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TAX FLASH NEWS

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The Mumbai Tribunal's decision on the applicability of the concept of 'beneficial ownership' to capital gains article under the India-Mauritius tax treaty

Executive Summary

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Blackstone FP Capital Partners Mauritius V Ltd[1] (the taxpayer) dealt with the applicability of beneficial ownership provisions to Capital Gains Article (Article 13) under the India-Mauritius tax treaty (tax treaty). The Tribunal observed that unlike in dividend or interest Article, which specifically provides for beneficial ownership in order to claim a treaty protection, there is no such provision in capital gains article. Therefore, the concept of beneficial ownership is not relevant in the context of capital gains article. Unless a condition is specifically set out in the tax treaty provision itself, it cannot possibly be inferred.

Accordingly, the Tribunal held that it is not at the whim or fancy of a tax authority to decide as to what constitutes 'beneficial ownership. Therefore, what constitutes 'beneficial ownership' must also be examined and categorical findings should be given as to how these requirements of beneficial ownership are satisfied in the present case. Accordingly, the matter was remitted back to the AO to pass a speaking order, in accordance with the law and after giving a fair and reasonable opportunity of hearing to the taxpayer in this regard.

Facts of the case

The taxpayer, a Mauritius based company, was incorporated on 8 June 2006 and it holds a global business licence (GBL) issued by the Financial Services Commission, Mauritius. The taxpayer is also registered as a foreign venture capital investor (FVCI) with the Securities and Exchange Board of India (SEBI). The taxpayer obtained a 'Tax Residency Certificate' (TRC) from the Mauritian tax authorities. During the Assessment Year 2016-17, the taxpayer had sold 8,31,67,132 equity shares of CMS Info Systems Ltd for a consideration of USD 159.50 million to a Singapore based entity. The cost of acquisition of these shares was USD 17.32 million and, accordingly, earned long term capital gains (LTCG) of USD 142.18 million.

The Assessing Officer (AO) observed that the taxpayer was a wholly owned subsidiary of Cayman Islands entity and it had no independent existence, and its entire activity was controlled and directed as per the directions of its affiliates. Since beneficial owner of the capital gains in question was an entity based outside Mauritius, the taxpayer was not entitled to the treaty protection in respect of capital gains in question. Thus, the AO held that the entire scheme of purchase and sale of shares was designed for the benefit of the entities in Cayman Islands and that it was a fit case to lift the corporate veil. The beneficial owner of the shares, on alienation of which the LTCGs have arisen, was not the taxpayer, and the benefit of Article 13(4) of capital gains of the tax treaty will not be available.

The Dispute Resolution Panel (DRP) upheld the order of the AO. Aggrieved, the taxpayer filed an appeal before the Tribunal.

Tribunal's decision

The Tribunal observed that unlike in Article 10 (Dividend) or Article 11 (Interest) of the tax treaty, which specifically provides for beneficial ownership of dividend or interest in order to be entitled for a treaty protection. There is no such provision in Article 13 of the tax treaty.

The Tribunal observed that the concept of beneficial ownership being a *sine qua non* to entitlement to treaty benefits cannot, in the absence of specific provision to that effect, be inferred or assumed.

On perusal of international tax literature, it indicates that, such an omission may not be inadvertent or unintentional. On reference to the United Nations Committee of Experts on International Cooperation on

[1] Blackstone FP Capital Partners Mauritius V Ltd v. DCIT (ITA Nos. 981 and 1725/Mum/2021) – Taxsutra.com

Tax Matters documents, it was observed that a sub-committee of Experts had requested Philip Baker for a consulting paper on this issue. Philip Baker observed the irrelevance of the domestic law meaning of 'beneficial ownership', justifying its 'international fiscal meaning' to be adopted, and the fact that there is only limited judicial precedents available elaborating upon that concept. He observed that 'the inclusion of a beneficial ownership limitation in the capital gains article of specific bilateral conventions was not a part of the current tax treaty practice of any State'.

He concluded that 'there was ultimately only limited support for inserting beneficial ownership in Article 13'. It would thus seem possible that reading a beneficial ownership test, when such a test is not embedded in the tax treaty provision itself, is rather than a permissible interpretation of the treaty provisions, a rewriting the treaty provision itself. The approach of the lower authorities fundamentally altered the criterion under which a person is entitled to the benefits of a treaty provision, thus frustrating and negating the certainty and predictability sought to be achieved by the tax treaty partners.

