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New Protocol to Singapore-India Tax Treaty

Taxation of capital gains

On 30 December 2016, Singapore and India signed a Protocol ("2016 Protocol") to amend their bilateral Avoidance of Double Taxation Agreement ("DTA") in New Delhi.

Prior to this, the DTA between Singapore and India provides for residence based taxation on gains arising from alienation of shares. In other words, gains derived by a resident of Singapore from alienation of shares in an Indian company will only be taxable in Singapore. India, therefore had no right to impose any tax on the gains derived though the asset in question were shares in an Indian company. Simultaneously, with no capital gains tax in Singapore, the alienator virtually received tax-free income if certain prescribed conditions are satisfied.

However, the subject position now stands amended through a third protocol to the DTA which introduced a source based taxation on gains arising from alienation of shares. Under this protocol, the erstwhile capital gains tax exemption (on gains from the alienation of shares in an Indian company) will only be available to shares acquired before 1 April 2017. The gains from alienation of shares acquired on or after 1 April 2017 will now be taxable in India under the source based taxation regime.

Further, a transitory provision is provided for gains arising during a window period of 1 April 2017 to 31 March 2019 for shares acquired on or after 1 April 2017. Such gains arising during the transitory period will be subjected to tax at 50% of the domestic tax rates as applicable in India. Hence, capital gains on shares acquired after 1 April 2017 but sold by or before 31 March 2019 can avail of these transition rules, subject to a Limitation of Benefits ("LoB") Article, which seeks to avoid misuse of the DTA by shell companies.

The following cumulative tests are provided in the LoB clause for a taxpayer to be eligible to claim the transitory period benefits:

- *Primary purpose test:* Transitory period benefit not available where the affairs of the taxpayer are arranged with the primary purpose of taking advantage of the Protocol without bona fide business activities;
- *Activity test:* Transitory period benefit will not be available to a shell or conduit company. A company would not be considered as a shell or conduit company if it is listed on recognised stock exchange or expenditure on operations is equal to or more than SGD 200,000 in Singapore or INR 5,000,000 in India for each of the 12 month periods in the immediately preceding period of 24 months from the date on which the capital gains arise. However, in respect of investments acquired after 1 April, 2017 and sold before 31 March, 2019, the expenditure test needs to be met for the 12 month period immediately preceding the date of transfer.

Other amendments

- **Transfer Pricing:** The 2016 Protocol has introduced Article 9(2) in the DTA which includes provisions to facilitate relieving of economic double taxation (taxation of two different persons with respect to the same income) in transfer pricing cases. Availability of corresponding tax adjustments would ensure that the same income is not doubly taxed due to transfer pricing disputes. This amendment will facilitate the resolution of transfer pricing disputes in transactions between India and Singapore through the Mutual Agreement Procedure ("MAP") or Bilateral Advance Pricing Agreement ("APA") route, and is in line with the OECD's recommendations under its Base Erosion and Profit Shifting ("BEPS") project.

- **Anti-avoidance measures:** The 2016 Protocol has introduced a new article which provides that the DTA shall not prevent either of the countries from applying its domestic laws and measures concerning the prevention of tax avoidance or tax evasion.

Key takeaways

Singapore was the largest foreign direct investor into India for the period April 2015 – March 2016 and one of the largest portfolio investors in India markets. The capital gains tax exemption regime must have been one of the contributing factors. The impact of the change on Singapore and India's economy would be closely watched. It is with much anticipation that some new initiatives on joint promotion of bilateral investments will be available soon. For now, businesses will have to revisit their existing investment structures in India and ensure that the taxes and the underlying currency fluctuations do not wipe out the expected gains.

Kindly contact us to understand further on how we can support you in riding this new wave of change.

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