BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX)

27th Day of February, 2012

PRESENT

Mr Justice P.K. Balasubramanyan (Chairman)
Mr. V.K.Shridhar (Member)

A.A.R. No. 1067 of 2011

Name & address of the applicant	:	**RST**
		Address in India
		S.R. Batliboi & Co., Chartered Accountants, C-401, 4th floor, Panchshil Tech Park, Yerawada, Pune-411006 Maharashtra, India.
Commissioner Concerned	:	Director of Income-tax (International Taxation) Bangalore
Present for the applicant	:	Mr. Rajan Vohra ,C.A.[S.R.Batliboi & Co.] Mr. Vinesh Kirplani,C.A.[S.R. Batliboi & Co.] Mr. Srirupa Tandon, C.A.[S.R.Batliboi & Co.]
Present for the Department	:	Ms. V.S. Sreelekha, Addl.DIT(Int.Taxn) Bangalore

R U L I N G

[By Justice P.K. Balasubramanyan]

The applicant is a company incorporated in Germany with limited liability. It is a part of a Group of companies. The applicant files income-tax returns in India as a non-resident. According to it, it has a wholly owned subsidiary in India, which is a public limited company incorporated under the Indian Companies Act (hereinafter, 'Companies Act').

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2. The applicant holds 43,83,994 shares in the Indian company being 99.99986% of the shareholding. One share each is held by 6 other companies, each constituting 0.00002% of the shares of the Indian company. According to the applicant, the six other companies holding shares are its nominees. The shares are held by them for complying with the requirements of the Companies Act with regard to the minimum number of members for a public limited company, fixed at seven by the Act.

3. The applicant submits that the shares in the Indian company are held by it as an investment and not as stock in trade. It has now received intimation from the Indian company that it is proposing a buy back of shares from the applicant. The buy back would result in transfer of shares of the Indian company from the applicant to the Indian company. The consideration for the proposed transfer is to be determined on the basis of pricing guidelines prescribed by the Reserve Bank of India as applicable for transfer of shares by a non-resident to a resident. Since the applicant wants to ascertain whether, based on the proposed transaction, the applicant would be liable to be taxed in India, it is approaching this Authority for a Ruling.

4. This Authority allowed the application for a Ruling under section 245R(2) of the Income-tax Act (hereinafter referred to as 'the Act') and raised the following questions for a ruling.

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1. *Whether, in the facts and circumstances of the case, would the transfer of shares of UVW India by the applicant to its wholly owned subsidiary UVW India, in the course of the proposed buy-back of shares, be exempt from tax in India in the hands of the applicant, in view of the provisions of section 47(iv)?*
2. *Without prejudice to Qestion 1, whether the applicant would not be liable to tax under the provisions of section 115JB of the Act, in the absence of any business presence or permanent establishment ('PE') in India?*
3. *Where, on the facts and circumstances of the case, the gains arising to the applicant on account of the proposed transfer of shares, in the course of buy-back of shares by UVW India, is not taxable in India under the Act, whether UVW Germany is entitled to receive the amount on buy-back of shares without any deduction of tax at source?*

In its submission, the Revenue has taken up the position that the gain is taxable in India as capital gains, going either by Section 46A of the Act or by Article 13.4 of the Convention between India and Germany. It is submitted that in a case like the present one, where the shares get extinguished on buyback, Section 47(iv) of the Act has no application. Section 47 also does not override Section 46A of the Act. Hence, the gain as postulated by Section 46A of the Act would be taxable in India.

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5. In its reply, the applicant has reiterated that Section 46A is not a charging section and that buyback of shares would be chargeable to tax under section 45(1) of the Act read with Section 46A for computation thereof. The liability to be taxed was under section 45 and section 47(iv) of the Act would be attracted and hence, the transaction was not taxable in India.

6. At the hearing, it was submitted on behalf of the applicant, that the applicant and its nominees together held 100% of the shares in the Indian subsidiary and in the case of a buyback, the transfer would stand exempted from taxation under section 47 (iv) of the Act. In the context of Section 77A of the Companies Act, the proposed buyback was a valid transaction and the proceeds will not be dividend in view of the amendment to the definition of dividend under the Act. It would be capital gains. Section 46A of the Act was only clarificatory and when the gain is not taxable, going by Section 45 of the Act read with Section 47(iv) of the Act, the gain arising out of the proposed buyback was not taxable as capital gains. The decision to buyback was a business decision taken and was bona fide. It was proposed for rationalizing the share capital of the Indian company.

