Tax alert: Sale of Rights Entitlement not taxable under India-Ireland tax treaty

12 June 2025

The Mumbai Bench of the Income-tax Appellate Tribunal (ITAT) has rendered its decision that Rights Entitelement (RE) is not covered under Article 13(4) and Article 13(5) of the India-Ireland tax treaty; it falls under Article 13(6) and is taxable only in the resident state i.e. Ireland.

In a nutshell

- REs are treated differently from shares by the SEBI and NSE.
- RE is an option to purchase a security (which could be shares of an Indian company) in the future.
- When a company offers right to the shareholders, the shareholder obtains an exercisable right to subscribe to shares which is different from the shares in the Indian company.

- Right to subscribe to any financial asset is distinct from financial asset or shares.
- Rights entitlements are not included under Article 13(5) of the India-Ireland tax treaty even after its amendment in 2019 post MLI. Accordingly, it can be held that REs does not fall within the ambit of alienation of shares.

- An asset, which may come into existence or derive its value from another underlying asset, cannot be regarded as being same as the original asset.
- RE, being a distinct asset, may be sold lapsed or subscribed and thus, akin to derivatives, ought to be not subject to tax under Article 13(6) of the India-Ireland tax treaty.

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Background:

- The taxpayer[1] is a non-resident entity and tax resident of Ireland. The taxpayer is registered with Securities and Exchange Board of India (SEBI) as a Foreign Portfolio Investor (FPI) for carrying out investment activity in Indian capital markets.
- The taxpayer filed its return of income for the Financial Year (FY) 2020-21, corresponding to Assessment Year (AY) 2021-22, and claimed short-term capital gains (STCGs) earned on sale of Right Entitilement (RE), as exempt under Article 13(6) of the India-Ireland tax treaty [related to gains from transfer of certain property taxable only in Ireland]. Further, the taxpayer had also incurred short-term capital loss (STCL) during the year under consideration, which was not set-off against the STCG earned (on sale of REs) and was carried forward to subsequent AYs under the provisions of the Income-tax Act, 1961 (ITA).
- The Assessing Officer (AO) during the course of audit proceedings, rejected the aforesaid manner of carry forward of STCL by stating that under sections 70 / 71 of the ITA, [relating to set-off and carry forward of losses] the current year STCL were to be set off against current year STCG as per the manner specified therein and as per the provision of section 74 of the ITA [relating to carry forward of capital loss], the brought forward losses have to be set off against the current year capital gain as per the manner specified therein. Hence, the AO held that before giving any relief under the tax treaty, the income of the taxpayer was to be computed first as per the normal provisions of the ITA and thereby set-off the STCG against the STCL by holding that STCG on sale of REs was taxable and denied the taxpayer's claim of STCG being exempt under Article 13(6).
- Aggrieved, the taxpayer filed an appeal and in the course of appeal proceedings, the matter reached before the before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

- **Relevant extract of section 70 of the ITA:**

  "Section 70. Set off of loss from one source against income from another source under the same head of income...

  ...(2) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any short-term capital asset is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset..."

- **Relevant extract of Article 13 of the India-Ireland tax treaty:**

  "...5. Gains from the alienation of shares other than those mentioned in paragraph 4 in a company which is a resident of a ContractingState may be taxed in that Contracting State.

  6. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident."

Decision of the ITAT:

The ITAT acknowledged that the question before them was whether:

– Capital gain earned from sale of REs can be claimed as exempt under Article 13(6) of India-Ireland tax treaty?

[1] Vanguard Emerging Markets Stock Index Fund A Series of VISPLC vs ACIT (International taxation), Mumbai ITA No. 4657/Mum/2023 (Mum-Trib.)

– REs are akin to shares and whether shares and REs are exactly similar assets? And if they are not in nature of shares, then whether can they be taxed in source state, that is, India?

Treatment of REs under the Company law, SEBI and National Stock Exchange of India Limited (NSE)

- As per section 62[2] of the Companies Act, 2013 REs are not equity shares because the shareholder in whose favour an 'offer' to subscribe to shares is made, may either accept the offer or exercise the right to renounce the offer or transfer the right to any other person. A shareholder obtains an exercisable right to subscribe to shares which is different from shares in the Indian Company.
- The SEBI had issued a Circular dated 22 January 2020 on *"Streamlining the Process of Rights Issue (SEBI Circular)",* wherein RE is credited to the demat account of the investor and it is an asset, which is different from shares of the company and therefore, a separate ISIN is given for rights entitlement.

