KPMG

TAX FLASH NEWS

3 August 2017

Transfer of shares by Mauritian company under the group reorganisation is not taxable in India under the India-Mauritius tax treaty

Background

Recently, the Bombay High Court in the case of JSH Mauritius Ltd.[1] (the taxpayer) held that capital gain in respect of the transfer of shares of an Indian company by a Mauritian company is not taxable in India under the India-Mauritius tax treaty (tax treaty).

The High Court observed that the shares were purchased and held by the taxpayer for a long period of 13 years. This suggests that it is a bona fide transaction. The said shares were again invested in another company of the same group in India, and the same are being held by the taxpayer. Therefore, the taxpayer cannot be treated as a shell company.

Facts of the case

- The taxpayer is incorporated in Mauritius on 4 April 1996. It is engaged in the business of investment and financing activities. The taxpayer does not have any business presence or Permanent Establishment (PE) in India.

- The taxpayer holds a Category 1 global business company license issued by the Financial Services Authority of Mauritius. The Mauritius revenue authority has issued Tax Residency Certificate (TRC) to the taxpayer evidencing that it is a tax resident in Mauritius and it is renewed from time to time.

- The taxpayer had invested in shares of Tata Industries Ltd (TIL) in June 1996 after obtaining government approval including approval in May 1996 from Department of Industrial Policy & Promotion (DIPP). The investment in shares of TIL was made with an intention of long term investment.

- Subsequently, the shares which were held for a period of 13 years in TIL were transferred in June 2009. Post transfer of shares of TIL, the entire sale proceeds have been reinvested by the taxpayer in another Tata group Company (Tata Power Limited) on 10 July 2009.

- The taxpayer filed its advance return in Mauritius offering its income to tax and also paid taxes in Mauritius. It is a resident under Article 4(1) of the tax treaty and is eligible to claim the benefits under the tax treaty.

- The taxpayer filed an application before the Authority of Advance Ruling (AAR) contending that as per the provisions of Article 13(4) of the tax treaty, the long-term capital gain arising on transfer of shares in TIL is not chargeable to tax in India. However, the tax department contended that the taxpayer is a shell company since it had not incurred expenses of wages, salaries to staff, electricity, etc. It states that the taxpayer did not have business/commercial substance of its own. The taxpayer was created only for the purpose of taking advantage of tax treaty benefit. Therefore, it is eligible for tax treaty benefit.

- The AAR held that the taxpayer is entitled to tax treaty benefits. Therefore, capital gains arising from the transfer of shares would not be liable to tax in India under the tax treaty. In the absence of PE in India, it could not be charged to tax under Section 115JB of the Income-tax Act, 1961 (the Act). The AAR observed that the taxpayer is not a shell or fly by night company and has not indulged in tax avoidance.

---

[1] CIT v. JSH (Mauritius) Ltd. (Writ Petition No. 3070 of 2016) – Taxsutra.com

High Court's decision

- The High Court in the exercise of its writ jurisdiction under Article 226 of the Constitution of India would not sit as an appellate authority over the finding of the AAR. The High Court will exercise its writ jurisdiction if the appreciation of facts and finding arrived at by the AAR is perverse or if the provisions of the law are not properly construed.

- Section 90(2) of the Act provides that where the Government of India had entered into a tax treaty with the government of any other country for granting relief of tax or any avoidance of double taxation, then in relation to the taxpayer to whom said agreement applies, the provisions of tax treaty shall apply to the extent they are more beneficial to the taxpayer. The Central Board of Direct Taxes (CBDT) Circular dated 30 October 1995 referred Circulars of the year 2003 and 2013 clarifies the said aspect.

- The Supreme Court in a case of Azadi Bachao Andolan & Anr.[2] observed that the court cannot judge the legality of treaty shopping merely because one section of thought considers it improper. The Supreme Court observed that the provisions of the tax treaty with respect to cases to which they apply would operate even if inconsistent with the provisions of the Act. The Circulars issued by the CBDT under Section 119 of the Act are binding on all officers and employees employed in the execution of the Act, even if they deviate from the provisions of the Act. The whole purpose of the tax treaty is to ensure that the provisions thereunder are available even if they are inconsistent with the provisions of the Act. The principle of piercing the veil of incorporation can hardly apply to a situation as the one in instant case.

