

ITAT Delhi allows 'Indirect Transfer' Exemption under India-Ireland DTAA

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Introduction

In *Fireeye Ireland Ltd v ACIT*, the Delhi Bench of the Income Tax Appellate Tribunal (ITAT) allowed the benefit of the capital gains tax exemption to an Irish tax resident on sale of shares of a US LLC deriving substantial value from India, a transaction commonly referred to as an '*indirect transfer*'. While allowing such exemption, the ITAT relied on Article 13(6) of the India-Ireland Double Taxation Avoidance Agreement (DTAA) which provides that income arising from the alienation of assets is taxable only in the state of which the seller is a resident. Further, the ITAT distinguished between the terms 'alienation' used under the DTAA, and 'transfer' defined in section 2 (47) of the Income Tax Act, 1961 (the IT Act) and held that the provisions of domestic law cannot be read into the DTAA.

This Ergo analyses the key aspects of this ruling and its implications.

Factual Background

- Fireeye Ireland Limited (Appellant) is a company incorporated in, and a tax resident of, Ireland, engaged in the business of providing software and cybersecurity solutions. At the relevant times, it employed over 150 employees and held a valid Tax Residency Certificate (TRC) issued by the Irish tax authorities.
- The Appellant also held an ownership interest in a US based limited liability company (US LLC) which, in turn, derived substantial value from an Indian subsidiary.
- Pursuant to an intra-group restructuring in 2021, the Appellant transferred its entire shareholding in the US LLC to another Irish group entity (Transaction). Such restructuring was tax-neutral in Ireland, and accordingly, no taxes were paid on the Transaction in Ireland.
- The Appellant disclosed the capital gains arising from the Transaction in its Indian income tax return for Assessment Year 2022-23 and claimed an exemption under Article 13(6) of the DTAA.

Revenue's Contentions

- The Assessing Officer (AO), pursuant to the directions of the Dispute Resolution Panel (DRP), held that the capital gains arising from the Transaction (*indirect transfer*) were taxable in India under Article 13(5) of the DTAA, which grants the 'source' state the right to tax capital gains arising from the 'alienation' of shares of a company that is a 'resident' of such source state.
- The AO further observed that the legislative intent underlying Section 90 of the IT Act is to avoid double taxation, and not to create opportunities for double non-taxation. These observations were seemingly made in light of the tax neutrality of such a reorganisation in Ireland.
- Notably, while Article 13(5) of the DTAA uses the term 'alienation', the term 'alienation' is not defined under the DTAA. Further, the IT Act defines the term 'transfer' in an 'inclusive' manner covering *indirect transfers* as well. The Revenue authorities sought to rely on the definition of 'transfer' under Section 2(47) of the IT Act to equate it with the term 'alienation' used under the India-Ireland DTAA.

Aggrieved by such final assessment order, the Appellant filed an appeal before the ITAT Delhi.

ITAT's Decision

The ITAT ruled in favour of the Appellant and held that capital gains arising from the sale of the shares of the US LLC were not taxable in India under Article 13(6) of the India-Ireland DTAA. The key aspects of the ruling are as follows:

- **Interpretation of 'alienation':** The ITAT held that the term 'alienation' used in the DTAA must be interpreted in accordance with its ordinary meaning, and the more expansive definition of 'transfer' under domestic law cannot be imported into the definition of 'alienation' under the DTAA.
- **Inapplicability of Article 13(5):** Article 13(5) of the DTAA grants India the right to tax capital gains only when shares of a company resident in India are alienated and not otherwise. Since the US LLC is neither incorporated in, nor a tax resident of, India, the ITAT held that Revenue's reliance on Article 13(5) was misplaced.
- **Limited 'look-through' or 'see-through' under Article 13(4):** The ITAT duly noted that under Article 13(4), gains from the alienation of shares of a foreign company which consist, directly or indirectly, principally of immovable property in India may be taxed in India. Accordingly, the DTAA already envisions a limited form of source state taxing rights for certain indirect transfers. By implication, indirect transfers ought not to be taxable in India where the value is not principally derived from immovable property in India.
- **Treaty override:** On the methods of interpretation, the ITAT affirmed the long-standing principle that provisions of domestic law—including the deeming fiction under Section 9 of the IT Act—cannot be imputed into the DTAA without a specific amendment.
- **No treaty abuse established:** On the facts, the ITAT noted that the Appellant was an operating company with substantial business operations, in existence since 2013, and that the internal restructuring of the group involved the transfer of 17 different entities including the US LLC. On this basis, the ITAT held that no case of treaty abuse had been alleged by the Revenue.

Comments

The position on taxability of capital gains arising from an indirect transfer under a tax treaty was well-established pursuant to the Andhra Pradesh High Court's view in *Sanofi Pasteur Holding SA v ACIT*, (2013) 345 ITR 316 (AP) where the High Court examined the tax implications arising from an indirect transfer under the India-France DTAA and held that capital gains were taxable under the India-France tax treaty if the capital gains arose from the transfer of shares of a company resident in India.

However, the ITAT Delhi's view is significant as it is the first ruling from an ITAT on the tax implications arising from an indirect transfer after the Supreme Court's observations in January this year on the taxability of an indirect transfer by a Mauritius Investment Fund ([See our Ergo Update on Tiger Global](#)). Notably, the ITAT's ruling does not engage with the Supreme Court ruling and neither the Revenue has referred or placed any reliance on the SC ruling in *Tiger Global*. It remains to be seen whether Tax authorities will seek to challenge this judgment before Delhi HC by way of an appeal and whether the Supreme Court's observations in *Tiger Global* will be clarified or distinguished by the judiciary in subsequent proceedings, if appealed.

The tax authorities also sought to rely on Article 6 of the Multilateral Instrument to argue that the objective of a DTAA is to avoid double non-taxation. Regardless, the ITAT noted that the impugned restructuring was a bona fide transaction carried out by an Irish operating company with adequate substance in Ireland. It remains to be seen how arguments concerning 'substance' and 'commercial rationale' evolve, particularly in tax disputes involving non-operational entities such as global investment funds as was the experience with *Tiger Global*.

This ruling reinforces India's commitment to honoring tax treaty relief for genuine international taxpayers and sets a precedent for future treaty disputes, which bodes well for investor confidence in the Indian market, and in particular for global deals with underlying India leg transfers.

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