7. Representative for the Revenue argued that Section 46A was introduced specifically to deal with buyback of shares and the rate of tax has to be computed in terms of Section 48 of the Act. Section 47 had no relevance in the context. Existence of the share after the transfer, was a

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must for attracting section 47(iv) of the Act. In a buyback the shares get destroyed and hence section 47(iv) has no application. That deals with a transfer of a capital asset being a share. Hence, that provision is confined to assets and on a buyback, there remains no asset.

8. In reply, the applicant submits that it is enough if a share is a capital asset to attract section 45 and 47 of the Act. Section 47(iv) and (v) apply to two different situations. They are not specifically for shares. The two conditions are not cumulative. The purpose of the amendment to the Act has also to be kept in view. For a moment after the buyback, the company becomes the owner of the shares bought back and hence it is a capital gain. Section 77A(7) of the Companies Act provides for extinguishment of the shares and for their destruction. No fresh issue of shares can also be made for one year thereafter.

9. Sec 77 of the Companies Act imposes a restriction on purchase by a company of its own shares or the shares of its holding company. This provision would have stood in the way of the proposed buy back. Taking note of the international commercial practices, Section 77A was introduced into the Act. The said section enabled a company to purchase its own securities subject to certain conditions. The buy back should be of 25% or less of the total paid up capital. On buy back, the company had to extinguish and physically destroy the securities bought back. If shares are bought back, there could be no fresh issue of shares within six months unless it be bonus shares. Sec 77B prohibited buy

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back in the circumstances enumerated therein. Sec 49 of the Companies Act mandates, subject to certain savings, that all investments made by a company on its own behalf shall be made and held by it in its own name. Sub-section 3 enables a company to hold shares in its subsidiary in the name or names of a nominee or nominees of the company so as to ensure that the number of members of the subsidiary is not reduced below seven, if it is a public company, and below two, if the subsidiary is a private company. Sub-section7 clarifies that securities includes stock and debentures.

10. The Indian subsidiary here, is a public company. That means that it has to have at least seven members, to be a legal entity in terms of Sec49(3) of the Companies Act. It is the case of the applicant that the other six members of the subsidiary are its nominees and they hold one share each. The definition of 'public company' in Sec3(iv) of the Act is not relevant in the present context.

11. In A.Ramaiya's Guide to the Companies Act (16th Edition Reprint 2006) at page 614 the following passage occurs: *"When the investment of a company consists of shares in another company the question arises whether shares held by the company in the name of its nominee must be deemed to be held by the company and whether the investments should be transferred to the name of the company. In considering this question, it is necessary to bear in mind the provisions of section 153 which provide that no notice of any trust, express, implied or constructive, shall*

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be entered in the register of members or debenture holders. A company, therefore, is bound to treat the person in whose name the shares are entered in its register of members as a member. If a company holds shares in the name of its nominee it is not entitled to any of the rights in respect of the shares such as right to dividend, to allotment of rights shares under section 81, to exercise voting rights in relation to the shares and other privileges which shareholders have. It does not, therefore, appear to be an implication of the provisions of section 49 that if a company holds shares in another company in the name of its nominee, the shares must be deemed to be held by the company and not by the nominee."

The position therefore appears to be that even if it is taken that the other six members of the subsidiary are the nominees of the applicant, it cannot be postulated that the applicant is holding 100% of the shares in the subsidiary.

12. Accepting an argument that the holding of the shares by the nominees should be treated as the holding of the shares by the applicant and the applicant must be treated to be holding 100% shares cannot be accepted in the face of the requirement under section 49(3) of the Companies Act and the illegality that would spring from its acceptance. The acceptance of the plea would mean that we have a public company in which the applicant holds 100% shares. Such a public company

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cannot be recognized in the eye of law in the face of Section 49(3) of the Companies Act.

13. In that case, the principle enunciated long ago in Holman V. Johnson, [(1775) 1.COWP 341] *Ex dolo malo non oritur actio,* 'no cause of action can be founded on an illegality', might also get attracted. The applicant cannot be heard to say that it owns 100% in a subsidiary in India on its own or that the members are holding shares benami for it and that enables it to the benefit of Section 47 (iv) of the Income-tax Act. This will be in the teeth of the requirements of Section 45(3) of the Companies Act. The Supreme Court in CIT v. Kurji Jinabhai Kotecha (1977) 107 ITR 101 has observed, "it is inconceivable that law can permit an illegal activity to be carried on from which a benefit could be obtained."

