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Singapore and India signed third protocol – amendments to the Double Taxation Agreement (DTT) between Singapore India

Following the changes in DTTs between India and Mauritius/Cyprus a third protocol for amendment of the India-Singapore DTT dated 1994 was signed on 30 December 2016. However, even if it is not yet ratified there is no doubt that it will come into force not later than 1 April 2017.

Firstly, as expected the amendments provide for source-based taxation of capital gains arising from alienation of shares. Secondly, the amendments do already reflect Singapore's and India's commitment to consider the BEPS minimum standards.

Changes in the taxability of capital gains arising from the alienation of shares

The key amendments of Article 13 in relation to the capital gain taxation are

- change of taxability of capital gains from the alienation of shares in a company resident in India acquired after 31 March 2017 as the capital gains will be taxable in India.

- The insertion of a grandfathering clause applicable for investments made before 1 April 2017, accordingly capital gains arising from alienation of grandfathered shares in an Indian resident company will remain to be taxable in Singapore.

- A two year transition period between 1 April 2017 and 31 March 2019 in which capital gains from the alienation of shares in an Indian resident company are indeed taxable in India, however a concessionary tax rate of 50% of Indian tax rate will apply.

In order to be eligible for the tax exemption in Singapore and the concessionary tax rate, the investor has to satisfy the conditions of the new two tiered limitation of benefit ("LOB") clause as stated in article 24A of the third protocol.

Thus, a Singapore based company will not be entitled to the benefits if

- The primary purpose of the establishment of the Singapore based entity has been to take advantage of the benefits (tax exemption and concessionary tax rate) (motive test) or

- The Singapore tax resident company claiming the benefits is a conduit or shell company conducting nil or negligible business operations or no real and continuous business activities in Singapore.

A deeming provision (expenditure test) has been introduced determining a company as a conduit or shell company if it does spend less than 200,000 SGD in Singapore or 5,000,000 Rs. in India annually. Furthermore, considering the condition of carrying out continuous business activities in Singapore the expenditures test has to be satisfied for a preceding period of 24 months following the date on which the capital gain arises (for a preceding period of 12 months respectively if shares will be sold within the two year transition period).

Scope of amended provisions

Interestingly, the amendments only refer to capital gains arising from the sales of “shares” of an Indian company.

Therefore, one may argue that the change of taxability does not apply to

- non-equity investments such as bonds, debentures, derivative instruments and
- capital gains from the transfers of indirect shares in Indian companies.

It has to be seen whether further clarification statements do follow in that respect.

What have investors to consider?

Due to the new two-tier LOB clause a thorough review and analysis of the current investment structure is advisable in particular if it is intended to sell grandfathered shares in the near future. Also the newly inserted General Anti Avoidance Rule (GAAR – see below) in Article 28A emphasises the increasing importance of having economic substance in Singapore or India respectively.

For future investments into Indian based companies new investment strategies should be developed by considering the limited scope of the new provisions. However, it remains to be seen whether further amendments or clarifications will follow.

Miscellaneous

- Insertion of a second paragraph to Article 9 (Associated entities) providing for correlative adjustments in a Contracting State after Transfer Pricing income adjustments in the other Contracting States which have been taxed in the other Contracting State.

The new provision does open the way to apply for a Mutual Agreement Procedure (MAP) in either Singapore or India in order to eliminate economic double taxation arising from on-sided transfer pricing adjustments.

- Implementation of a General Anti Avoidance Rule (GAAR, new Article 28A) according to which the agreements of the DTT shall not prevent the Singaporean or Indian Tax Authorities from applying its domestic law concerning the prevention of tax avoidance or tax evasion. Investors should consider domestic GAAR which might apply in relation to further tax benefits according to the DTT (such as reduced WHT rates).

- Although the treaties between India and Mauritius and Cyprus provide a WHT rate on interest of 7.5 % and 10% respectively, the WHT in the India Singapore DTT remains at 15 % (10 % for banks and other financial institutions).

For further guidance, information and assistance please feel free to contact us anytime.

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