- In the present case, it would be relevant to note that the shares were purchased by the taxpayer in the year 1996 and were held for long period of 13 years and were sold in the year 2009. This goes to suggest the bona fide of the taxpayer. The said shares were again invested in another company of the same group in India, and the same are being held by the taxpayer. Considering this aspect, it has been observed by the AAR that the taxpayer is not a fly by night or a shell company.

- It does not appear that while considering the factual matrix of the matter, the AAR has perversely recorded any finding. It has based its finding on the basis of evidence on record. The said findings is a findings of fact arrived at on the basis of appreciation of evidence.

- The tax department contended that the provisions of Section 245R(2)(iii)[3] of the Act takes away the power of the AAR to decide cases which involve the subject of tax evasion. It does not recognise admission or final stage. This vital aspect has lost sight by the AAR. With regard to the objection raised by the tax department, the High Court held that the same would not arise at this stage. The said provision would come into operation when the application relates to a transaction or an issue which is designed *prima facie* for the avoidance of income tax. On 14 September 2011, the AAR passed an order stating that the issue with regard to the investment made by holding company would be considered while considering the application for ruling under Section 245R(4) of the Act. The said AAR order was never assailed by the tax department. The AAR on considering the application and the documents and the facts on record had conclusively held that the transaction is not designed for the avoidance of income tax. Once such conclusive finding is given, it would not be open for the tax department to fall back on Section 245(R)(2)(iii) of the Act.

- On reference to the tax treaty, it is clear that the capital gains from the alienation of the shares situated in India could only be taxed in Mauritius and not in India. The Supreme Court in a case of Azadi Bachao Andolan & Anr. clearly observed that the terms and provisions of the tax treaty shall operate even if they are inconsistent with the provisions of the Act. The tax department could have relied on Section 9(1)(i) and Explanation 5 if the present case would have not been covered by the tax treaty.

- On perusal of the AAR ruling, it transpires that the AAR has considered all the relevant aspects of the matter and has arrived at the conclusion. The tax treaty has also been rightly considered. Accordingly, the Writ Petition filed by the tax department is liable to be dismissed.

Our comments

Availability of benefit of the India-Mauritius tax treaty vis-à-vis transfer of shares under a reorganisation has been a matter of debate before the Courts. The Bombay High Court in this decision observed that the taxpayer was holding Indian company's shares from a long period of 13 years. Since the taxpayer was not a shell company, the capital gain on transfer of Indian company's shares was not taxable in India under the India-Mauritius tax treaty.

---

[2] Union of India v. Azadi Bachao Andolan [2003] 132 Taxman 373 (SC)

[3] Section 245(R)(2)(iii) of the Act – The AAR shall not allow the application where the question raised in the application relates to a transaction or issue which is designed *prima facie* for the avoidance of income-tax

The instant decision is in line with various AAR rulings[4], allowing India-Mauritius tax treaty benefit. The fact that the taxpayer could demonstrate a business rationale for the transfer appears to have been a significant factor in negating allegations of tax avoidance and paved the way for tax treaty relief.

It is pertinent to note that in May 2016, India and Mauritius have signed a protocol amending the tax treaty with effect from 1 April 2017. It provides that gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of India may be taxed in India. In other words, gains from transfer of shares of an Indian resident company may be taxed in India. The tax rate on such capital gains arising during the period from 1 April 2017 to 31 March 2019 shall not exceed 50 per cent of the tax rate applicable on such gains in the state of residence of the company whose shares are being alienated. A Limitation of Benefit (LOB) Article has been introduced which provides that a resident of a state shall not be entitled to the benefits of 50 per cent of the tax rate applicable in transition period (1 April 2017 to 31 March 2019) if its affairs were arranged with the primary purpose to take advantage of such benefits.

The amendment to the India-Mauritius tax treaty underlines the focus of the Indian government in implementing the Base Erosion and Profit Shifting (BEPS) project to deal with prevention of double non taxation and treaty abuse.

[4] In re, Dow AgroSciences Agricultural Products Ltd. [2015] 65 taxmann.com 245 (AAR), SmithKline Beecham Port Louis Ltd [2012] 24 taxmann.com 153 (AAR), Castleton Investment Limited [2012] 24 taxmann.com 150 (AAR), Dynamic India Fund I [2012] 251 CTR 206 (AAR), Ardex Investments Mauritius Ltd. [2011] 340 ITR 272 (AAR)

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai – 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
Reliance Humsafar, 4th Floor
8-2-618/2, Road No.11, Banjara Hills
Hyderabad – 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Jaipur
Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672