Saturday International Tax Gyaan

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SITG No. 223

Tiger Global International III Holdings
v.
Authority For Advance Rulings

TRC benefit and tax exemption under the grandfathering clause cannot be denied under the India- Mauritius DTAA in respect capital gains from 'indirect transfers' of shares of Singapore company

14.09.2024

[2024] 165 taxmann.com 850 (Delhi – High Court)[28-08-2024]

Jain Shrimal & Co.

Facts of the Case

- Tiger Global International III Holdings (Petitioner) was a tax resident of Mauritius and acquired shares of Flipkart Private Limited Singapore before 1st April 2017, company incorporated under the laws of Singapore.

- The tax payer had a Category 1 Global Business License and the primary objective of undertaking investment activities with the intention of long term capital appreciation.

- The Singapore company had investment in the shares of Indian companies and derives its value substantially from assets in India.

- On 02.08.2018 taxpayer had applied to the Indian Tax Authorities for a certificate of ‘Nil’ withholding under section 197 of The Income Tax Act in relation to transferred certain shares from Singapore company to Fit Holdings S.A.R.L., Luxembourg on 18.08.2018.The transfer of holding took place in 2018 as part of large takeover scheme spearheaded by Walmart Inc.

Facts of the Case

- A Tiger Global management LLC a company incorporated in terms of laws of Delaware USA was asserted to be the Petitioner Investment Manager.
- Further, the petitioner file an application before the Authority of advance ruling (AAR) to determine the tax implications in India in relation to the sale of shares.
- The AAR rejected the application on the ground that transaction was designed for the availing the benefit of India-Mauritius tax treaty.
- Thereafter, petitioner filed a writ petition before the Hon’ble Delhi HC against the aforesaid ruling of the AAR.

Assessee's Contention

- Assessee referred the para 3A of Article 13 of India-Mauritius DTAA and contented that gain arising from the transfer of shares would be exempt from taxation in India in respect of shares acquired prior to 1st April 2017.

- The capital gain arises from transfer of Indian capital asset and as per Article 13 of the India-Mauritius Tax treaty, such capital gain would only be taxable in Mauritius.

- Assessee referred the CBDT circular no. 682 dated 13th March 1994 and states that any resident of Mauritius deriving income from sale of shares of Indian companies will be liable to capital gain tax only in Mauritius as per Mauritius tax laws will not have any capital gain tax liability in India.

- The petitioners were intended to operate as pooling vehicles for investments, held a Category 1 GBL, had aggregated funds from more than 500 investors located across 30 jurisdictions worldwide.

Assessee's Contention

- TGM LLC was engaged as the investment manager and whose services were sought to be availed for various purposes which subject to review and final approval by the BOD.

- Taxpayer relied on the speech of Hon'ble Finance minister where in it was clarified that indirect transfer provisions would not override provisions of DTAA and would impact cases where transaction were routed through low tax or no tax jurisdiction with which India did not have any DTAA.

- India-Mauritius DTAA does not contain an enabling provision which authorise Indian Tax Authorities to tax on indirect transfer of asset. So, indirect transfer of shares should not be taxable in India.

- The taxpayer submitted that they had incurred commensurate expenditure in Mauritius to satisfy the condition prescribed under the Article 27A of DTAA(LOB) and shall not be treated as shell companies.

Assessee's Contention

❖ Assessee further contented that Tax residency certificate (TRC) issued by the Mauritius tax authorities would constitute sufficient evidence for the purpose of applying the DTAA and the taxpayer relied on the various judgement to substantiate that TRC would be conclusive evidence to claim benefit of DTAA.

Revenue's Contention

❖ The revenue contented that management and control of petitioner companies was in the hands of holding company (Tiger Global Management LLC- TGM LLC) and held that petitioners were only shell companies and disentitled to claim the benefits of DTAA since the transaction lacks commercial substance.

❖ Further, revenue states that petitioner establish the entity in Mauritius and the principal aim is to derive the undue benefit of India- Mauritius Tax treaty and it is evident from their financial statements that petitioner had not made any other investment other than shares of Flipkart.

❖ Revenue referred the amendment introduced in DTAA in relation to the grandfathering clause and states that petitioner were not entitled to claim benefit of exemption of capital gain on sale of shares of Singapore company because the objective of India-Mauritius DTAA was to allow exemption of capital gains on transfer of shares of Indian company only.

Revenue's Contention

- In absence of any direct investment in India we can conclude that arrangement of transaction created for tax avoidance purpose.

