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TAX FLASH NEWS

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The AAR rejects application because the arrangement was designed prima facie to avoid tax and to avail the benefit under the India-Mauritius tax treaty

Recently, the Authority for Advance Rulings (AAR) in the case of Tiger Global International II Holdings[1] rejected the application as the entire arrangement of sale of shares of Singapore company[2] was designed prima facie to avoid tax in India. Further real intention behind the structure of transaction was to avail the benefit of the India-Mauritius tax treaty (the tax treaty).

Facts of the case

In August 2018, Tiger Global International II Holdings, Tiger Global International III Holdings and Tiger Global International IV Holdings[3] (Mauritian companies - subsidiaries of a US corporation[4]) transferred shares of Flipkart Private Limited (Singapore company) to Fit Holdings S.A.R.L. (Luxembourg company).

Singapore-company had invested in multiple companies in India and the value of the shares of Singapore company was derived substantially from assets located in India. These transfers were undertaken as part of a broader transaction involving the majority acquisition of Singapore company by Walmart Inc. (USA)

The applicants approached the tax department under Section 197 of the Income-tax Act, 1961 (the Act) for 'nil' withholding certificate. The tax department observed that the applicants were not eligible to avail benefit under the tax treaty as the applicants were not independent in their decision making. Further the control over the decision making of the purchase and sale of the shares did not lie with them. The tax department had passed an order under Section 197 prescribing a withholding rate in respect of sale of shares by the applicants.

Subsequently, the applicants filed an application with the AAR.

Key observations of AAR

The AAR observed that at the stage of admission the requirement is not to conclusively establish that there was tax avoidance rather it has to be demonstrated that prime facie the transaction or the issue was designed for avoidance of tax. Therefore, the probability of avoidance of tax has to be decided on the basis of evidences and materials brought on record and by drawing inferences therefrom.

Pendency of appeal

The proceedings under Section 197 were already concluded. The provisions of the Income-tax Act do not bar an applicant to approach the AAR after the matter was examined in the proceeding under Section 195 or 197.

Further no proceeding with respect to the question raised was pending on the date on which the applications were filed before the AAR. Therefore, the bar as stipulated in the proviso to Section 245R(2)[5] was not attracted. The AAR relied on various decisions[6] and distinguished the decision in the case of Areva T&D India Ltd[7].

Whether determination of Fair Market Value (FMV) is involved

The question raised before the AAR does not involve an issue of valuation of shares of Singapore Company

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[1] Tiger Global International II Holdings [2020] 116 taxmann.com 878 (AAR)
[2] Deriving its value substantially from the assets located in India
[3] Applicants
[4] The applicants are part of Tiger Global Management LLC, USA and have been held through its affiliate entities based in Cayman Islands and Mauritius

[5] Clause (i) of proviso to Section 245R(2) provides that AAR shall not allow the application where the question raised in the application is already pending before any Income-tax Authority or the Appellate Tribunal.
[6] Hyosung Corpn v. AAR [2016] 382 ITR 371 (Del), Burmah Castrol Plc [2008] 174 Taxman 95 (AAR), Asgarali Nazarali Singaporawalla v. State of Bombay (AIR 1957 SC 503)
[7] Areva T&D India Ltd [2012] 346 ITR 456 (AAR)

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or computation of capital gains arising on transfer of such shares. The AAR in the case of Worldwide Wickets[8] held that the computation of capital gains is embedded in the concept of valuation of shares and merely for this reason the question of capital gains arising in application cannot be held as barred by Section 245R(2)[9].

Since in the instant case, the question raised by the applicants was on the taxability of capital gains, the bar as stipulated in the proviso to Section 245R(2) was not attracted.

Whether transaction/issue was designed prima facie for avoidance of tax[10]

The applicants were part of US entity and have been held through its affiliates through web of entities based in Cayman Islands and Mauritius. Though the holding-subsidiary structure might not be a conclusive proof for tax avoidance, the purpose for which the subsidiaries were set up does indicate the real intention behind the structure. The applicant companies were set up to make investment and to derive benefit under the tax treaty.

