

Tax Hotline

January 19, 2017

INDIA'S TAX REGULATOR ISSUES PRESS RELEASE, KEEPS IN ABEYANCE CLARIFICATIONS ON INDIRECT TRANSFER

- CBDT had recently, in December 2016, released a circular containing clarifications on questions raised by stakeholders on various issues relating to indirect transfer provisions, particularly in the context of offshore funds and FPIs.
- Within less than a month of issuance of the clarifications, CBDT has issued a press release stating that pending further decision, the circular is being kept in abeyance.
- Decision taken to consider stakeholders' concerns of multiple taxation of the same income.

Recently, on December 21, 2016, the Central Board of Direct Taxes ("CBDT") released a circular¹ ("Circular") containing responses to questions raised by various stakeholders (including foreign portfolio investors ("FPIs"), foreign institutional investors ("FIIs") and venture capital funds ("VCFs") etc.) in the context of the applicability of the indirect transfer provisions under the Indian Income Tax Act, 1961 ("ITA"). Pursuant to the issuance of the Circular, the CBDT received representations from such stakeholders regarding the operation of the Circular, especially as to how it does not address the issue of possible multiple taxation of the same income. Since the CBDT is considering and examining the representations made, it has, on January 17, 2017, issued a press release² ("Press Release") declaring its decision to keep in abeyance the operation of the Circular "for the time being".

BACKGROUND

On June 15, 2016, the CBDT had constituted a working group to examine the issues raised by stakeholders with respect to the indirect transfer provisions added in the Indian tax rules in 2012. After considering the comments of the working group, the CBDT, through the Circular, issued clarifications on the concerns raised in the format of answers to frequently asked questions ("FAQs").

While you can find a detailed analysis of the Circular [here](#), in brief, the Circular contained responses to queries on the indirect transfer provisions in a number of different contexts such as redemptions by offshore funds registered as FPIs, master-feeder structures, corporate reorganisations etc. While the expectation was that the Circular would examine the practical problems being faced by stakeholders and propose rectifications to the indirect transfer provisions or, at least, relax the rigours arising from a mechanical application of the existing provisions, the Circular instead confined itself to an excessively literal interpretation and provided little guidance to stakeholders.

Upon tracing the history of the indirect transfer provisions in India, it can be surmised that the genesis lay in seeking to tax income on transfer of assets deriving substantial value from Indian assets although the Indian assets may not themselves have been transferred (and therefore no capital gains tax could be imposed on such transfers). However, unfortunately, the language of the indirect transfer provisions is such that even if tax has been paid in India on gains arising from a transfer, upstreaming of such gains can again be potentially made liable to taxation. The Circular, by sticking to a literal interpretation, re-emphasised this possibility of multiple levels of taxation on the same income, while at the same time overlooking the potentially increased risk of litigation and related tax uncertainty.

THE PRESS RELEASE

Through the Press Release, the CBDT has communicated that it has received representations from various stakeholders, including FPIs, FIIs and VCFs after the issuance of the Circular. Further, the Press Release states that the stakeholders have represented that the Circular does not address the issue of possible multiple taxation of the same income. The representations made are currently under examination and consideration. Therefore, pending a decision in the matter, the Press Release clarifies that the operation of the Circular has been kept in abeyance for the time being.

CONCLUSION

The announcement by the CBDT through the Press Release is a welcome step. It is heartening to see that cognizance has been taken of the issues raised by the stakeholders. There appears to be a tacit acceptance that the Circular did not provide guidance to the extent that it intended to.

The Press Release states that the Circular has been kept in abeyance "pending a decision in the matter". Hence, it can be expected that a definitive step will be taken towards resolution of the issues raised in the Circular. It is possible that such resolution may also be in the form of amendments to the ITA through the Budget, with the Budget speech scheduled to be delivered soon on February 1, 2017. Accordingly, the CBDT might modify the Circular and operationalise it with a suitably amended scope and application.

While the Press Release only refers to the issue of possible multiple taxation of the same income, which is the most

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important issue brought to light by the CBDT's clarifications, it is hoped that a comprehensive relook on indirect transfer provisions will be taken. Accordingly, even other issues, such as (i) anomalies arising out of valuation as of a prescribed 'specified date' (which might be different from the date of transfer); (ii) extension of exemptions upon corporate reorganisations all the way up to the ultimate shareholders; and (iii) excessive compliance burden imposed by reporting obligations under the Income Tax Rules, 1962, should also be addressed.

The industry keenly awaits the next steps to be taken by the Government in approaching the issues raised by the indirect transfer provisions. Positive moves by the Government in this regard, especially through the Budget, will go a long way in reinforcing its seriousness in promoting the 'ease of doing business' and in marketing India as an investment destination. That being said, as with most things tax, here as well, the devil will most surely lie in the details.

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You can direct your queries or comments to the authors

¹ Circular No.41 of 2016

² Press release dated January 17, 2017 titled "Clarification on Indirect Transfer provision under the Income Tax Act, 1961" issued by the CBDT.

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