INSIGHTS

Direct Tax

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Share swap under a scheme of amalgamation involving transfer of shares held as stock-in-trade taxable as business income[1]

Under a scheme of amalgamation, transfer of shares held as a capital asset by a shareholder, in lieu of allotment of shares of the amalgamated company ('new shares'), is not liable to capital gains in the hands of such shareholder under Sec. 47(vii) of the Income Tax Act, 1961 ('the Act').

However, where the shares exchanged are held as stock in trade by the amalgamating company, Delhi High Court[2] has held that such exchange results in taxable business income. This view has been, in principle, affirmed by the Supreme Court (SC) by holding that when shares of an amalgamating company, held as stock-in-trade, are substituted by shares of the amalgamated company, the differential value of prices between the shares shall be taxable as business profits u/s. Sec 28 of the Act. The income shall accrue on allotment of the new shares, and not on the appointed date or date of court sanction.

However, the Apex Court has also laid down certain tests for ascertaining the taxability of such business income in case where the new shares are non-marketable securities. As per the ruling, factors such as marketability, definite valuation, commercial realisability and free disposition of the new shares need to be considered to determine whether taxable income can arise at the stage of receipt of new shares.

Based on these tests, the Court has observed that in case where the amalgamated company is a closely held company, since the market value of such shares is not ascertainable i.e. the test of definite commercial value is not satisfied, no income shall accrue at the amalgamation stage.

The intent of the decision appears to curb tax evasion by stock traders under the garb of tax neutral amalgamation schemes.

Issues

- **Implications due to carve out for closely held companies**

  The carve out may lead to the following possible positions where shares are held as stock in trade by the amalgamating company

  i. No taxation as Business Income at amalgamation stage in case of merger of two unlisted companies;

  ii. No taxation as Income from Other Sources u/s. 56(2)(x) in the hands of a shareholder should arise on receipt of shares of a closely held amalgamated company to be held as stock in trade by the shareholder.

- **Impact on subsequent conversion of Closely held Amalgamated Company**

  If such closely held company is subsequently converted into a public company or listed on stock exchange, before sale of the new shares, whether business income accrues on market value of such shares on the date of such conversion?

[1] Nalwa Investment Ltd v. CIT [TS-13-SC-2026]

[2] [2020] 427 ITR 229 (Del HC)

- **Impact on Demergers**

  In case of demerger, where shares of the demerged company are not transferred - whether taxability, if any, can be contended?

- **Shares acquired with controlling interest are capital assets**

  In the current case, the Revenue assumed that the shares were held as stock-in-trade, though it remains factually to be decided by the Tribunal on remand. *De hors* this finding, it has been held by the Supreme Court[3] that if shares are held for acquiring controlling interest, they cannot be treated as stock-in trade even though the assessee was otherwise a dealer in shares.

Supreme Court applies Substance over Form test to invoke General Anti-Avoidance Rule (GAAR) to pre-2017 arrangement[4]

In a landmark ruling, Supreme Court has upheld rejection of advance ruling sought by Tiger Global, Mauritius [the taxpayer] seeking India-Mauritius Treaty exemption for a transaction involving sale of Singapore shareholding deriving substantial value from assets of Indian Company (indirect transfer), this being the core question put forth before the SC. The AAR had rejected the application on the grounds that the underlying transaction is designed prima facie for the avoidance of income-tax u/s. 245(R)(2)(iii) of the Act.

The Apex Court, further observed that in order to claim Treaty benefit, the assessee has to establish that it is a resident of the Contracting State covered by the relevant Double Tax Avoidance Agreement (DTAA/Treaty) by producing all relevant documents. Focusing on the substance of the structure and the commercial motive behind the transaction, the Court considered the assessee to not be eligible to claim the benefit of the Indo-Mauritius DTAA.

In doing so, the Apex Court has made several important observations as under. Whether or not these observations would be regarded as *ratio decidendi* or *obiter dicta* is open to interpretation and argument:

- The Apex Court has held that Tax Residency Certificate (TRC) alone is insufficient to avail the Treaty benefit i.e. TRC can be an entry point for a Treaty eligibility but not a conclusive evidence of residency, particularly considering the introduction of Section 90 (2A) and Chapter XA to the Act and the Rules. Circular No. 789 dated 13.04.2000, which upheld the supremacy of TRC has been held to be superseded by foregoing subsequent statutory amendments in the Act.

- The Court has also observed that "indirect transfers" which are taxable under the domestic tax laws u/s. 9, are not entitled to Treaty protection under Article 13 of the India-Mauritius tax Treaty irrespective of whether the alienator is regarded as a resident or not of Mauritius.

- Further, the grand fathering protection under Article 13 for investments prior to April 1, 2017 as well as the Limitation of Benefit (LOB) clauses shall not protect in cases where the transaction can be regarded as an impermissible avoidance agreement under the provisions for GAAR. In holding so, the Court has distinguished between *"investment" made prior to April 1, 2017 vs.*

[3] Ramnarain Sons (P) Ltd v. CIT [1961] 41 ITR 534
[4] AAR v. Tiger Global International II Holdings [2026] 182 taxmann.com 375 (SC)

structure which is characterised as an "arrangement" under GAAR.

- The Court further held that Judicial Anti Avoidance Rule (JAAR) continues to operate in parallel with GAAR and empowers Indian authorities to deny Treaty benefits in cases involving Treaty abuse or conduit structures.