Funds were ultimately controlled by the founder and partner of the US entity and the applicants had only a limited control over their funds. The US entity's founder not only had financial control but also had powers to make decisions. He was the beneficial owner as disclosed in the application for 'Global Business License' filed with the Mauritian authorities. Therefore, the head and brain of the companies and consequently their overall control and management (and not day to day affairs) was situated outside Mauritius i.e. in USA.

The applicants had not made any other investment other than in the shares of Singapore company. They were only 'see-through entities' to avail benefit under the tax treaty.

The AAR applied the yardsticks laid down by the Supreme Court in the case of Vodafone1 and observed that the applicants failed miserably on such yardsticks. There was no foreign direct investment made by the applicant companies in India and, therefore, there cannot be any question of participation in investment. The applicants also failed on other yardsticks viz. the period of business operation in India, the generation of tax revenue in India, timing of exit and continuity of business on such exit. In the absence of any strategic foreign direct investment in India there was neither any business operation in India nor they ever generated any taxable revenue in India. Therefore, the arrangement was a pre-ordained transaction which was created for tax avoidance purpose.

[8] Worldwide Wickets [2018] 303 CTR 107 (AAR)

[9] Clause (ii) of proviso to Section 245R(2) provides that AAR shall not allow the application where the question raised in the application involves determination of FMV of any property.

[10] Clause (iii) of proviso to Section 245R(2) provides that 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.

[11] Vodafone International Holdings B.V v. UOI [2012] 341 ITR 1 (SC)

The exemption from capital gains tax on sale of shares of a company not resident in India (Singapore company) was never intended under the original or under the amended tax treaty. Therefore, the applicants were not entitled to claim benefit of exemption of capital gains under the tax treaty on the sale of shares of Singapore company.

The entire arrangement made by the applicants was with an intention to claim benefit under the tax treaty, which was not intended by the lawmakers. Such an arrangement was nothing but an arrangement for avoidance of tax in India. Therefore, the bar under Section 245R(2) is applicable. Accordingly, the AAR rejected the application.

Our comments

The controversy surrounding availment of benefit under the India-Mauritius tax treaty has been a matter of debate before the Courts. The Mauritian companies in this case had approached the AAR to obtain clarity with respect to their transaction of transfer of Singapore company's shares to a Luxembourg company and claiming benefit under the tax treaty.

The AAR has not given proper reasoning that how the factors like notes to the financial statements and no other investment (except in Flipkart Singapore) are sufficient to establish that the purpose was to obtain benefits under the tax treaty. Further the AAR appears to have overestimated the relevance and importance of a person being named as a signatory to the bank accounts. The AAR did not appreciate that the signing authority over bank accounts is at best an administrative power, which is to be exercised by a person subject to the directions of the Board and may not by itself amounts to the Board ceding the decision-making power to such signatory.

Whether the AAR has indirectly applied some elements of 'Principle Purpose Test' of BEPS MLI. It is important to note that Mauritius has not included India in its covered tax agreements for the purpose of MLI.

The AAR did not grant the tax treaty benefit vis-à-vis indirect transfer. However, it is important to note that the Courts/Tribunal in some of the cases[12] have upheld the eligibility to claim tax treaty exemption in respect of indirect transfers.

The AAR has not merely rejected the application but seems to have gone further and have given some far reaching observations treating the entire structuring as device to avoid the tax and the real intention to take the benefit of tax treaty. The AAR order does not have binding authority, however, in future the tax department may use such observations while determining the availability of tax treaty benefits.

[12] Sanofi Pasteur Holding SA vs. Dept of Revenue [2013] 354 ITR 316 (AP), GEA Refrigeration Technologies GmbH [2018] 89 taxmann.com 220 (AAR)

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