and accordingly the gains would not be taxable in India.
- Further, the AAR observed that the TP provisions fall under the head 'Special Provisions Relating to Avoidance of Tax' and the same are aimed at preventing avoidance of tax by certain well known devices, determination of arm's length price, computation of income in certain cases etc, in relation to international transaction. **It stated that these provisions are machinery provisions which would not apply in the absence of liability to pay tax** and the applicant would not be required to comply with the same.

Various other rulings in which reliance has been placed on *Praxair Pacific Limited* and *Vanenburg Group BV*, the AAR has held that TP provisions are machinery provisions and the same are not applicable on the assessee where there is no liability to pay tax

— —

An analysis of the decisions discussed in this article, rendered in the context of whether TP provisions are applicable give rise to the open ended question before the Tax payers as to whether the Tax payer would be required to comply with the TP provisions in case no income is chargeable to tax in India.

— —



on the income earned in India. The list of the same is as under:

- *Deere & Co 337 ITR 277 (AAR);*
- *Dana Corporation in re vs. DIT 788 of 2008 (AAR);*
- *Amiantit International Holidays 322 ITR 678 (AAR);*
- *Canoro Resources Ltd in re vs. DIT 313 ITR 2 (AAR).*

Conclusion

In the case of *Castleton Investments Limited*, the AAR has emphasised on the statutory applicability of TP provisions, and has held that these provisions do not automatically become inapplicable if there is no liability to pay tax. Yet, at the same time, the AAR appreciates that applying the TP provisions may not eventually be fruitful, i.e. if capital gains itself are not liable to tax, then the arm's length determination thereof, even if undertaken, would have no revenue consequences.

Thus, an analysis of the above discussed decisions rendered in the context of whether TP provisions are applicable give rise to the open ended question before the Tax payers as to whether the Tax payer would be required to comply with the TP provisions in case no income is chargeable to tax in India.

Thus, there are significant inconsistencies in judicial thinking on the issue of whether the provisions of Section 92 to 92F of the Act pertaining to transfer pricing are applicable – where no income is chargeable to tax in India – and accordingly, the Taxpayers are facing ambiguity with regards to the position to be adopted for the same. ■