THE INDIA-SINGAPORE TAX TREATY HAS BEEN AMENDED

Introduction

The bilateral double taxation avoidance agreement between India and Singapore (the "**Singapore DTAA**") has been amended. On December 30, 2016, India's Central Board of Direct Taxes announced the signing of the protocol (the "**Protocol**") amending the Singapore DTAA. The Protocol will be effective from April 1, 2017. Although the text of the Protocol is awaited (as it has not as yet been ratified by the India's Ministry of Finance), the key changes to the Singapore DTAA and their impact are listed below.

Capital gains taxation and limitations of benefit

Under the erstwhile Singapore DTAA, capital gains arising from the sale of any property (including securities) could be taxed only in Singapore and not in India. Moreover, Singapore did not levy capital gains tax on the transfer of securities of an Indian company by a Singapore resident seller if the annual expenditure on the Singapore resident seller's operations in Singapore equaled to or was more than S$200,000 for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arose ("the **LOB Clause Conditions**").

Now, subject to compliance with the LOB Clause Conditions, gains arising from the sale of "shares" (not "property") acquired of an Indian company by a Singapore resident before April 1, 2017 will be exempt and will not be subject to capital gains tax even if transferred by the Singapore resident after April 1, 2017. However, the transfer of "shares" of an Indian resident company acquired by a Singapore resident on or after April 1, 2017 will be subject to capital gains tax in India under the Protocol. For sale transactions of "shares" acquired between April 1, 2017 and March 31, 2019, the capital gains tax rate will be limited to 50% of the domestic tax rate in India, provided the annual expenditure on the Singapore resident seller's operations in Singapore equals to or is more than S$200,000 for the immediately preceding 12-month period. For sale transactions of "shares" acquired on or after April 1, 2019, the capital gains tax rate will be 100% of the domestic tax rate prevailing in India.

Note that the Protocol does not prevent India from applying its domestic tax law and measures concerning the prevention of tax avoidance or tax evasion by a Singapore resident. The GAAR provisions of Indian domestic tax law will be operative from April 1, 2017, and although Indian tax law specifically provides that Indian tax provisions will apply only when they are more beneficial than a tax treaty, GAAR can be applied even if its application is not beneficial. Therefore, it is imperative that appropriate substance is created in Singapore holding companies.

Our comments

With the amendment of the double taxation avoidance agreement between India and Mauritius on May 10, 2016, the amendment to the Singapore DTAA was expected. The Protocol is similar to the amendments made to the Mauritius DTAA. Further, it aligns with India's objective of providing for source-based taxation of capital gains from sale of shares of a company resident in India, which is also reflected by the recently amended double taxation avoidance agreement between India and Cyprus.

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Venture capital and private equity funds, foreign portfolio investors and foreign companies who have invested in shares of Indian companies using Singapore holding structures will have to re-examine their structures as also their permanent establishment status in India. From the standpoint of the Indian government, the Protocol will tackle the long pending complaint that India has had over suspected treaty abuse**,** round-tripping of funds**,** curbing revenue loss, preventing double non-taxation, and improving transparency in tax matters **,** as promulgated under the OECD BEPS initiative to stop double non-taxation.

However, the good thing about the Protocol is that it is prospective in its application, and investments up to April 1, 2017 have been grandfathered. Importantly, the source-based taxation in India will be in respect of "shares" of a company resident in India and will, most likely, not extend to any other securities, including convertible or non-convertible debt instruments or derivatives. Further, the Protocol does not amend the tax treatment of interest payments under the Singapore DTAA. Therefore, Mauritius will continue to have an advantage as a jurisdiction for routing debt transactions with its 7.5% withholding tax rate, which is lower when compared to Singapore (up to 15%) and Cyprus (at 10%).

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