Unless a condition is specifically set out in the treaty provision itself, it cannot possibly be inferred. One must remember that the tax treaties are replete with choices but once these choices are consciously made by two willing partners these choices cannot be unilaterally nullified on the basis of perceptions about some underlying notions of what would constitute good public policy.

In the context of international tax treaties, respect for negotiated bargains between the contracting states is fundamental to ensure tax certainty and predictability and to uphold the principle of *pacta sunt servanda*, which is specifically referred to in Article 26 of the Vienna Convention on the Law of Treaties and which provides that 'Every treaty in force is binding upon the parties to it and must be performed by them in good faith'. Any violation of this approach, no matter how well-intended, can only be at a huge cost of tax unpredictability, something tax administrations can ill afford. These discussions clearly demonstrate that the approach adopted by the lower authorities in ducking the issue as to whether the provisions of beneficial ownership can be read into the provisions of Article 13 of capital gains and proceeding by taking the position of beneficial ownership as granted in the scheme of Article 13, is unsustainable in law.

The Supreme Court of Canada[2] has declined to read, by a 6:3 majority view, a requirement of 'sufficient substantive economic connection' in Article 13 of capital gains. A conscious call, therefore, on the question as to whether the requirement of beneficial ownership is embedded in Article 13, is sine qua non before proceeding on the basis. The decision in the case of Aditya Birla Nuvo Ltd[3] relied on by the tax department was distinguishable on facts of the case . Therefore, this decision cannot be an authority for the proposition that the requirements of 'beneficial ownership' can be read into the provisions of Article 13. Similarly, AAR ruling in the case of AB Mauritius[4] was also distinguishable on facts of the case. Further, AAR ruling has no binding precedence value before the Tribunal. The question regarding relevance of 'beneficial ownership' requirement in the scheme of Article 13 thus remains an issue unaffected by these judicial precedents, and these judicial precedents cannot be pressed into service to infer such a requirement implicit in the scheme of Article 13 of the tax treaty.

The AO had made an error in proceeding on the basis that the concept of beneficial ownership is relevant in the context of Article 13, without assigning any specific and cogent reasons. The Tribunal was unable to accept this approach. Therefore, the Tribunal deemed it fit and proper to vacate the assessment order and remitted the matter back to the AO to decide the fundamental issue as to whether the requirement of beneficial ownership can be read into the scheme of Article 13 of the tax treaty. It is only in the event of the answer being in the affirmative, the question of the beneficial ownership of the taxpayer, in respect of the shares, can be examined.

It is not at the whim or fancy of a tax authority to decide as to what constitutes 'beneficial ownership. It is absolutely fundamental that as what constitutes 'beneficial ownership' must also be examined and categorical findings should be given as to how these requirements of beneficial ownership are satisfied in the present case. The issue should be dealt with by the AO and he should pass a speaking order, in accordance with the law and after giving a fair and reasonable opportunity of hearing to the taxpayer in this regard.

Our comments

Normally, the term 'beneficial owner' is not defined under the Indian tax treaties. Under the provisions of the Income-tax Act[5] it is used in various provisions qua determination of ownership. A circular[6] issued by the Central Board of Direct Taxes in context of the India-Mauritius tax treaty linked beneficial ownership to tax residency and clarified that a TRC is sufficient evidence for accepting the status of residence as well as beneficial ownership. This was subsequently confirmed by the supreme court in the case of Azadi Bachao Andolan[7].

The concept of beneficial ownership was introduced by the OECD in 1977 as a safeguard to prevent abuse of tax treaties by undertaking treaty shopping and primarily applies to passive incomes like dividend,

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[2] Her Majesty v. Alta Energy Luxembourg SARL (2021) SCC 49, dated 26 November 2021
[3] Aditya Birla Nuvo Ltd v. DDIT [2011] 200 Taxman 437 (Bom)
[4] AB Mauritius In Re [2018] 90 taxmann.com 182 (AAR)
[5] The term 'beneficial owner' has been used in Section 2(18), Section 2(22)(e), Section 79, etc.
[6] Circular No. 789, dated 13 April 2000
[7] UOI v. Azadi Bachao Andolan [2003] 132 Taxman 373 (SC)

interest & royalties. The term 'beneficial ownership' is applied to distinguish legal ownership from economic ownership in circumstances where the legal owner is not the economic owner of an asset.