Issues

One of the findings of the SC is that 'indirect transfer' of capital assets, as contemplated under Explanation 5 to Section 9(1)(i) is not covered under Article 13 of the Indo-Mauritius DTAA and therefore, at the threshold, Treaty benefit is not available for such indirect transfers, irrespective of whether the person claiming the benefit is regarded as a eligible 'resident' or not of the other Contracting State under the Treaty.

Observantly, if a transaction is regarded to not fall under any particular Article of the DTAA, its taxability would need to be determined as per Article 22 of the DTAA, which deals with 'Other Income', which covers income not expressly dealt with in the other Articles of the Treaty. Interestingly, even under said Article, income of a resident is taxable only in the State of residence. This aspect has not been dealt in the said decision.

Further, if an indirect transfer is not eligible for Treaty benefit, the transaction would be regarded as taxable both under domestic law as well as the Treaty. If that be the case, the question of the transaction being an impermissible avoidance agreement would become moot!

Also, the question before the SC did not deal with the said issue of eligibility of indirect transfers to Treaty benefit.

Considering the above, one may consider arguing that the observation of the SC with regards to eligibility of indirect transfer to Treaty benefits is not binding.

Substance Test - Way forward*

Health checks to substantiate economic substance would now necessarily include evaluation of daily management of tasks including administrative tasks like management of bank accounts, tax and legal compliance by qualified staff, commensurate with size, functions and risks undertaken by the entity.

Further, documentation of key personnel meetings, (apart from mandatory board meetings) for decisions on investments, disposal of income/assets, re(financing) demonstrating actual control of key managerial personnel over strategic and operational decisions of the entity, ownership of assets and ability to take investment risks, can fortify substance. Other factors* like - presence of infrastructure and commercial rationale for operating in specific jurisdiction (e.g. – cost efficiency, local skilled workforce, strategic location) may be evaluated for existing structures before entering into exit transactions.

**Persuasive and not conclusive*

Residency Test - Relaxed stay period of 182 days only for 'Non-resident' Indian Citizens visiting India[5]

In a recent ruling, on the issue of residential status of Flipkart's former CEO and Founder - Mr. Binny Bansal (the taxpayer), the Bangalore Tribunal has held that, only non-resident Indian citizens who visit India in a financial year shall be eligible to take the extended benefit of 182 days stay period instead of 60 days, as provided by Explanation1(b) to Sec. 6(1)(c) of the Act. The Tribunal held that the taxpayer was a 'resident' in the year under consideration and accordingly his global income would be taxable in India.

The residential status of an individual determines the extent to which his income is taxable in India. As per Sec. 6(1)(c) of the Income Tax Act (the Act), an individual shall be considered **'resident'** in India if he has been in India for –

Sec. 6(1)(a) - Stay of at least 182 days in India

or

Sec. 6(1)(c) [*dual condition]*

(i) Stay of at least **60** days in the current year and;

(ii) Stay of at least 365 days in the preceding 4 years.

As per *Explanation* to Sec 6(1)(c), the aforesaid period of 60 days, is relaxed to 182 days for an Indian Citizen who in a financial year (FY) -

Explanation 1(a) - 'leaves India for employment'

Explanation 1(b) - 'being outside India', comes to India for visit(s) in that FY

In case of dual residency under a Tax Treaty, i.e. when an individual is considered resident in 2 or more countries simultaneously under respective taxation laws, the tie-breaker test as per the relevant Tax Treaty shall be applied to determine his residential status.

Factual Matrix

- The taxpayer, a resident of India in Year 1 with a stay period far exceeding 365 days in past 4 years, relocated to Singapore for employment in the fag end of such Year 1.
- He returned India in Year 2 (within 6-7 months) and then immediately resigned from his employment in Singapore to join a new company, in Singapore. His aggregate stay in India was 141 days.
- Year 2 is the year under consideration for which he claimed a 'non-resident' status by construing his relocation to Singapore in Year 1 as –'being outside India' before returning to India in mid Year 2.
- In Year 2, he also sold equity shares of Indian listed companies and shares of Flipkart Private Limited, Singapore which has derived its valuation from an Indian entity - Flipkart India Private Limited. He claimed exemption from capital gains in India under Article 13(5) of India-Singapore DTAA and as per Explanation 7(a) to section 9(1)(i) of the Act.

Further, the taxpayer claimed that he was a resident of Singapore under Article 4 of the India-Singapore DTAA on applying the tie breaker test.

Key Controversy

The key controversy was on the issue of interpretation of the phrase 'being outside' India used in aforementioned Explanation 1(b) to

[5] Binny Bansal v. DCIT [2026] 182 taxmann.com 226 (Bang Trib)

determine whether the taxpayer can be regarded as a non-resident as per the provisions of Sec. 6 of the Act. Consequently, whether capital gains from the sale of shares of Flipkart Pvt. Ltd, Singapore were taxable in India?

Tribunal ruling

The Tribunal rejected taxpayer's literal interpretation of the phrase 'being outside India' and relied on the legislative history of Explanation to Sec. 6 to hold that, the purposive interpretation of the phrase was to cover only non-resident Indians who make occasional or casual visit/(s) to India in the current financial year.

In the present case, since the assessee had not become non-resident in the preceding year, the benefit of the said Explanation was held to be not available to him even though he had admittedly relocated outside India in the preceding year.

Essentially what emanates from this decision is that a taxpayer cannot decide his current residential status by ignoring the past year/(s) residential status and subsequent year/(s) expected residential status, more so if he has been a resident historically and is in process of relocating or has relocated in the current year or a recent past year. Further, where the year of relocation for employment is convergent with the year in which income on exit transactions is earned and where such income is claimed exempt by the taxpayer on the grounds of change in residential status, such linked events may invite deeper tax scrutiny.

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