

Capital gain exemption available on corporate reorganization and not on buy-back of shares under India-Netherland DTAA

Summary – The Mumbai ITAT in a recent case of *Accordis Beheer B V.*, (the Assessee) held that where assessee, a Netherlands based company, tendered part of shares in an Indian company under scheme of buy back on direction of High Court, said arrangement did not fall under definition of 'reorganization' under article 13(5) of India & Netherlands DTAA particularly when object of arrangement was not financial restructuring

Facts

- The assessee, a Netherland based company, tendered equity shares of a public listed Indian company named (CEL), under a scheme of arrangement by way of buy back of own shares as per approval of High Court. Said tendering resulted in capital gain. The assessee placed reliance on paragraph 5 of Article 13 of India Netherlands DTAA in order to contend that the said capital gain was not taxable in India.
- The Assessing Officer held that exception given in article 13(5) was not applicable to said transaction and the capital gains was taxable in India as per Article 13(5). Besides the above, the Assessing Officer noted that the assessee had not paid tax on the impugned capital gains in Netherlands also and, accordingly, held that the assessee it was trying to claim double benefit by taking recourse to DTAA.
- The Commissioner (Appeals) upheld the view taken by the Assessing Officer by observing that the claim of assessee that there was no transfer of shares was not tenable in law. It was seen that the assessee had tendered the shares, thus tendering of shares amount to transfer of share.
- On appeal: the assessee submitted that the tax authorities were not justified in rejecting the claim of the assessee on the ground that the assessee did not pay tax on the same in Netherlands. He submitted that taxability in one country is not a *sine qua non* for availing relief under the treaty in the other country and that transferred the shares under a scheme of arrangement approved by the High Court of Calcutta and the same fell in the category of 'reorganization' specified in article 13(5) of the DTAA entered between India and Netherlands.

Held

- In view of various judicial pronouncements the contention of the assessee that payment of tax on the capital gains in Netherlands may not be a condition for availing DTAA benefits in India was to be agreed with.
- The Commissioner (Appeals) has observed that the colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that the it is honourable to avoid payment of tax by resorting to dubious methods. The assessee, in the instant case, is pleading for

relief on the basis of its own interpretation of article 13(5). The fact that it has tendered the shares to the CEL under a scheme of arrangement approved by Calcutta High Court is not disputed. Hence there is no colourable device in the claim made by the assessee and accordingly the observations made by Commissioner (Appeals) may not be relevant to the facts prevailing in the instant case.

- The assessee had transferred a part of shares held by it to CEL and accordingly earned capital gain. Subsequently, the above said company had reduced its paid up capital and reserves by cancelling the shares bought by it. As per the definition of the term 'reorganisation', since there should be a major change in the financial structure and the same should result in alteration in the rights and interest of security holders. However, in the instant case, there was only reduction in share capital and, the same cannot be considered as a major change in financial structure. Further, the security holders continued to enjoy the same type of rights and interests even after the reduction of share capital and hence there is no alteration in the rights and interests of security holders. Accordingly, arrangement entered by the assessee in selling part of its shareholding to the company in the scheme of buy back did not fall under the definition of 'reorganization' given in the dictionary.
- The assessee also placed reliance on a study material titled as 'Strategic Financial Management' issued by the Board of Studies of the Institute of Chartered Accountants of India.
- These discussions made by the ICAI only explain various forms of financial management. There is no change in the rights and interests of the shareholders. Only change that occurred on reduction of share capital through writing off of the shares purchased from the assessee is the change in the shareholding pattern of the promoter groups, *i.e.*, the percentage of shareholding of the promoter group has gone up. The same cannot be considered as the change in the rights and interests of shareholders. Before and even after the reduction of share capital, the promoter groups continued and continues to remain as promoter groups with the same rights and interests.
- From the decision taken by Commissioner (Appeals), it can be noticed that the Commissioner (Appeals) has observed that the scheme of arrangement framed by CEL was only with the purpose of providing an exit route to the non-resident shareholders. Thus, the objective of the scheme was to enable the assessee to transfer its shareholding. Further the Commissioner (Appeals) has observed that the subsequent cancellation or writing off the shares is nothing to do with the transfer made by the assessee, even though the same has resulted in reduction of paid up share capital of the company, CEL, the above said observations made by Commissioner (Appeals) was to be agreed. As observed by him, two different activities have been combined with the scheme of arrangement. The first one was to buy back shares belonging to non-resident shareholders and the second one was to cancel the shares so purchased they are two different actions and both should not be clubbed together, even though CEL has combined the same, for the sake of its convenience, in the scheme of arrangement. The assessee, should in no way be concerned by the action of cancellation of share resulting in reduction of share capital. Accordingly, the attempt of the assessee to bring the transferring of shares within the ambit of the term 'reorganisation' may not be correct,

since the object of the arrangement was not financial restructuring, but to provide an exit route to the non-resident shareholders.

- In view of the above, the Commissioner (Appeals) was justified in upholding the view taken by the Assessing Officer on this issue. Accordingly, said order on this issue was to be upheld.