  The NSE had issued a similar Circular dated 19 February 2020 according to which trading in dematerialized REs on the stock exchanges shall be chargeable to Securities Transaction Tax (STT) at the rate specified in Finance (No.2) Act, 2004 [FA 2004], in respect of 'Sale of an option in securities (i.e. payable by the seller at the rate of 0.05% of the value at which such REs are traded).

  Thus, REs are treated differently from shares by the SEBI and NSE.

Treatment of REs under FA 2024

- As per the FA 2004 'option in securities' was defined to have the same meaning assigned to it under section 2(d) of the Securities Contracts (Regulation) Act. 1956 (SCRA) which defines 'option in securities' to mean purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a taji mandi, a galli, a put, a call or a put and call in securities.

  Accordingly, REs is an option to purchase a security (which could be shares of an Indian company) in the future. Further, the prescribed rate of STT on purchase of equity shares is different, which shows that REs are not the same as shares.
- When a company offers right to the shareholders, the shareholder obtains an exercisable right to subscribe to shares which is different from the shares in the Indian company. Reliance was placed on an earlier ruling[3] of the Supreme Court in this regard.

Treatment of REs under the ITA

- Under the ITA also, REs were considered distinctly as compared to the shares in the company itself, for instance:
  – Section 2(42A)[4] of the ITA reckons holding period in respect of right to subscribe to any financial asset which is renounced in favour of any other person from the date of offer.

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[2] "Section 62. Further issue of share capital (1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares such shares shall be offered 1. (a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion. as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely (1) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days 1 for such lesser number of days as may be prescribed) and not exceeding thirty days from the date of the offer within which the offer if not accepted shall be deemed to have been declined, (ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favours of any other person, and the notice referred to in clause (1) shall contain a statement of this right; (ii) after the expiry of the time specified in the notice aforesaid or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to

the shareholders and the company."

[3] Navin Jindal v. Assistant Commissioner of Income Tax[187 Taxmann 283 [2010]

[4] Related to Period of holding of an asset to classify as short-term or long-term capital asset

  - Section 55(2)(aa)[5] of the ITA deals with a scenario where the person becomes entitled to subscribe to additional financial asset and if such entitlement is in relation to any right to renounce the entitlement, the cost is taken to be NIL.

- Based on above provisions it could be said that right to subscribe to any financial asset was distinct from financial asset or shares.

Provisions under various international tax treaty model and amendment to India-Ireland tax treaty post Multilateral Instrument (MLI)

- Articles 13(4) & 13(5) of UN Model convention were amended in 2017 to expand their scope to include **'other comparable interests'** apart from shares. However, Article 13(5) of India-Ireland tax treaty does not contain the mention of 'other comparable interest' either in para 4 or para 5 of Article 13.

- Pursuant to introduction of Multilateral Instrument (MLI), India-Ireland tax treaty was amended in the year 2019 and reference to 'comparable interest' was included under Article 13(4) and not under Article 13(5). Thus, the two countries even while making the amendment post introduction of MLI have not included 'comparable interest' under Article 13(5) which clearly indicates that Article 13(5) of India-Ireland tax treaty only refers to share of a company, and even Article 13(4) specifically defined 'comparable interest' to include interest in partnership or Trust.

  Thus, rights entitlements are not included under Article 13(5) even after its amendment in 2019 post MLI. Accordingly, it can be held that REs do not fall within the ambit of alienation of shares.

Clarification in respect of India-Mauritius tax treaty

- The taxpayer relied on the clarification issued by the Government of India in respect of amendment to the India-Mauritius tax treaty in 2016 to re-allocate the taxation rights in respect of sale of shares between India and Mauritius. Pursuant to the amendment, India gained rights to tax gains arising on sale of share of Indian companies.

- To address certain ambiguity perceived with regards to applicability of the amended provisions to gains arising on sale of other capital assets. The Government of India's stand was clarified[6] that shares would cover 'shares of Indian Company' and not derivatives and other securities. Accordingly, gain on alienation of securities other than shares would continue to be taxed in the resident country and not in India.

  As per aforesaid clarification, for the purpose of the present case, Res, which are distinct from shares, can be taken as a guidance to see the intention of the Government while negotiating or amending the Articles of a tax treaty.

Taxability under the India-Ireland tax treaty

- The definition of shares under section 2(84) of the Companies Act, 2013 provides a restrictive definition of shares to mean a share in the share capital of a company and includes stock. Otherwise also, an asset, which may come into existence or derive its value from another underlying asset, cannot be regarded as being same as the original asset. An analogy may be drawn to a 'derivative', which may derive its value from the underlying equity, but it is a well established principle that the derivative contract is a distinct and separate asset.

