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Update on India's Tax Treaty With Singapore

Following the amendments and revisions to India's double tax avoidance agreements with Mauritius and Cyprus, India and Singapore have, on December 30, 2016, entered into a protocol ("Protocol") amending the existing double taxation avoidance agreement ("Existing Treaty") between the two contracting states. While the Protocol is yet to be notified, the Ministry of Finance of the government of India issued a press release to this effect on December 30, 2016. The complete text of the Protocol has been made available on the Singapore Inland Revenue Authority's website.

Below is a brief analysis of the key amendments introduced by the Protocol and the anticipated impact on existing and future investments between entities incorporated in India and Singapore.

Key Amendments	Existing Treaty	Protocol
Capital gains	Capital gains arising from sale of shares/other capital assets situated in India are liable to be taxed according to the residence of the seller, i.e., under the laws of Singapore, subject to compliance with the Limitation of Benefit clause (LOB). Such capital gains are not taxable in India and are exempt from capital gains tax in Singapore.	Authority to tax shifted onto the jurisdiction of the source of capital gains. Accordingly, capital gains arising from alienation of shares of an Indian entity will be taxable in India. These changes with be implemented in a phased manner with certain benefits, subject to the revised LOB clause, as set out below.

Grandfathering Provisions and Transition Period

Shares in Indian companies acquired on or after April, 1 2017 – Disposal of such shares will now be subject to tax in India. This change shifts the residence-based incidence for capital gains under the Existing Treaty to source-based incidence of capital gains tax.

Shares in Indian companies acquired before April 1, 2017 – Such shares will continue to benefit from the current capital gains exemption under the Existing Treaty. However, to avail this exemption, the transaction will have to be compliant with the revised LOB clause (as amended by the Protocol and described below).

Shares acquired on or after April 1, 2017 but disposed of before March 31, 2019 ("Transition Period") – Limited transitional provisions will be applicable. Disposal of such shares will be subject to a reduced tax of 50% of the domestic rate in India. This benefit will also be subject to the revised LOB clause.

Key Amendments	Existing Treaty	Protocol
Limitation of Benefits clause	The LOB clause currently states that the capital gains exemptions will not be available if the affairs of the Singapore resident entity are arranged with the primary purpose to take advantage of such benefit. Similarly, shell or conduit companies, being legal entities with negligible or nil business operations or with no real and continuous business activities, will not be able to avail the benefits either. An entity is not deemed to be a shell or conduit company if: • Its annual expenditure in Singapore is more than SGD 200,000 in Singapore during each of the two 12 month blocks in the immediately preceding period of 24 months from the date on which the capital gain arises • It is listed on a recognized stock exchange of the country	With respect to availing the benefit during the Transition Period, the LOB clause will apply with one modification: • The entity's annual expenditure in Singapore must be more than SGD 200,000 in Singapore only in the immediately preceding period of 12 months from the date on which the capital gain arises

Key Amendments	Existing Treaty	Protocol
Express applicability of domestic law measures	The Existing Treaty does not expressly provide for the application of domestic measures for prevention of tax avoidance or tax evasion.	Newly inserted Article 28A states that "[t]his Agreement shall not prevent a Contracting State from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion." This specifically provides that a contracting state will not be prevented from applying its domestic laws to address concerns of tax avoidance or tax evasion.

Impact on Foreign Investment in India

The Protocol does not affect the rate of tax applicable on interest income, which under the Existing Treaty may be as high as 15%. It is interesting to note that the tax treaty between India and Mauritius (as amended) provides for a capped withholding tax rate of 7.5% on interest payments.

Under the Protocol, only capital gains arising from an alienation of shares will be subject to source-based taxation. The Protocol (as published as on the date of this update) does not impact capital gains arising from a disposal of debentures, partnership interests and other capital assets, including indirect transfers of Indian company shares effected by a two-tiered Singapore structure.

The express provision on applicability of domestic law and measures concerning the prevention of tax avoidance or tax evasion allows for the implementation of stringent domestic tax measures, such as the general anti-avoidance rules (GAAR) provisions set to be rolled out. Accordingly, while investments made through hybrid instruments including compulsory convertible debentures would continue to be exempt from tax in India, such transactions may be otherwise affected by GAAR provisions and other domestic measures that may be applicable.

Indian companies intending to set up Singapore-based holding structures may be required to re-assess the implications post-transition period. While grandfathering provisions will continue to provide existing benefits to such cross-border structures, with the GAAR set to come into force, and ongoing efforts by the government of India to introduce source-based taxation in its tax treaties, offshore investors may be required to reconsider their transaction structures.

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