14. The applicant relies on Section 47(iv) of the Income-tax Act to contend that it is enough if the applicant and its nominees together hold 100% shares in the subsidiary for claiming the benefit of that provision. Section 77B of the Companies Act introduced along with Section 77A prohibits a buyback through any subsidiary company including its own subsidiary. The applicant wants the words "the parent company or its nominees" read as the parent company and its nominees. A transfer of a capital asset by a company to its subsidiary would not be hit by section 45 of the Act, if "the parent company or its nominees, hold the whole of the share capital of the subsidiary company" **[emphasis supplied]** and the

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holding company is an Indian company. Such a reading, it is urged, will alone make Section 47 (iv) of the Act workable. In the context of Section 49 (3) of the Companies Act, there cannot exist a subsidiary Indian company, whether public or private, in which the parent company could legally hold 100% of the shares.

15. Section 47(iv) postulates that a company must hold 100% shares in a subsidiary Indian company, either directly or through its nominees. If under Indian law, a parent company cannot hold 100% in a subsidiary, it would only mean that the Parliament did not intend to confer the benefit of Section 47(iv) of the Act on such a parent company. In its wisdom, it thought that the benefit must be confined to cases where a parent company holds 100% shares in an Indian subsidiary, through its nominees. It is true that such an approach may confine the relief to a particular species of parent companies. But that would not enable us to hold that the provision is unworkable or would become unworkable. In the context and in such situations, nothing is to be supplied and nothing is to be taken away from the section.

16. The Companies Act and the Income-tax Act recognize holding of shares by a nominee. But that does not mean that the nominee holds the shares benami for the company. That would offend the Benami Transactions (Prohibition) Act, 1988. It would also offend the spirit of Section 49 of the Act, and even its manadate. There is no case that the nominee is a trustee. Even otherwise such a claim may fail in the

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teeth of Section 153 of the Companies Act. The result achieved by adding up the shares held by the parent company and its nominees would bring about the same result. The company under the Companies Act, can look to and cater only to its shareholders. It cannot go in search of beneficiaries or alleged beneficiaries. We are satisfied that we would not be justified in reading the word 'or' in Section 47(iv) of the Act, as 'and'.

17. Section 45 of the Act makes any profits or gains arising from the transfer of a capital asset effected, chargeable to tax under the Act. Section 47 of the Act is an exemption provision. It exempts certain transfers from within the purview of section 45 of the Act. Being an exemption, it has to be strictly construed. If we accept the plea that the word 'or' must be read as 'and', we would be recognizing an entity that would be violative of Sec 49(3) of the Companies Act. Sec 49(3) insists that a public company if it wants to hold shares in its subsidiary which is a public company, that subsidiary should have 7 members and the numbers shall not be reduced. If we treat the other six members as not having independent existence, it would mean that the subsidiary would become an illegal entity in the face of Sec 49(3) of the Companies Act. That would mean that the applicant would be founding its cause of action on an illegality.

18. Section 46A of the Act is plain and clear. It provides that if a shareholder receives any consideration from any company for purchase

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of its own shares, then subject to Section 48 of the Act, the difference between the cost of acquisition and the value of consideration received by the shareholder shall be deemed to be the capital gains arising to such shareholder. Thus, in the case of a company buying back its shares, a fiction or yardstick for computing the capital gains has been enacted. Section 45 of the Act similarly says, in cases of transfer of capital assets, the profits arising therefrom would be the capital gains arising out of that transaction. Section 45 is a general provision dealing with transfer of all capital assets. Section 46A in that context can be understood only as a special provision dealing with purchase of its own shares by a company. This being a special provision dealing with such buybacks, it has to prevail over the general provision incorporated in section 45 of the Act.

19. It is argued based on the principle stated in CIT v. Gotla [(1985) 156 ITR 323] that 'where a plain literal interpretation of a statutory provision produces a manifestly unjust result which would never have been intended by the legislature, the court might modify the language used by the Legislative so as to achieve the intention of the Legislature and produce a 'rational construction'. The Ruling in Hoechist GmbH, In re [(2007) 289 ITR 312] is also relied on. When the same legislature has also introduced Section 46A of the Act to cover a particular situation brought about by the amendment to the Companies Act, how can the application of that provision said to lead to an unjust result? When an

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exception is provided by Section 77A of the Companies Act from the prohibition otherwise contained in Section 77 of that Act, the legislature hemmed in that exemption with an obligation to pay the tax on that transaction. Unless it is argued that impressing a tax itself is unjust, an argument that the taxing of the transaction would lead to an unjust result can only be rejected.

