SATURDAY INTERNATIONAL TAX GYAN !!!

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SATURDAY INTERNATIONAL TAX GYAN

SITG No. 172

Sarva Capital LLC
Vs
ACIT (IT)

In case of CCPS, for India Mauritius Treaty date of issue/acquisition of CCPS shall be considered as date of acquisition of converted equity shares

23.09.2023

Jain Shrimal & co.

ITA No. 2289/Del/2022

Facts of the Case

- The assessee is a non-resident corporate entity incorporated under the laws of Mauritius and a tax resident of Mauritius.
- It was incorporated primarily for the purpose of making investments in India in education space, agriculture, healthcare, microfinance institutions and other financial services.
- The assessee had made investment in Indian companies by way of equity shares, which it sold shares of 2 companies and derived income under the head 'long term capital gain'.
- The assessee in the original return offered the income derived from sale of equity shares, as capital gain, however claimed the same as an exempt income as per Article 13(4) of India-Mauritius DTAA. The assessee further filed the revised return on 13.03.2022 offering the long term capital gain from sale of shares of Veritas Finance Pvt. Ltd. (one of the 2 sold) under Article 13(3B) of India-Mauritius DTAA
- The Ld. A.O. proceeded to examine assessee's claim of benefit and while doing so, he concluded that the assessee is not entitled for treaty benefits. Hence the Ld. A.O. brought to tax the entire LTCG under the provisions of domestic law and accordingly completed the assessment.
- The assessee further raised the objections before Ld. DRP, however in sum and substance endorsed the view of the Ld. A.O.

Revenue's Contention

The Ld. A.O. submitted the reasons as to why the benefit of treaty should not be given to the assessee and why such Capital gain should not be taxed as per domestic law of Mauritius:

- The scheme of arrangement employed by the assessee is a tax avoidance through treaty shopping mechanism.
- The assessee company is just a conduit and the real owner is the shareholders/ investors who are tax residents of different countries.
- The TRC is not sufficient to establish the tax residency if the substance establishes otherwise.
- The assessee company is also not a beneficial owner of income as control and dominion of fund is not with the company.
- There is no commercial rationale of establishment of assessee company in Mauritius as the commercial outcomes would identical irrespective of location of funds.

Revenue’s Contention

Further, Ld. DRP relying on the submissions of Ld. A.O. submitted the following-

- All the decisions of relating to the business activities are taken out of Mauritius, **as the Board Meetings were mostly through Video Conferencing**. The shareholders are residents of the country who have LOB clause incorporated in their respective treaties in India, hence they have set up the assessee’s company in Mauritius as a conduit for the purpose of treaty shopping.
- The assessee does not have any second business in Mauritius and its investment activities in India after 01.04.2017 have reduced.
- The assessee is fiscally transparent entity. Since the assessee is not liable to tax in Mauritius, it cannot be treated as a resident of Mauritius as per Article 4(2) of the treaty. Therefore, the LTCG has been rightly brought to tax by applying the provisions of domestic law.

Assessee's Contention

The Ld. Counsel in response to the grounds raised Ld. A.O. and Ld. DRP, submitted the following-

- The assessee is not only incorporated in Mauritius but also a resident of Mauritius, which is well proven from the TRC issued by Mauritius revenue authorities.
- Once TRC is issued by the competent authority of another country, it is sufficient evidence to claim treaty eligibility, residential status and legal ownership and hence the tax authorities cannot go behind TRC. Same view had been adopted by the Hon'ble SC in case of *UoI v. Azadi Bachao Andolan, 132 Taxman 373 (SC)*.
- Further the assessee maintains the regular books of accounts, and other statutory records in their Mauritius along with the key policy decisions taken collectively outside India by assessee's BoD in the board meetings, who are all non-residents including the resident directors in Mauritius.
- The financial statements placed on record proves that the assessee has incurred substantial operational expenditure in past years and hence it is evident that neither it a sham entity nor a conduit company, as alleged by Ld. A.O.
- The decision of the departmental authorities in denying the treaty benefits to the assessee doubting the residency is all the more unacceptable since in the A.Y. 2016-17 and 2017-18, the Ld. A.O. allowed the treaty benefits to the assessee, while completing the assessments u/s 143(3) of the act, in respect of Capital Gain. Thus, the rule of consistency has to be applied.

Assessee's Contention

- **The assessee on conservative basis offered the capital gain from sale of shares of Varitas Finance Pvt. Ltd. under Article 13(3B) of India-Mauritius DTAA, however capital gain from such shares is not at all taxable in view of the Article 13(4) of the DTAA, as the CCPS (compulsory convertible preference shares) were acquired prior to 01.04.2017**. Hence, Assessee reversed it's position taken in Revised income tax return and claim such income as exempt in India.
- The Ld. Counsel also contended that, with regards to Veritas Finance Pvt. Ltd. of conversion of CCPS into the shares, it results only into qualitative change in the nature of rights of the shares and does not alter the voting or other rights with the assessee.

