



## Tax Insights

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### Gains derived by Mauritius taxpayer on sale of shares of Indian company not taxable in India as per pre-amended Article 13(4) of the India-Mauritius DTAA – Delhi bench of the Tribunal

#### In brief

The Delhi bench of the Income-tax Appellate Tribunal<sup>1</sup> (Tribunal) allowed the appeal in favour of the Mauritius taxpayer company by allowing the India-Mauritius Double Taxation Avoidance Agreement (DTAA) benefits on short-term capital gains arising on the transfer of shares of an Indian company. The Tribunal, *inter-alia*, held that the Tax Officer (TO) has made a desperate and unacceptable attempt to overcome the ratio laid down by the Supreme Court in the case of *Azadi Bachao Andolan*<sup>2</sup> by anticipating a futuristic event of ratification of the Multilateral Instrument (MLI) providing amendment to the preamble of the India-Mauritius DTAA by the Mauritius Government, which was not applicable in the relevant period.

#### In detail

##### Facts

- The taxpayer company is a tax resident of Mauritius holding a valid tax residency certificate (TRC) entitling it to claim benefit under the India-Mauritius DTAA. It does not have a permanent establishment in India in the year under consideration. The holding company of the taxpayer company is a company incorporated in the Netherlands.
- The taxpayer company acquired shares of an Indian company, in September 2016 and sold the same in March 2017 to another Indian-based corporate entity (in which the seller of the shares of the Indian company was a key management personnel), resulting in short-term capital gain which was claimed as exempt under Article 13(4) of the India-Mauritius DTAA.
- In the course of the assessment proceedings, the TO called for details relating to the share transaction and after analysing all the facts, *inter-alia*, held that the taxpayer company is a mere conduit entity through which the holding company at Netherlands has invested in the shares of the Indian company. The TO held that the taxpayer company was not entitled to claim benefit under the India-Mauritius DTAA mainly on account of the following reasons:

<sup>1</sup> ITA No.1023/Del/2022

<sup>2</sup> Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

- The Indian company and the Indian-based corporate entity are associated enterprises of the taxpayer company and the seller of shares of the Indian company is a key management personnel of the Indian-based corporate entity.
- The taxpayer company lacks commercial and economic substance.
- It had no financial strength to invest in the shares of the Indian company, and the entire fund was routed through the taxpayer company by the holding company in Netherlands.
- The taxpayer incurred meagre expenses and almost negligible expenses for operational requirements for running a business or commercial venture.
- The effective control and management of the taxpayer company lies with the holding company in Netherlands. The taxpayer company is merely used as a conduit to get the benefit of the India-Mauritius DTAA.
- At the time of passing of the order by the TO, India had deposited the ratified MLI with the OECD, and it came into force in India on 1 October 2019. The TO observed that the MLI preamble will be added to the India-Mauritius DTAA, once Mauritius signs the MLI and notifies the India-Mauritius DTAA as a Covered Tax Agreement.
- Once the MLI preamble is added to the DTAA, there would have been significant change in the legal position established in the case of *Azadi Bachao Andolan*<sup>2</sup>, as the MLI preamble specifically provides for prevention of opportunities for tax avoidance and evasion through DTAA shopping.

### Tribunal's ruling

- The Tribunal held that the present transaction of the taxpayer company would be governed under the pre-amended Article 13 of the India-Mauritius DTAA, because amended provisions are effective from assessment year 2018-19 and applies to shares acquired on or after 1 April 2017.
- The Tribunal further held that the taxpayer would be eligible for benefit under the pre-amended Article 13 based on the following reasoning:
  - On the factual aspects of the issue in dispute, the Tribunal observed that it is a fact that the taxpayer company is a resident of Mauritius, and the Mauritian tax authorities have issued the TRC in favour of the taxpayer company. Thus, on the strength of the TRC, the taxpayer company has claimed benefit under Article 13(4) of the India-Mauritius DTAA as it existed prior to its amendment.
  - As regards the reasoning of the TO in denying the DTAA benefits to the taxpayer company, the Tribunal accordingly held the following:
    - o The taxpayer company made substantial investments in India apart from investment in Indian-based corporate entity.
    - o Indian-based corporate entity is a company wherein the taxpayer company held 82.94% shares.
    - o The shares of the Indian company sold to the Indian-based corporate entity were still held by the Indian-based corporate entity, which clearly establishes that the taxpayer company is not a fly-by-night operator or a mere conduit company.
    - o Merely borrowing money to invest in the shares of the Indian company, ipso facto, cannot be a reason to treat the taxpayer company as a conduit company.
    - o The Tribunal reiterated the legal position that as per the Central Board of Direct Taxes (CBDT) Circular No. 789 dated 13 April 2000, where a TRC is issued by the Mauritian tax authorities, it will constitute sufficient evidence for accepting the status of residence as well as the beneficial ownership for DTAA benefits and followed the Supreme Court decision in the case of *Azadi Bachao Andolan*<sup>2</sup>.

### The takeaways

This is a welcome ruling from the Delhi bench of the Tribunal. The Tribunal has looked at the facts and held that the Mauritius company is not merely a conduit company. It has also referred to and taken support from the legal

position laid down by the CBDT Circular No. 789 dated 13 April 2000 and ratio of the Supreme Court in the case of *Azadi Bachao Andolan*<sup>2</sup>. The Supreme Court upholding the circular had held that where a TRC is issued by the Mauritian tax authorities, it will constitute sufficient evidence for accepting the status of residence as well as the beneficial ownership for granting the DTAA benefit to the Mauritian company.

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