Double taxation avoidance agreement between India and Singapore renegotiated

January 2, 2017

In brief

The Government of India (GoI) and the Government of Singapore (GoS), on 30 December, 2016, signed a Protocol (2016 Protocol) amending the Double Taxation Avoidance Agreement (tax treaty) between India and Singapore (India-Singapore tax treaty). The key features of the 2016 Protocol are:

- Introducing source based taxation for capital gains arising on the transfer of shares acquired on or after 1 April, 2017;
- Introducing the mechanism of corresponding tax adjustments in order to prevent economic double taxation; and
- Enabling the application of domestic laws to curb tax avoidance or tax evasion.

The 2016 Protocol will come into force latest by 1 April, 2017, even if there is a procedural delay by either of the countries to bring the Protocol into force as per their respective domestic laws.

In detail

Taxation of capital gains

In 2005, Singapore and India had signed the Comprehensive Economic Cooperation Agreement (CECA). Pursuant to CECA, *vide* the 2005 Protocol, capital gains tax exemption was introduced in the India-Singapore tax treaty, subject to fulfilment of the conditions specified in the Limitation of Benefits (LOB) Article.

However, a sunset clause provided that the capital gains tax exemption would continue till the time the capital gains tax exemption in respect of shares of an Indian resident company survived under the tax treaty between India and Mauritius (India-Mauritius tax treaty).

The amendment of the India-Mauritius tax treaty *vide* a Protocol signed in May, 2016 providing for source based taxation of capital gains on shares, kick-started the renegotiation of the India-Singapore tax treaty. Marking a culmination of their recent negotiations, the GoI and the GoS on 30 December, 2016, signed the 2016 Protocol amending the India-Singapore tax treaty. The GoI has issued a press release dated December 30, 2016 (Press Release) providing a gist of the key amendments. The GoS in addition to a press release has also released the 2016 Protocol on the IRAS Singapore website, *albeit* the procedures to bring it into force are pending.

The following are the provisions of the 2016 Protocol from the perspective of taxability in India of the income of a resident of Singapore:

- Gains from transfer of shares acquired before 1 April, 2017 in a company which is a tax resident of India, shall be taxable only in Singapore. In other words, investments in shares prior to 1 April, 2017 have been grandfathered, subject to fulfilment of the LOB clause. Thus, it is a *status quo* so for as this category of investments is concerned.
- India will have the right to

tax capital gains arising from the sale of shares in an Indian company, if such shares have been acquired on or after 1 April, 2017.

- There is a lower tax rate applicable to shares acquired on or after 1 April, 2017, if such shares are sold before 1 April, 2019. In such cases, subject to fulfilment of the LOB clause, the gains would be taxable in India as per the Indian tax laws, but the rate of tax will be equal to 50% of the applicable tax rate for such capital gains.
- The LOB conditions provided in the 2016 Protocol are similar to the conditions prescribed in the 2005 Protocol. To be specific, in respect of capital gains arising from transfer of shares acquired prior to 1 April, 2017, the LOB conditions are same as in the 2005 Protocol. 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 twelve month period immediately preceding the date of transfer.
- Gains arising to a resident of Singapore from alienation of any other property (including other securities, by way of illustration - compulsorily convertible debentures, non-convertible debentures) continue to be taxable only in Singapore.

Transfer pricing

The 2016 Protocol inserts provisions to facilitate relieving of economic double taxation in transfer pricing cases. In Article 9 of the tax treaty on 'Associated Enterprises', an additional paragraph has been inserted [i.e., Article 9(2)]. The introduction of Article 9(2) *vide* the 2016 Protocol will allow taxpayers to claim corresponding tax adjustments in case of transfer pricing disputes arising from cross-border transactions between India and Singapore.

Simply put, in case of a dispute relating to a cross border transaction, where the income of a taxpayer is re-determined on account of a transfer pricing adjustment, then Article 9(2) enables the enhanced income to be taxed in one country, with the other country providing tax relief (i.e., a corresponding tax adjustment) to the extent of the enhancement. This is to ensure that the same income is not doubly taxed.

The prevention of such economic double taxation will typically require the Competent Authorities of both countries to engage in respect of transfer pricing disputes.

Anti-avoidance measure

The 2016 Protocol introduces a new article which explicitly provides that the India-Singapore tax treaty shall not prevent either of the countries from applying its domestic laws and measures concerning the prevention of tax avoidance or tax evasion.

The takeaways

Taxation of capital gains

The GoI has continued to deliver on its stated intent of moving to source based taxation in respect of capital gains.

Continuing the policy of adopting a pragmatic approach and allaying the fears of foreign investors, the India-Singapore tax treaty provides for grandfathering of investments made upto 1 April, 2017. Further, like the India-Mauritius tax treaty, transitionary provisions that accord concessional tax rate from 1 April, 2017 to 31 March, 2019 have been provided in the 2016 Protocol.

It is pertinent to note that while gains from transfer of other securities were taxable only in Singapore even under the erstwhile provisions of the India-Singapore tax treaty, such exemption was subject to fulfilment of the conditions provided in the LOB clause. As per the 2016 Protocol, the fulfilment of such LOB conditions may no longer be required.

Transfer pricing

The introduction of the much awaited Article 9(2) in the India-Singapore tax treaty is undoubtedly a significant step towards the stated objective of the GoI towards making dispute resolution mechanisms more effective. This taxpayer-friendly measure is in line with India's commitment to implement the minimum standards agreed under OECD's Base Erosion and Profit Shifting (BEPS) Project. BEPS Action Plan 14 is one of the minimum standards agreed to be implemented, the objectives of which are essentially to ensure:
(i) improvement of access to Mutual Agreement Procedure (MAP);
(ii) implementation of MAP in good faith; and
(iii) that MAP cases are resolved in a timely manner.

Given that many multinational groups which operate in India have transactions with Singaporean entities, the introduction of Article 9(2) *vide* the 2016 Protocol has opened the window for taxpayers to settle transfer pricing related disputes/ issues by either moving an application for a MAP, or by applying for a Bilateral Advance Pricing Agreement (APA).

Anti-avoidance measure

Given the introduction of the new anti-avoidance provision, an important question that merits attention is whether the General Anti-Avoidance Rules (GAAR), which will be effective from 1 April, 2017, under the Indian domestic tax laws, could override the LOB clauses provided in the India-Singapore tax treaty.

The tax rate on interest income in the India-Singapore tax treaty continues to be 15%, unlike the lower tax rate of 7.5% provided in the India-Mauritius tax treaty. Having said that, these beneficial tax rates would be subject to GAAR.

Promotion of bilateral investments

As per the media release issued by the GoS, both the countries have agreed to conclude an agreement in the second half of 2017 laying down new joint, initiatives to be undertaken for promotion of bilateral investments.

This is a welcome development, and may give an impetus to future cross border investments.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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