Tax Wire

India enters into protocol amending Singapore DTAA

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Protocol amending India - Singapore DTAA

Background

It has always been a matter of dispute in India whether alienation of shares of Indian companies by companies located in tax jurisdictions like Mauritius or Cyprus can avail the benefit of treaty. This was mainly due to the allegation by the tax authorities that the companies are resorting to treaty shopping and deliberately investing from countries like Mauritius, Cyprus, Netherlands etc, despite there being no substance to companies in such jurisdiction. However, courts have continuously not accepted the contention of the tax authority and ruled in favour of the tax payer.

In the last few months, India has been aggressively trying to sign protocols amending various Double Tax avoidance Agreements (DTAA or tax treaty), which was perceived to be aiding certain tax evasion. It began with India signing a protocol amending tax treaty with Mauritius in May 2016 and with Cyprus in November 2016. While, these treaties have been under renegotiation for a very long time, it is only now; it has reached some kind of conclusion.

Similarly, a protocol amending the India - Singapore treaty has now been signed amending some of the key provisions. While owing to a protocol signed in 2005 to India - Singapore treaty, the possible misuse of Singapore as a jurisdiction for investment was already clipped, this protocol deviates from rules of taxation and shifts from being residence based to source based taxation.

India – Singapore DTAA - as it stands

Singapore has a territorial system of taxation, under which its residents are not subject to tax on offshore income unless it is **remitted** to Singapore. Thus, if income earned by a Singapore resident is considered as offshore income (say, from India) and is not remitted to Singapore, it would not be subjected to tax in Singapore.

The tax treaty between India and Singapore was in place since 1994. It has been amended twice in the past in 2005 and 2011. Under the Singapore treaty as it stands today before the protocol signed now, capital gains arising from alienation of shares of an India company by a resident of Singapore are taxable only in Singapore. This was subject to certain Limitation of Benefit conditions that are to be satisfied to ensure that the resident of Singapore is not a shell or conduit company.

The Protocol for Amendment

A protocol for the amendment of the DTAA was signed on 30th December, 2016 between the Government of the Republic of Singapore and the Government of the Republic of India. The protocol contains the following amendments:

1) Taxation of Capital gains:

Taxation of the capital gains arising on the transfer of shares in a company:

a) The gains from alienation of shares acquired ***after 01.04.2017*** in a company shall be taxable only in the country of residence of the company. That is, if a resident of Singapore incurs gains from the alienation of shares (acquired after 01.04.2017) of a **company in India**, these gains shall be subject to tax in India, being the state of residence of the Company.

b) The gains arising from alienation of shares ***acquired prior to 01.04.2017*** has been grandfathered and they shall be taxable only in the resident state of the alienator. In other words, if a resident of Singapore incurs gains from the sale of shares

(acquired prior to 01.04.2017) of a company in India, these gains shall be subject to tax only in and according to the tax laws of Singapore.

c) Further to the above, a 2 year transition period from ***01.04.2017 to 31.03.2019*** in respect of the gains from the alienation of the shares acquired after 01.04.2017 has been provided during which the capital gains in the source country will be charged at ***50% of the normal tax rate***.

d) The gains from alienation of any property other than shares shall be taxable only in the country of which the alienator is a resident.

2) Insertion of new article on Limitation of Benefit (LOB):

Article 24A has been inserted to limit the above benefits of; residence based taxation for shares acquired prior to 01.04.2017 and reduced rate of tax for 2 years; if the alienator does not satisfy the following conditions:

a) An alienator whose affairs are solely arranged to take advantage of the benefit of the lower rate.

b) A shell/conduit company – any entity with negligible or nil business operations, or with no real and continuous business activities.

   Further, a company is deemed to be a shell/conduit company if its annual expenditure on operations is less than S$ 200,000 in Singapore or Indian Rs.50,00,000 in India. However, the article also mentions that a company will not be considered as shell/conduit if it is listed on a recognised stock exchange.

3) Transfer Pricing:

The protocol also provides for providing consequential relief to residents of other country if a TP adjustment is made between Associated Enterprises.

4) A very significant introduction in this protocol is enabling provision to use any anti avoidance law in the domestic tax law of each country.

Conclusion

The protocols signed by India with Mauritius, Cyprus and now Singapore clearly indicates the intention of Government of India to avoid any treaty related abuse that some multinationals might have resorted to.

It is important to note that the proposed changes in the protocol relates only to shares and might not apply to other instruments of investment or right in LLP, which would continue to be taxed under residence rule. This is however subjected to any anti avoidance provisions that maybe introduced in the domestic law.

The enabling provision for GAAR also indicates that Government would make all attempts to ensure no abuse of treaty provisions is possible.

The protocol including sufficient grandfathering for earlier investments is a welcome move as it sets to rest ambiguities for investors entering into India via Singapore route. While this would increase the taxation for investors coming from the Singapore route, it however brings parity for all the investors investing in India. One cause of concern is the enabling provision for GAAR in the treaty. The GAAR provisions provide sweeping powers to tax authorities to question any arrangement, which could work counterproductive to the investment attractiveness of the Indian economy.

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