Legal Provisions

According to **Article 13(1), (2), (3), (3A) (3B) and (4)** of India- Mauritius DTAA,

1. Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.
3. Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
[3A. Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.
3B. However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated;]
[4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.]

Legal Provisions

According to **Article 27A** of India- Mauritius DTAA,

1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.
2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.
3. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian Rs.1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.
4. A resident of a Contracting State is deemed not to be a shell/conduit company if:

(a) it is listed on a recognised stock exchange of the contracting state; or

(b) its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs.1,500,000 or Indian Rs.2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

Explanation: The cases of legal entities not having bona fide business activities shall be covered by Article 27A(1) of the Convention.]

Ruling

- The A.O. denied the treaty benefits despite having the valid TRC by applying the theory of substance over form. However it cannot be accepted since it is well settled law that the A.O. in India cannot question the residency of the entity, if the tax resident of Mauritius is holding a valid TRC.
- The sanctity of CBDT Circular No. 789 dated 13.04.2000, before the Hon'ble HC and while deciding the case of *UoI v. Azadi Bachao Andolan (Supra)*, not only upheld the validity of the undersigned circular but also held that once the TRC has been issued, the concerned entity would be eligible to avail the benefits under India-Mauritius DTAA.
- Regarding no liability to tax due to entity being fiscally transparent entity, the Hon'ble Tribunal took inference from the case of *UoI* v. *Azadi Bachao Andolan* where the Hon'ble SC held that merely because tax exemptions have been granted under the domestic tax laws of Mauritius, it cannot lead to the conclusion that the entities availing such exemption are not liable to taxation. The contention of Revenue that avoidance of double taxation can arise only when tax is actually paid in one of the contracting states had been categorically rejected by the Hon'ble SC in the case mentioned-above.
- **The assessee being conduit company or having no commercial rationale of the assessee is also not borne out from any cogent or concrete evidence brought on record.** The authorities failed miserably to establish the fact of assessee being a conduit company with reference to Article 27A of the treaty.

Ruling

- Thus, capital gain of equity shares acquired before 01.04.2017 would be considered as exempt as per DTAA.
- Capital gain from Veritas Finance Pvt. Ltd., where assessee raised an additional ground to claim exemption under Article 13(4), is acceptable. Since the assessee acquired CCPS prior to 01.04.2017 and got converted on 04.08.2017 as per the terms of issue **without any substantial change in the rights of the assessee**.
- As per Hon’ble Tribunal’s, the word ‘shares’ has been used in a broader sense and will take within its ambit all shares, including preference shares. Thus since the assessee acquired CCPS prior to 01.04.2017, the capital gain derived from sale of such shares would not be covered under Article 13(3A) or 13(3B) of the treaty.
- On the contrary, it will fall under Article 13(4) of the treaty, hence shall be exempt as the capital gain earned is taxable only in the country of residence of the assessee.
- Offering capital gain under Article 13(3B) of the treaty shall not preclude the assessee from claiming benefit under Article 13(4) when the capital gain falls under its ambit. Therefore, the Hon’ble Tribunal allowed assessee’s additional ground and hold that capital gain is not taxable as per Article 13(4) of the treaty.

Our Comments

- Although TRC is the ultimate proof of proving the residency of a country. However, it cannot be considered as the only proof of residency as we have seen in various cases. If an assessee does not have TRC but any other proof to claim residency of a country he can still be given benefit of DTAA.

- There have been instances wherein the judicial authorities have gone beyond TRC and raised corporate veil of assessee to check whether the claim of treaty benefit is legitimate or not. Further, with introduction of MLI, it is also important to satisfy the purpose test before taking any benefit of DTAA.

- In case of CCPS period of holding of shares could be considered from the day a person was holding the CCPS irrespective of fact for how much period the person held it after it was converted to equity shares, if there is no change in rights and powers of the holder.

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Sarva Capital
LLC **(The Assessee)**

The assessee invested in the shares of shares of the Indian company and sold the shares and earned capital gain to claim the exemption in terms of Article 13(4) of the treaty.

Sewa
Gruh Rin Ltd.

The assessee after selling the CCPS earned the capital gain, offered such LTCG under Article 13(3B) of the treaty in revise return. However, again claimed it as exempt income before ITAT.

Veritas
Finance Pvt. Ltd.

3.) The Ld. A.O. proceeded to tax the entire LTCG as per the domestic law and accordingly completed the assessment

A.O.

The Hon'ble Tribunal held that the Capital Gain derived by the assessee from the sale of equity shares is not taxable in terms of Article 13(4) of the treaty. Hence the hon'ble tribunal allowed the appeal partly.

Section/Article	Article 13(3B), 13(4) and 27A of DTAA
DTAA/Country	India- Mauritius DTAA
Court	Delhi Tribunal
Date of decision	10.08.2023

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