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INTERNATIONAL TAX ALERT 16 April 2025

Hon'ble Mumbai ITAT upheld that capital gains earned from sale of units of mutual fund by a non-resident, being covered under Article 13(5) of India-Singapore DTAA, shall not be taxable in India.

FACTS OF THE CASE

- The assessee, Anushka Sanjay Shah, a non-resident Indian & tax resident of Singapore had declared capital gains of ₹1.35 crore from mutual fund redemptions (₹88.75 lakh from debt funds and ₹46.91 lakh from equity funds) and claimed exemption under Article 13(5) of the India-Singapore Double Taxation Avoidance Agreement (DTAA).

- Article 13(5) of DTAA stipulates that gains from the alienation of property, other than those specified in earlier paragraphs i.e. shares, immovable property etc. are taxable only in the country in which the alienator is a resident.

- Learned Assessing Officer ('Ld. AO') did not accept the contentions of the assessee and held that the gains were taxable in India asserting that the mutual fund units derived substantial value from assets located in India, thus rejecting the DTAA benefit. Accordingly, Ld. AO passed the draft order considering the capital gains to be taxable in India.

- Aggrieved by the same, the assessee filed an appeal before the Ld. DRP. However, the Ld. AO's action was endorsed by the Ld. DRP. Subsequently, Ld. AO proceeded to tax the short-term capital gain vide the assessment order under s. 143(3) r.w.s. 144C(13). Thereupon, Assessee filed an appeal before the Hon'ble Tribunal.

ISSUES BEFORE THE HON'BLE MUMBAI ITAT

- Whether the Ld. AO is justified in treating capital gain from the sale of units of mutual funds by a non-resident as sale of shares of a company and classifying the transaction under the ambit of Article 13(4) of DTAA between India and Singapore, thereby considering the same as taxable in India?

RULING OF THE HON'BLE MUMBAI ITAT

- The Hon'ble Mumbai ITAT noted that the fats of the instant case are identical to the facts of the case of **DCIT v. K.E. Faizal (2019) 183 DTR (Cochin)(Trib) 173** where the ITAT held that since the term share was neither defined under Article 3 of the tax treaty and the Income Tax Act, the meaning of the term has to be construed from other allied Indian laws. The term 'share' has been defined under the Companies Act, 2013 to mean a 'share in the share capital of the company and includes stock'. Further, the term 'Company' has been defined to mean a 'company incorporated under the Companies Act, 2013 or under any previous company law'. Under the SEBI (Mutual Funds) Regulations, 1995, Mutual Funds, in India can be established only in the form of 'trusts', and not 'companies'. Hence, the units issued by Indian Mutual funds will not qualify as 'shares' for the purpose of Companies Act, 2013.

- Further, from the perusal of definition of term 'securities' as per Securities Contract (Regulation) Act, 1956, it is clear that shares and units of a mutual fund as two separate types of securities. Therefore, the gains arising from the transfer of units of mutual funds, not being transfer of shares, should not be covered under Article 13(4) of the tax treaty. Accordingly, the sale of units shall fall under the Article 13(5) of the tax treaty and hence, shall not be liable to tax in India.

- Relying on the judicial pronouncements of **K. E. Faizal (Supra)** and **Sanket Kanoi vs. DCIT (2024) 168 taxman.com 418 (Delhi - ITAT),** the Hon'ble Mumbai ITAT allowed the deduction claimed in respect of short term capital gain on sale of units of mutual funds.

KEY TAKEAWAYS

- This is a welcome judgement wherein the Hon'ble Tribunal has provided the clarity and consistency on interpreting the mutual funds units different from shares of the Indian companies.

- Further, the ruling sets a precedent for other NRIs investing in Indian mutual funds to avail the treaty benefit w.r.t capital gain, provided treaty language supports it.

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