20. It was argued that Section 45 of the Act alone was the charging section and section 46A cannot be resorted to, to tax the capital gains arising out of such transaction. Sec 47 of the Income-tax Act contains a non-obstante clause as it were only in respect of Sec 45 of the Act. It says "nothing contained in Sec 45 shall apply to the following transfers" That means two things. One, it does not override Sec46A and two, by virtue of Sec 47, a transfer is not deemed to be not a transfer. It is only an exempted transfer. Therefore in the context of Sec 77A of The Companies Act, it is a permissible transfer attracting Sec 46A of the Income-tax Act. It may be noted that Sec 77A was introduced with effect from 31-10-1998 and Sec 46A was inserted with effect from 1-4-2000. Specific securities used in the section is explained as having the meaning assigned to it in Sec 77A of the Companies Act It is therefore clear that Sec 46A was introduced in the context of permitting such transfers in the teeth of Sec 77 of the Companies Act. The words of Sec46A are plain and clear. It is only subjected to Sec 48 of the Act. It has application when the event referred to therein occurs. It says that the

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difference between the cost of acquisition and the value of consideration received shall be deemed to be the capital gains arising to the seller. There appears to be no reason to go into an enquiry as to whether it is a charging section or not and whether we can only understand Sec 45 as the charging section. The section says what the capital gains is, arising out of such a transaction and mandates resort to Sec 48. Sec 48 only deals with the mode of computation and Sec 46A having determined the capital gains, the tax needs alone to be computed as provided for therein.

21. The applicant has relied on the speech of the Finance Minister, while introducing Section 46 A of the Act. The Hon'ble Finance Minister stated:

> *"Very recently, the Companies Act, 1956 has been amended to permit transactions relating to buy-back of shares. There is some ambiguity in the interpretation of the law as to whether such transactions would be treated as subject to dividend tax in addition to capital gains tax. In view of this, I propose to amend the law to put it beyond doubt that on buy-back of shares, the shareholders will not be subject to dividend tax, and would only be liable to capital gains tax."*

According to us, this speech, if at all, makes it clear that the gain from such a transaction is taxable as capital gain and not as dividend. Section 46A obviously provided the means of determining the capital gains arising from such a transaction. Similarly, Circular No. 779 issued by the Board also does not help the applicant. Paragraph 28.3 only states:

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"28.3. The Act, therefore, has amended clause (22) of section 2 of the Income-tax Act by inserting a new clause to provide that dividend does not include any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act, 1956. It has also inserted a new section, namely, section 46A in the Income-tax Act, to provide that any consideration received by a share holder or a holder of other specified securities from any company on purchase of its own shares or other specified securities shall be, subject to provisions contained in section 48, deemed to be the capital gains."

It says that the gain would be 'deemed to be the capital gains'. That is obviously, by virtue of Section 46 A of the Act.

22. Even if we accept the plea of the applicant to read 'or' as 'and' in Section 47(iv) of the Act, it is of no avail to the applicant in our view that Section 46A of the Act would be applicable in the case of a buyback of shares and Section 46A is not subjected to Section 47 which at best only overrides Section 45.

23. We are, therefore, of the view, that in the case of a buyback of shares, section 46A of the Act will be attracted and resort to Section 45 is not warranted.

24. Once we have found that section 46A of the Act is attracted when there is a buyback of shares as in this case, obviously the gains have to be taxed in terms of that provision read with Section 48 of the Act. Hence, the answer to question no. 1 formulated for our Ruling has to be that the proposed buyback of shares would not be exempt in view of Section 47(iv) of the Act.

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25. Question no. 2 is whether the applicant would be liable to be taxed under section 115JB of the Act in the absence of a Permanent Establishment in India or in the absence of a business connection in India. The applicant argues that Section 115JB would apply only to domestic companies and not foreign companies. The relevant notes on clauses to Finance Bill, 2000 is relied on in support. Earlier Rulings of this Authority in that behalf are also relied on. The Revenue has not joined issue on this, merely stating that the question has to be decided on merits.

26. On a reading of Section 115JB coupled with the definition of company in the Act, it may not be difficult to say that Section 115JB will be applicable to a company incorporated outside India. Sub-section (2) also may not stand in the way since it seeks preparation of accounts in accordance with the provisions of Parts II and III of schedule VI to the Companies Act "for the purpose of this section". It may not depend on an obligation otherwise to prepare such an account.

27. But, we are not pursuing this aspect further since the aspect was not pursued and the parties proceeded as if the provision may have no application. Hence, accepting the plea of the applicant, we rule that section115JB has no application in this case.

28. Since we have held that the income is chargeable to tax in terms of Section 46A of the Act read with section 48 of the Act, we rule on

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question no. 3 that the applicant is not entitled to receive the amount on buy-back of shares without any deduction of tax at source.

29. Accordingly, the ruling is pronounced on this, the 27th day of February, 2012.

(V.K. Shridhar)
Member

(P.K. Balasubramanyan)
Chairman

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