

High Court quashes reassessment proceedings for denial of treaty benefit on sale of shares, upholds sufficiency of the tax residency certificate for treaty eligibility

The availability of tax treaty benefit on capital gain arising in the hands of a non-resident shareholder from sale of shares of an Indian company has been a controversial issue from a long time. The Supreme Court in the case of *Azadi Bachao Andolan*¹, referring to the circular issued by the Central Board of Direct Taxes (CBDT), held that Tax Residency Certificate (TRC) is sufficient evidence for accepting the status of resident for applying the India-Mauritius tax treaty. Recently, the Delhi High Court in the case of *Blackstone Capital Partners (Singapore) VI FDI Three PTE Ltd*² (taxpayer) dealt with the issue whether the Assessing Officer (AO) can initiate reassessment proceedings to deny treaty benefit to the taxpayer despite availability of TRC.

Facts of the case

- The taxpayer acquired equity shares of an Indian company in 2013. During the Financial Year 2015-16, the taxpayer sold all the equity shares. In the return of income, the taxpayer claimed that the gains on the sale of shares of the Indian company were not taxable in India under Article 13(4) of the India-Singapore tax treaty (the tax treaty) based on the TRC.
- The taxpayer's return of income was processed under Section 143(1) with no demand. On 31 March 2021, a reassessment notice was issued to the taxpayer under Section 148. The AO recorded the reason to reopen the case as the transaction's genuineness and taxability remained unverified as no assessment was carried out.

- The taxpayer objected initiation of the reassessment proceedings and claimed that the transaction between the parties was genuine and it was entitled to the benefit of the tax treaty. The AO disagreed and passed the order disposing the objections of the taxpayer. The taxpayer filed the writ petition against such order.

High Court's decision

Writ petition was maintainable

- The tax department raised a preliminary objection that no writ lies against the show cause notice. The High Court noted that the impugned order was not only the show cause notice but also the 'reasons to believe' for reopening the proceedings and the order disposing of the objections. The High Court referred the Supreme Court decision in the case of *Calcutta Discount Co. Ltd.*³ Where in the Supreme Court had held that the existence of 'reasons to believe' that income chargeable to tax has escaped assessment is an issue of jurisdiction and is therefore amenable to writ jurisdiction.

Recourse to Section 147 to extend the time for verification is illegal

- The High Court held that the reason for reopening the assessment i.e. verifying the nature and genuineness of the transaction, was untenable in law as the return of income was filed within time with full particulars. Further, the time period for verification as well as for seeking clarifications or additional documents and information had expired⁴.

³ *Calcutta Discount Co. Ltd. v. ITO* [1961] 41 ITR 191 (SC)

⁴ The High Court referred to *KLM Royal Dutch Airlines v. ADIT* [2007] 159 Taxman 191 (Del)

¹ *UOI v. Azadi Bachao Andolan* [2003] 132 Taxman 373 (SC)

² *Blackstone Capital Partners (Singapore) VI FDI Three PTE Ltd v. ACIT* [W.P.(C) 2562/2022 & CM APPL. 7332/2022] (Del) - Taxsutra

The reassessment notice was issued on borrowed satisfaction

- In the present case, the tax department had merely done a 'cut and paste' job as the notice was based on information forwarded by the TDS officer without any independent application of mind or verification or investigation. Consequently, the High Court held that the notice was issued on borrowed satisfaction which is impermissible in law.

Common for companies to be incorporated with a minimum paid-up share capital

- It is quite common for companies to be incorporated as a special purpose vehicle for a particular investment/project and that too initially with a minimum paid-up share capital of 1 USD. It was not in dispute that the taxpayer was subsequently adequately capitalised and a genuine investment was made in India which had grown exponentially and from which the taxpayer had exited.

No link between the material and the formation of belief

- Reasons for reopening should show that AO has recorded its satisfaction after considering all the facts. The AO has to show that there is a live link between the material and the belief that there has been escapement of income chargeable to tax. In the present case, there was no live link.
- The tax department had not furnished any documents to show that the taxpayer was a tax resident of USA. The taxpayer was incorporated in Singapore and was managed by its board of directors based in Singapore.

The concept of beneficial ownership

- The concept of beneficial ownership under the tax treaty was attracted for transactions of dividend, interest and royalty and not for capital gains.

Applicability of Explanation 2(b) to Section 147

- The tax department incorrectly referred to Explanation 2(b) to Section 147. It applies only if the taxpayer has understated its income or claimed excessive loss, deduction, allowance or relief in its return of income.
- In this case, the taxpayer claimed the benefit of Article 13(4) of the tax treaty, which only provides for the allocation of taxation rights among the countries. The claim of benefit in Article 13(4) does not qualify as a deduction, relief or exemption.

Reasons recorded cannot evolve or be allowed to grow with age and ingenuity

- The AO seeks to enlarge the reasons for reopening, which is not permissible. It is a settled law that the reasons recorded cannot evolve or be allowed to grow with age and ingenuity. The reasons which were recorded cannot be supplemented by affidavits.
- The Supreme Court in New Delhi Television Ltd⁵ held that the AO is not allowed to alter its reasons, which must be considered only based on their recordings.

