

TAX FLASH NEWS

15 March 2023

The Bombay High Court quashes the AAR ruling denying the India-Mauritius tax treaty benefit on capital gains transaction

Executive Summary

The claim of tax treaty benefit on capital gains arising in the hands of a non-resident shareholder from the sale of shares of an Indian company has been a controversial issue from a long time. Recently, the Delhi High Court in the case of Blackstone Capital Partners (Singapore) VI FDI Three PTE Ltd¹ while dealing with the India-Singapore tax treaty held that the Assessing Officer (AO) cannot go behind the Tax Residency Certificate (TRC) issued by the other tax jurisdiction as the same is sufficient evidence to claim treaty eligibility.

Recently, the Bombay High Court in the case of Bid Services Division (Mauritius) Limited² (the taxpayer) dealt with the taxability of capital gains arising from the sale of shares of an Indian company by a Mauritian company under the India-Mauritius tax treaty. The High Court upheld the validity of TRC as evidence for the residential status as well as beneficial ownership. In the instant case, except for allegations, the tax authorities had not placed any material on record to demonstrate or establish that the taxpayer was a device to avoid tax or that there was fraud or any illegal activity. Accordingly, the High Court quashed and set aside the decision of Authority for Advance Rulings (AAR) which denied the tax treaty benefit on capital gains transaction and remanded the matter back to the AAR for reconsideration.

Facts of the case

- The taxpayer, a Mauritian entity, is a wholly-owned subsidiary of a South African company. The taxpayer had a valid TRC issued by the Mauritian tax authorities.
- Bidvest Group Limited (taxpayer's parent group), along with other members in the consortium, filed their expression of interest with the Airport Authority of India (AAI) for the development of Mumbai and Delhi airports. Subsequently, Bidvest informed AAI that the taxpayer would hold 27 per cent of the total share capital of the Joint Venture Company (JVC) if the consortium was selected as the successful bidder.
- In consultation with the Ministry of Civil Aviation, Government of India, the AAI selected the consortium as the successful bidder for modernising and developing the Mumbai airport. Subsequently, Mumbai International Airport Limited (MIAL/JVC) was incorporated.
- Shareholder's agreement was entered into between AAI, MIAL, GVK Airport Holdings Pvt. Ltd. (GAHPL), the taxpayer and AGL. Under such an agreement, the taxpayer subscribed and acquired 27 per cent of the share capital of MIAL. The balance equity shares were acquired by GAHPL (37 per cent), AGL (10 per cent) and AAI (26 per cent).
- After holding such investment in MIAL for more than 5 years, the taxpayer entered into a Share Purchase Agreement (SPA) on 1 March 2011 with GAHPL, to sell 13.5 per cent of its holding in MIAL. The taxpayer applied under Section 197(1) for a nil withholding certificate and the AO authorised GAHPL to pay the taxpayer for the transfer of shares without deduction of any tax at source.

¹ Blackstone Capital Partners (Singapore) VI FDI Three PTE Ltd v. ACIT [2023] 146 taxmann.com 569 (Del)

² Bid Services Division (Mauritius) Limited v. AAR (Writ Petition No. 713 of 2021) – Taxsutra.com

- Further, the taxpayer filed an application with AAR to determine the taxability of the capital gains arising in India from the sale of shares in MIAL. The AAR while denying tax treaty benefit held that the taxpayer was a mere conduit for routing funds from South African Holding Company and was created to avoid tax. The taxpayer was incorporated and introduced in the consortium for obtaining tax benefits.

High Court decision

- As per CBDT Circular³, TRC issued by Mauritian Authorities would constitute sufficient evidence for accepting the status of residence as well as beneficial ownership. Further, the CBDT press release⁴ issued in 2013 clarified that the TRC produced by the resident of a contracting state will be accepted as evidence that he is a resident of that contracting state and the tax authorities will not go behind the TRC and question his residential status. The Supreme Court in the case of *Azadi Bachao Andolan*⁵ and *Vodafone International Holdings B. V.*⁶ upheld the validity of the Circular.
- The mere holding of a TRC cannot prevent an enquiry if it can be established that the interposed entity was a device to avoid tax. However, the above decisions of the Supreme Court have clearly upheld the conclusivity of the TRC absent fraud or illegal activities. In the instant case, except for allegations, the tax authorities had not placed any material on record to demonstrate or establish that the taxpayer was a device to avoid tax or that there was fraud or any illegal activity. Change in the consortium, the entire structure and the transaction of sale were in the full knowledge of the tax authorities.
- The LOB clause was introduced in the India-Mauritius tax treaty effective from 1 April 2017 to deny the tax treaty benefits to shell/conduit companies. Thus, the arguments of the tax department with respect to shell company/conduit can only be considered for investments with effect from 1 April 2017 and not to the facts of the present case.
- Further, the source-based taxation of capital gains arising from the alienation of shares was introduced in the tax treaty for shares acquired on or after 1 April 2017 in a company resident in India. Investments made before 1 April 2017 have been grandfathered and will not be subject to capital gains taxation in India.

- On analysis of various agreements and the transaction, it was observed that the taxpayer was not an entity created or interposed to evade tax. The entire bidding structure as well as the bid was evaluated by the AAI. Neither the AAI nor the government nor any other person objected to the taxpayer's introduction or investment.
- The AO had also issued a nil withholding tax certificate to GAPHL for payment of consideration to the taxpayer. Therefore, the AAR's observations that the taxpayer's involvement at the stage of bidding process was without the approval of the authorities did not have substance.
- Accordingly, the High Court quashed and set aside the AAR ruling and remanded the matter back to the AAR to reconsider the taxpayer's application in light of the above discussion, which the AAR shall decide within a period of eight weeks.

Our comments

The Bombay High Court reaffirmed the importance of TRC for claiming the tax treaty benefit. The High Court observed that to deny the TRC and consequently the tax treaty benefit, the tax authorities have to establish that the taxpayer was a device to avoid tax or that there was fraud or any illegal activity. However, in the present case, the tax authorities were not able to demonstrate or establish the same. Further, the High Court emphasised that under the India-Mauritius tax treaty the LOB clause as well as the source-based taxation of capital gains are applicable with effect from 1 April 2017 and investments made prior to 1 April 2017 have been grandfathered and will not be subject to capital gains taxation in India.

³ Circular No. 789, dated 13 April 2000

⁴ Press Release, dated 1 March 2013 [Finance Ministry's clarification on TRC]

⁵ *UOI v. Azadi Bachao Andolan* [2003] 263 ITR 706 (SC)

⁶ *Vodafone International Holdings B.V. v. UOI* [2012] 341 ITR 1 (SC)

KPMG in India addresses:

Ahmedabad

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

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

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

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytila, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

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

Mumbai

2nd Floor, Block T2 (B Wing),
Lodha Excelus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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