- Revenue contented that taxpayer head and brain i.e. control and management of the company were situated in the USA.

- The entire arrangement made for avoidance of tax in India and hence application was rejected under clause (iii) of proviso of section 245R (2) which provides that AAR shall not allow application which relates to transactions entered prime facie for avoidance of income tax.

Legal provisions

<u>Section 9 (1)(i) of the Act:</u>

The following incomes shall be deemed to accrue or arise in India :—

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1.—For the purposes of this clause—

(a) in the case of a business, other than the business having business connection in India on account of significant economic presence, of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

<u>Section 195 of the Act:</u>

Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force:

Legal provisions

Section 197 of the Act:

1) Subject to rules made under sub-section (2A), where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J, 194K, 194LA, 60[194LBA], 194LBB, 194LBC, 194M, 194-O and 195, the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at any lower rates or no deduction of income-tax, as the case may be, the Assessing Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate.

(2) Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

Legal provisions

Article 13 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;]

Legal provisions

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 recognized 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.

Ruling

- The Hon'ble Delhi High court held that petitioner had genuine economic activities and was not just a shell entity for tax avoidance and the TGM LLC was only the investment manager with no equity participation or investments made by it in the petitioner company.

- The petitioner have incurred expenditure amounting to USD 1,063,709 roughly translating to MUR 36,436,182 as against the threshold of MUR 150000 as prescribed in Article 27A. Therefore, the petitioner cannot be said to be lacking in economic substance.

- The Hon'ble High court states that establishment of investment vehicles in tax friendly jurisdictions cannot be considered to be an anomaly or presume that purpose of evading tax or engaging in treaty abuse.

Ruling

- The Hon'ble Delhi court had relied upon the decisions rendered by the supreme court in Azadi Bachao Andolan and Vodafone to hold that no sham corporate entity brought into existence solely for the purposes of avoiding capital gain liability under the provisions of the Act.

- The High court further states that Once the condition specified in the Article 27A were met then an entity should not be considered a shell company.

- The revenue would thus not be justified in doubting the presumption of validity attached to the TRC as it would inevitably result in an erosion of faith and trust reposed by contracting states in each other. There cannot be an assumption of treaty shopping and treaty abuse merely because a subsidiary or any related entity is established in a tax friendly jurisdiction.

Our Comments

- Decision of Hon’ble Delhi High court is a welcome relief that not always made doubt on the presumption of validity attached to the TRC as it would inevitably result in an erosion of faith and trust reposed by contracting states in each other.

- While the availability of capital gains tax benefit under the tax treaty would need to be analysed based on specific facts of each case (viz. commercial substance of the overseas entity holding Indian shares, control, and ownership of the overseas entity, etc.), consistency established by this ruling is significant.

- The petitioner company incurred expenses for establishing the commercial or economic benefit in the Mauritius. So, for claiming the benefit of Limitation of benefit clause (LOB) in DTAA we have to check that commercial substance of the entity has been created as per Article 27A of India-Mauritius DTAA.

- For referring the decision of AAR - Click Here

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Applicant Company incorporated on 15.06.2011 in Mauritius

on 17.06.2011

GBL-1 granted to the Applicant

19.10.2011

17.04.2015

Shares of Flipkart Singapore company acquired by applicant

09.05.2018

Share purchase agreement entered that applicant agreed to sell shares of Singapore company

02.08.2018

Applicant approach for Indian Tax Authorities for nil withholding certificate under section 197

17.08.2018

Tax Authorities issued letter to applicant and not permitted to avail benefits of DTAA

18.08.2018

Sale of shares of Flipkart Singapore by the applicant

2018

19.02.2019

Date of application filing to AAR

2020

Writ Petitioner filed before Delhi High Court

28.08.2024

Decision of Delhi High Court in favour of applicant

The funds of applicant company was managed by the TGM LLC and the applicant company incurred expenses in Mauritius, more than that specified in the Article 27A of DTAA so that the economic substance of the applicant company in Mauritius. Further, Hon'ble High court states that establishment of investment vehicle in tax friendly jurisdiction can't be considered for purpose of evading tax and benefit of TRC availed to applicant company

Section/Article	Section 9(1)(i) read with 195 and 197 of IT Act and Article 13 and 27A of DTAA
DTAA/Country	India Mauritius
Court	Delhi High Court
Date of decision	28.08.2024

Note: Case law name in Red- in favor of the revenue, Green-In favor of the Assessee, Orange = Partial

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