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Indirect Transfer provisions not triggered when value from Indian assets is only around 5 % of the total assets (AAR)

The AAR, in an application filed by GEA Refrigeration Technologies GmbH (Applicant) ruled that the indirect transfer provisions did not apply to the Applicant's acquisition of shares of a German company with an Indian subsidiary, as the value of the Indian subsidiary was only around 5% of the value of the total assets. The AAR also ruled that gains arising on the transaction would in any event not be taxable in India under the India-Germany Tax Treaty.

Background

The Applicant was a German company. In 2011, it acquired shares in Bock Kaltemaschinen GmbH (Bock GmbH), another German Company, from its shareholders who were also tax residents of Germany. Bock GmbH had a subsidiary in India, as well as in several other countries.

A ruling from the AAR was sought in respect of the taxability of this transaction in India under the Income-tax Act, 1961 ('the Act') and the India-Germany tax treaty.

Ruling

The Applicants obtained a valuation report showing that the value of the Indian subsidiary as on 31 December 2010 was INR 136.7 million. This constituted only 5.4% of the fair market value of the assets of the foreign company (which was determined to be INR 2533 million based on the price paid by the Applicant for acquiring Bock GmbH).

The AAR ruled that since the value of the assets located in India was less than the requirement of 50% set out in Explanation 6 to section 9(1)(i) of the Act, the gains on the transfer of shares of Bock GmbH could not be brought to tax in India.

The AAR also ruled that the gains arising to the transferors would not be taxable in India under Article 13(5) of the India-Germany tax treaty, under which only Germany had the right to tax such gains.

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Since the transferors were not liable to tax in India in respect of this transaction, the AAR relied on the Supreme Court's decision in *GE India Technology Centre Private Ltd.* v. *CIT* [2010] 327 ITR 456 (SC) and ruled that the Applicant was not required to withhold any taxes under section 195 of the Act.

Dhruva Comments

Considering the very low value attributable to assets located in India in this case, the outcome was on expected lines. However, there are a few important takeaways from this ruling:

a) The AAR observed that its ruling was based on the valuations presented before it. It also noted that if the valuations were subsequently found to be different, the Revenue would not be bound by this Ruling. This observation is also in line with the Clause (ii) of the proviso to section 245R(2) under which the AAR cannot allow applications where the question involves determination of the fair market value of any property.

   Valuation (which is undoubtedly a factual matter) is central to determining the taxability of indirect transfers in India. Hence, the efficacy of the AAR route in such cases may be debatable.

b) Although the transaction in question took place in 2011 (even before the retrospective amendments to tax indirect transfers were introduced), the AAR:

   (i) Applied the 50% threshold and the concept of 'specified date' set out in Explanation 6 (both of which were introduced by the Finance Act, 2015)

   (ii) Treated the transaction value as the '*fair market value of the assets of the foreign company*' in terms of Rule 11UB(6)(i) (which was notified in June 2016)

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