Tax Flash News

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The capital gain of the Mauritian company on the sale of shares of an Indian company is not taxable under the India-Mauritius tax treaty

Executive summary

The eligibility to claim tax treaty benefits has often been challenged by the tax authorities in India, especially in the context of claiming exemption from capital gains tax under the India-Mauritius tax treaty (the tax treaty). Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of SAIF II-SE Investments Mauritius Limited[1] (the taxpayer) held that the capital gain derived by a Mauritian company from the sale of shares of an Indian company is not taxable under Article 13(4) of the tax treaty. The taxpayer is entitled to the tax treaty benefits since it was a resident of Mauritius having a valid Tax Residency Certificate (TRC) and was also a beneficial owner of the income derived from the sale of such shares. The Tribunal observed that the taxpayer was not a conduit company on the basis of various factors like the process of purchase and sale of shares was approved by various Indian government authorities and agencies, the period of holding of shares, having a valid TRC and no substantial evidence provided by the tax department to prove lack of commercial substance.

Facts of the case

- The taxpayer, a Mauritian company was incorporated in 2008. It operates as an investment holding company for undertaking various investments. The taxpayer had a TRC issued by the Mauritius Tax Authorities and Global Business License (Category 1) (GBL-1) issued by the Financial Services Commission of Mauritius.

- The taxpayer's holding companies are SAIF II Mauritius Company Ltd. (SAIF II) having 51 per cent shareholding and SAIF III Mauritius Company Limited (SAIF III) having 49 per cent shareholding in the taxpayer company. Further ultimate holding companies of SAIF II and III were in Cayman Islands.

- In the year 2007, SAIF II made investment in National Stock Exchange (NSE) by acquiring 5 per cent unlisted equity shares after obtaining all regulatory approvals[2]. Subsequently, in 2009, as a part of group's internal reorganisation, SAIF II transferred its entire investment in NSE to the taxpayer.

- In Financial Year 2017-18, the taxpayer sold the shares in NSE and earned long-term capital gain. The taxpayer claimed an exemption under Article 13(4) of the tax treaty.

- The Assessing Officer (AO) denied the capital gains tax exemption to the taxpayer on the basis of following:

  - The taxpayer cannot be treated as a tax resident of Mauritius. The taxpayer did not have any commercial substance and was set-up as a conduit company under a scheme of arrangement to obtain tax benefits under the tax treaty. The real owners were in Cayman Island.

  - TRC was not sufficient to establish the tax residency if the substance establishes otherwise.

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[1] SAIF II-SE Investments Mauritius Limited v. ACIT (ITA No. 1812/Del/2022) – Taxsutra.com

[2] FIBP, SEBI, RBI, NSE conditions

- There was no commercial rationale of establishment of the taxpayer in Mauritius.
- The taxpayer's principal activity was to hold investments; however, the taxpayer had held the investment in only one company throughout its existence, i.e., NSE. It had not booked any income from its principal activity in the earlier years. Similarly, it had not booked any operating expenses during these years.

- The Dispute Resolution Panel (DRP) rejected the taxpayer's objection and upheld the decision of the AO.

Tribunal's decision

- At the time of the acquisition of shares by SAIF II, the various regulatory authorities of the Government of India, such as, FIPB, SEBI, RBI, NSE India undertook due diligence with regard to the credentials of the taxpayer by verifying all the documents regarding the corporate structure of the company, beneficial ownership, financial structure, and various other factors.
- At the time of the transfer of shares from SAIF II to the taxpayer, the regulatory authorities again carried out due diligence and approved the transfer of shares. Further, the due diligence was also carried out at the time of sale of shares by the taxpayer.
- Thus, the entire process relating to the acquisition of shares of NSE and its sale by the taxpayer went through a process of scrutiny and approval by various government authorities and agencies of India.
- The findings of the departmental authorities that the taxpayer was a conduit company lacking commercial substance runs in the teeth of approval granted by various government agencies and authorities approving the purchase and sale of shares.
- The taxpayer was holding the shares in NSE for more than a decade, since the year 2009, and even post sale it was still holding 3.5 per cent shares in NSE. The holding period of shares demonstrates the status of the taxpayer as a genuine entity carrying on the business in holding investment.
- TRC issued by an authority of other tax jurisdiction is the most credible evidence to prove the residential status of an entity and the TRC cannot be doubted[3]. The Supreme Court in the case of Azadi Bachao Andolan[4] upheld the validity of CBDT Circulars and TRC. The Supreme Court observed that for economic development, initially, many developing countries allowed some amount of treaty shopping to attract Foreign Direct Investment (FDI).
- The Delhi High Court in the case of Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd.[5] held that the departmental authorities cannot question the validity of TRC which proves residential status of the entity.
- Various allegations of the AO regarding residential status of the taxpayer, lack of commercial substance, etc. were in the nature of vague allegations without backed by substantive evidence, hence, did not deserve consideration.
- The taxpayer was not only a resident of Mauritius but also a beneficial owner of the income derived from sale of shares. Thus, on the basis of valid TRC, the taxpayer was eligible for tax treaty benefits.
- The taxpayer sold shares in the year under consideration were acquired in 2009, much prior to 1 April 2017. Therefore, the newly introduced provisions of Article 13(3A) of the tax treaty to tax capital gain on the basis of source of income would not be applicable.
- Accordingly, the capital gain derived by the taxpayer from sale of shares of the Indian company was covered under Article 13(4) of the tax treaty and not taxable in India.

Our comments

The Tribunal reiterated that the TRC is important for claiming the tax treaty benefit. It has also reiterated that the tax authorities should provide sufficient evidence and prove that the intermediary company is a conduit company, and such company is not eligible for the tax treaty benefit. However, in the present case, the tax authorities were not able to demonstrate or establish the same. Further, it is important to note that under the India-Mauritius tax treaty, the source-based taxation of capital gains is applicable with effect from 1 April 2017 and investments made prior to 1 April 2017 have been grandfathered.

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[3] CBDT Circular Nos. 682, dated 30 March 1994 and 789, dated 14 April 2000
[4] UOI v. Azadi Bachao Andolan and Another [2003] 263 ITR 706 (SC)
[5] Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd. v. ACIT [W.P.(C) No.2562/2022] (Del)

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