Tax Flash News

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In the absence of an evidence to rebut the genuineness of business activity, the benefit of India-Mauritius treaty granted basis the residency certificate

Executive summary

The Revenue has been challenging the non-taxability in India of the capital gains arising in the hands of a Mauritian company from the transfer of shares of an Indian company under the India-Mauritius tax treaty.

The Revenue often goes beyond the tax residency certificate (TRC) and alleges that the Mauritian company is a conduit company created merely to take benefit of the treaty and is not the beneficial owner of the shares of the Indian company.

The Delhi bench of the Tribunal in the case of *India Property (Mauritius) Company-II*[1] granted the treaty benefit observing that the taxpayer was not a fly by night operator created merely for the tax avoidance purposes. The tax officer had no evidence to rebut the statutory evidence of presumption of genuineness of business activity of the taxpayer on the basis of TRC.

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[1] *India Property (Mauritius) Company-II* v. *ACIT* (ITA No.1020 /DEL/2023) (Del) – Source: Taxsutra

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Facts of the case

- The taxpayer, a resident of Mauritius, was incorporated as an investment fund in 2006 and was held by another Mauritian company (IPM-I). The latter company pools capital from the investors from several countries through a series of funds which was used for investment into the taxpayer by way of the equity infusion.
- The taxpayer in turn made investment in various entities in India. These investments were held as capital assets.
- The taxpayer held a valid TRC and Global Business Licence I (GBL I licence) issued by the Mauritian authorities.
- During the year under consideration, the taxpayer transferred the shares of the Indian companies and earned capital gains.
- The taxpayer claimed that the gains are not taxable[2] in India as per the treaty.

Revenue's contentions

- The taxpayer was not eligible for the treaty benefit as it was not a beneficial owner of the shares and was merely a conduit company. Immediately after the sale of shares of the Indian companies, the taxpayer transferred the sales proceeds to the holding company.
- The TRC is not a conclusive evidence in determining the tax residency and in granting the treaty benefit.
- The taxpayer did not furnish Know Your Customer (KYC) documents submitted to the banks.
- The taxpayer did not incur any administrative expenditure such as salary, rent.
- The directors of the taxpayer do not have any effective role in running the company. The decisions of the taxpayer were taken by the employees of its group companies and the effective management and control of the taxpayer was outside Mauritius.

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[2] Article 13(4) of the treaty

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Taxpayer's contentions

- The TRC is sufficient evidence to claim the treaty benefit and to accept the tax residency as well as the beneficial ownership.[3] The taxpayer fulfilled all the parameters required to obtain the TRC consistently over the years.
- All the key management and commercial decisions including investment and divestment were taken by the taxpayer's Board of Directors holding meetings in Mauritius.
- Though some employees of a group company attended the board meetings by teleconference (as they were investment advisers engaged by IPM-I), however, as per the minutes of the board meeting, the decisions were taken by the Board of Directors.
- The investments were made through proper banking channels, with appropriate KYC checks in place and were in accordance with the foreign direct investment regulations and foreign exchange regulations in India.
- The bank accounts were opened around 15 years ago and the KYC documents submitted at that time were not readily available.
- The taxpayer had invested out of funds infused by the parent entity. There was justification to transfer the consideration back in the form of dividend and buy back of shares to reap the benefit out of investments made in India.
- With regard to the tax officer's contention that the taxpayer has not incurred any operational expenditure, the taxpayer argued that the limitation of benefit (LOB) clause in the treaty which prescribes expenditure threshold to claim the treaty benefit is applicable with respect to the shares acquired on or after 1 April 2017 and not to the instant case where the shares were acquired prior to 1 April 2017.
- As per the Mauritian Financial Services Act, 2007, the corporations holding a GBL I licence are required to be administered by a management company holding GBL II licence. The administrator was appointed for providing day-to-day services and the taxpayer paid professional fees for the same.

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[3] Relying on CBDT Circular No. 789 dated 13 April 2000, *UOI* v. *Azadi Bachao Andolan* [2003] 263 ITR 706 (SC), *Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd.* v. *ACIT* [2023] 452 ITR 111 (Del), *MIH India (Mauritius) Ltd.* v. *ACIT* [ITA No. 1023/Del/2022] (Del)

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- The taxpayer is an investment company, and the investment/ divestment decisions were taken by the board of directors. It was not required to have employees and incur fixed expenses such as rent.

Tribunal's decision

- The taxpayer was not a conduit company and was eligible for the treaty benefit.
- The taxpayer was holding the investment in its own name, beneficially and legally.
- The investments were held for over five years before the sale. The taxpayer was earlier also making investments and divestments, and still held investments in various other companies.
- The taxpayer was not a fly by night operator created merely for the tax avoidance purposes.
- As per the Mauritian law, the taxpayer had outsourced its day-to-day activities and it was the taxpayer's commercial decision. The Revenue cannot question the genuineness of the business operations of the taxpayer.
- The taxpayer cannot be presumed as a conduit company merely on the basis of the transfer of the consideration immediately after divestments because, ultimately, the funds under investments were to be returned to the investor companies. Such model is obvious in the case of an investment fund. The relevant criteria are the period of holding of investment and the commercial expediencies.
- The commercial rationale for the existence of the taxpayer in Mauritius was not any scheme of tax avoidance but a business model to attract funds from different jurisdictions for investment in India. The Supreme Court in the case of *Azadi Bachao Aandolan* had observed that when the whole endeavour of the Government of India is to procure investment in joint venture and infrastructure projects for the benefit of economy, then attributing a malice to investment funds is not justified.
- The tax officer has no evidence to rebut the statutory evidence of presumption of genuineness of business activity of the taxpayer on the basis of TRC.

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Our comments

On 7 March 2024, India and Mauritius signed a protocol to amend their treaty by replacing the existing treaty preamble and introducing the principal purpose test (PPT) in the treaty. The protocol is yet to enter into force and is not yet effective.

In another recent decision[4], the Delhi bench of the Tribunal observed that as the protocol is yet to come into force, it cannot be made applicable.

Once applicable, the amendment of the preamble and the introduction of the PPT in the treaty could create additional challenge for intermediary holding structures to claim treaty benefit, especially for capital gains on pre-April 2017 investments and dividend income.

[4] ITA No. 1766/Del/2023 dated 23 July 2024

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