The LOB clause under the tax treaty was satisfied

- With respect to the issue of satisfaction of the requirement under the Limitation of Benefit (LOB) clause, it was apparent from the record that the taxpayer had placed on record its audited financial statements as well as independent Chartered Accountant certificate to show that the LOB clause was satisfied. The said fact was not disputed by the AO.
- The taxpayer was a bonafide entity and not a shell/conduit entity as it complied with the LOB clause. Accordingly, the allegation of treaty shopping was irrelevant.

AO cannot go behind the TRC

- The entire attempt of the AO to question the TRC was wholly contrary to the government's repeated assurances to foreign investors by way of CBDT Circulars as well as press releases, legislative amendments.
- The Supreme Court, in the case of Azadi Bachao Andolan, upheld the validity of CBDT Circulars⁶. The Supreme Court held that the TRC is conclusive evidence for determining the status of residence and beneficial ownership of an asset under a tax treaty.
- The Finance Bill, 2013 proposed an amendment that TRC shall be a necessary eligibility condition but shall not constitute sufficient evidence of residency. However, serious concerns were expressed by foreign investors with regard to the aforesaid proposed amendment. Thus, the government vide Press Release⁷ reiterated that TRC shall be treated as a sufficient condition for claiming relief under a tax treaty. Accordingly, the proposed amendment was not introduced in the Act.

⁵ New Delhi Television Ltd v. DCIT [2020] 116 taxmann.com 151 (SC)

⁶ CBDT Circular No. 682, dated 30 March 1994 and Circular No.789 dated 13 April 2000

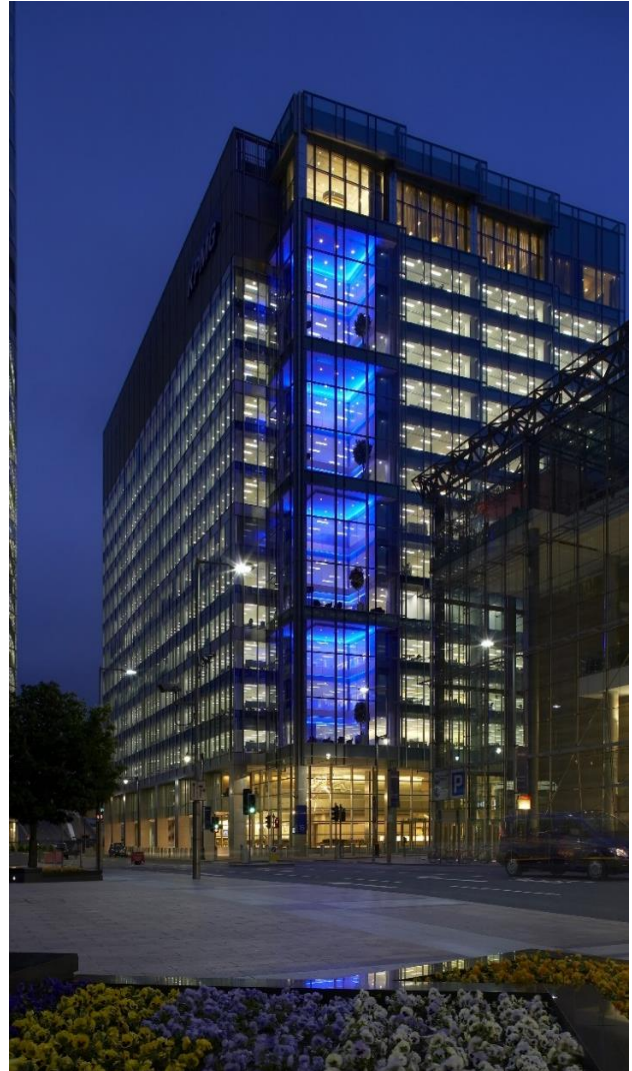
⁷ Dated 1 March 2013

- The Singaporean authorities granted the TRC to the taxpayer after a detailed analysis of the documents. The AO cannot disregard the same as it would be contrary to international law.
- The AO cannot go behind the TRC issued by the other tax jurisdiction as the same is statutorily only and sufficient evidence to claim treaty eligibility, residence status and legal ownership. There was no capital gain earned by the taxpayer liable to tax in India.

In view of the above, the High Court held that the reassessment proceedings were without jurisdiction and thus quashed the reassessment notice and order disposing taxpayer's objections.

Our comments

The High Court has addressed several legal aspects with regards to the conditions attached to initiation of reassessment proceedings and challenge to its validity before High Court by way of a Writ petition. Specifically in the context of reassessment proceedings for taxation of offshore share sales where the shareholder is eligible for treaty benefit, the High Court has reaffirmed important principles of non-applicability of Beneficial Ownership requirements to capital gains article, satisfaction of LOB clause in the tax treaty and TRC being sacrosanct for determination of tax residency of the foreign company.



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