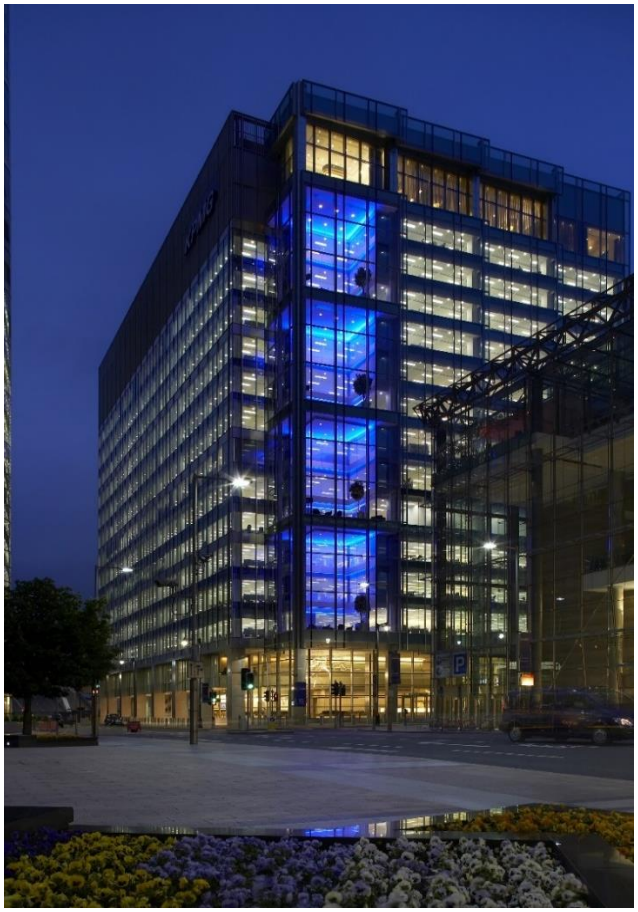
The AAR in the case of Becton Dickinson (Mauritius) Ltd.[8] held that the capital gain arising on transfer of shares of an Indian entity by a Mauritian entity to a Singapore entity under group reorganisation is not taxable in India by virtue of India-Mauritius tax treaty. The AAR did not accept the tax department's contention that the applicant was a benami shareholder, a name lender and the actual owner of the shares of Indian entity was some other entity. Accordingly, it was held that the transaction was not designed, prima facie, for avoidance of tax.

The AAR in the case of Moody's Analytics Inc[9] observed that it is legal ownership of Mauritius entity should be looked into and not beneficial ownership to be looked into while deciding taxability of share sale transaction. The theory of beneficial ownership has not prevailed over the apparent legal ownership. Further, Company Law also recognized the recorded owner of shares and not person on whose behalf it may have been held. Therefore, the benefit of the tax treaty cannot be denied.

The AAR in the case of E-trade Mauritius Limited[10] held that in case shares of an Indian company were purchased by the applicant with funds received from its parent company by way of capital contributions and loans, it cannot be said that beneficial owner of shares was the parent company. The AAR held that even if the entire sale consideration goes back to the parent holding company, it will not dilute the separate legal identity of the applicant.

However, the Bombay High Court in the case of Aditya Birla Nuvo Ltd.[11], based on the facts of the case, held that the Mauritius company was only a 'permitted transferee' of its US parent company, hence, the beneficial owner of Indian company was the US parent company. Accordingly, the High Court applied the US tax treaty instead of the Mauritius tax treaty.

In the present case, the Mumbai Tribunal, has distinguished the decision of Aditya Birla Nuvo Ltd and given an important observations with respect to application of 'beneficial ownership' test. The Tribunal observed that unlike dividend or interest article of the tax treaty, which specifically provides for beneficial ownership in order to be entitled for a treaty protection, capital gains article does have such condition. Thus, the concept of beneficial ownership is not relevant in the context of capital gains article.



[8] Becton Dickinson (Mauritius) Ltd. (A.A.R. No. 1306, 2012)
[9] Moody's Analytics Inc., USA [2012] 24 taxmann.com 41 (AAR)
[10] E Trade Mauritius Ltd. [2010] 324 ITR 1 (AAR)
[11] Aditya Birla Nuvo Ltd v. DDIT [2011] 200 Taxman 437 (Bom)

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