- Under the India-Ireland tax treaty a derivative deriving its value from underlying equity would not be subject to tax in India under Article 13(6). Likewise, REs which are granted on account of shareholding cannot be regarded as being the same as shares especially since the rights shares are allotted, only on subscription. The rights entitlement, being a distinct asset, may be sold lapsed or subscribed and thus, akin to derivatives, ought to be not subject to tax under Article 13(6) of the India-Ireland tax treaty.

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[5] Related to determination of cost of asset in case of certain cases

[6] Vide an article in newspaper by then Economic Affairs Secretary Mr. Shaktikanta Das to 'Business Standard' newspaper dated 21 August 2015

- Similarly, the investor can either sell the REs option or exercise the option to get shares or decline the offer for shares.
- Hence, REs would also be covered under the provisions of Article 13(6) of India-Ireland tax treaty and in that case, it would not be subjected to tax in India but it shall be taxable in the resident state i.e. Ireland.

In view of the above, the ITAT held that REs are not covered under Article 13(4) and Article 13(5) of the India-Ireland tax treaty and it falls under Article 13(6) and are taxable only in the resident state i.e. Ireland.

Comments:

With business evolving, multiple instruments other than debt and equity are available in the market. One such instrument is RE which entitles the shareholder and gives a right to subscribe to additional shares or renounce or sell such rights. Hence, a question may arise whether such REs are akin to shares or a different financial asset/instrument so as to determine their taxability on their sale.

The ITAT in this ruling, has examined the provisions of various laws such as Companies Act, 2013, SEBI, NSE, SCRA, etc. in addition to the provisions of the India-Ireland tax treaty. The ITAT after examining the same has held that RE is not covered under Article 13(4) and Article 13(5) of the India-Ireland tax treaty; it falls under Article 13(6) and is taxable only in the resident state i.e. Ireland. While holding the same, it has upheld / laid down the following principles:

- REs are treated differently from shares by the SEBI and NSE.
- RE is an option to purchase a security (which could be shares of an Indian company) in the future.
- When a company offers right to the shareholders, the shareholder obtains an exercisable right to subscribe to shares which is different from the shares in the Indian company.
- Right to subscribe to any financial asset was distinct from financial asset or shares.
- Rights entitlements are not included under Article 13(5) of the India-Ireland tax treaty even after its amendment in 2019 post MLI. Accordingly, it can be held that REs do not fall within the ambit of alienation of shares.
- The Government of India's stand was clarified[7] that shares would cover 'shares of Indian Company' and not derivatives and other securities.
- An asset, which may come into existence or derive its value from another underlying asset, cannot be regarded as being same as the original asset.
- The rights entitlement, being a distinct asset, may be sold lapsed or subscribed and thus, akin to derivatives, ought to be not subject to tax under Article 13(6) of the India-Ireland tax treaty.

Separately, on the issue of adjustment of STCG arising on sale of REs from which the taxpayer had claimed benefit of Article 13(6) of India-Ireland tax treaty against the STCL arising on sale of shares which is taxable in India in terms of Article 13(5) of the India-Ireland tax treaty.

The ITAT, by relying on an earlier ruling[8] of the co-ordinate bench of the Mumbai ITAT, held that the capital loss incurred under the provisions of the ITA r.w. Article 13(5) of India-Ireland tax treaty cannot be set off against STCG derived from sale of REs because such gains was not subjected to tax in India under Article 13(6) of India-Ireland tax treaty and therefore, taxpayer had rightly excluded from the computation of total income.

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[7] Vide an article in newspaper by then Economic Affairs Secretary Mr. Shaktikanta Das to 'Business Standard' newspaper dated 21 August 2015

[8] J.P. Morgan India Investment Company Mauritius Ltd. (2022)143 taxmann.com 82 (Mum-Trib.)

It is pertinent to note that subsequently, the Mumbai ITAT in another ruling[9] by relying on the current ruling has held that REs are distinct from shares and STCGs earned from the sale of such REs are only taxable in the resident State in the context of Article 13(6) of the India-Saudi Arabia tax treaty.

Taxpayers with similar facts may evaluate the impact of this ruling to the specific facts of their cases.

[9] General Organization for Social Insurance vs. ACIT (IT)-2(3)(2) (2025) ITA No. 1408/Mum/2025 (Mum-Tirb.)