CAPITAL GAIN CONTROVERSY CONTINUES IN INDIA-MAURITIUS TREATY

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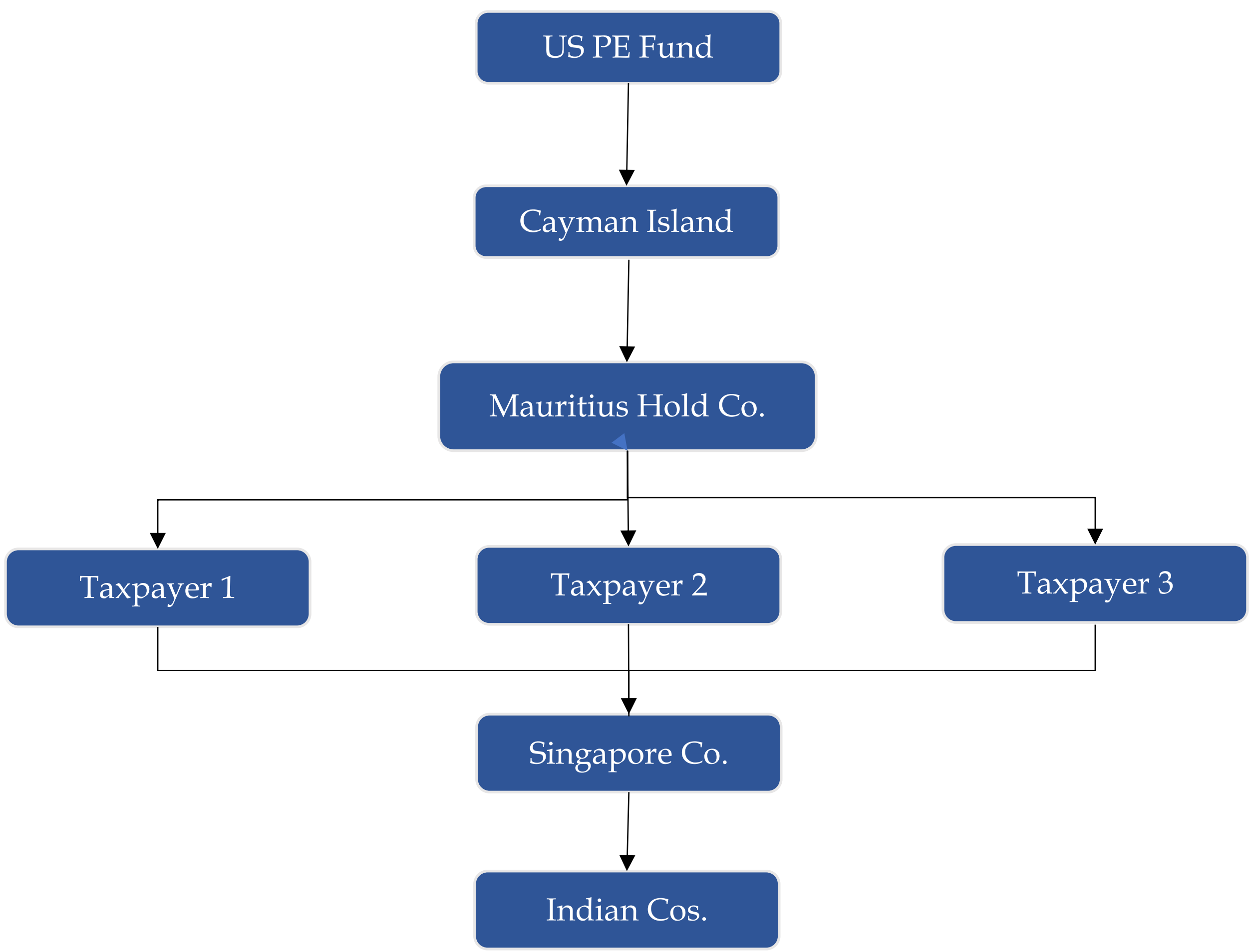
The AAR rejects the admission of application of the Taxpayers on the grounds that the entire arrangement was designed prima facie to avoid tax and avail the benefits of India-Mauritius Tax Treaty

This alert summarizes the recent ruling of the Authority for Advance Rulings ('AAR') in the case of Tiger Global International II Holdings[1], alongwith other applicants ('the Taxpayers').

Background

In this case, there were three Mauritian resident companies. They are subsidiaries of Tiger Global Management LLC, USA and have been held through its affiliate entities based in Cayman Island and Mauritius.

The Taxpayers had invested in shares of a Singapore Company ('S Co') which had in turn invested in multiple Indian companies and derived substantial value from assets located in India. The diagrammatic representation of the organization structure is given below:



[1] (2020) 116 taxmann.com 878 (AAR)

The investment in shares of S Co was subsequently transferred to Fit Holdings S.A.R.L., Luxembourg, as part of a broader transaction involving the majority acquisition of S Co by Walmart Inc., USA.

Prior to completion of the transfer of shares of S Co, the taxpayers approached the Indian Revenue Authorities ('IRA') for obtaining 'Nil' withholding tax certificates under Section 197 of the Income-tax Act, 1961 ('the Act'). In response thereto, the IRA held that the Taxpayers were not eligible to avail benefit under the India-Mauritius Tax Treaty ('the Tax Treaty') as they were not independent in their decision making and the control over the decision making of the purchase and sale of the shares did not lie with them. The IRA issued certificate prescribing withholding tax rate in respect of sale of shares by the Taxpayers.

Subsequently, the Taxpayers filed an application before the AAR to determine chargeability of the share transfer transaction to income-tax in India.

AAR Ruling

The AAR, after considering the IRA's contentions and the Taxpayers' arguments, held as under:

Application made by the Taxpayers to obtain lower/nil tax withholding certificate is not a reason to reject AAR application

The proceedings under Section 197 of the Act were already concluded by the IRA. Further, there were no pending proceedings in the case of Taxpayers on the date of making the AAR application.

Accordingly, in the absence of any pending proceedings, the bar as stipulated under Section 254R(2) was not attracted. The AAR relied on the CBDT Circular No. 774 of 1999, various judicial precedents[2] and distinguished the decision of the AAR in the case of ArevaNP SAS, France, dated 20 January 2020.

The application before the AAR was w.r.t. chargeability of income-tax and not for determination of FMV

The question raised before the AAR does not involve an issue of valuation of shares of S Co or computation of capital gains arising from transfer of shares of S Co.

Accordingly, in the absence of requirement to determine FMV, the Taxpayers' applications cannot be rejected merely on this count. The AAR relied on the decision of Worldwide Wickets[3] wherein it had held that the computation of capital gains is embedded in the concept of valuation

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[2] Burmah Castrol Plc (174 Taxman 95) (AAR); OPJ Trading Private Ltd (259 Taxmann 36) (Guj)

[3] (2018) 303 CTR 107 (AAR)

of shares, and merely for this reason the question of capital gains arising in application cannot be held to be barred from admissibility before the AAR.

The transaction is designed prima facie for avoidance of tax

The Taxpayers were part of US entity and have been held through its affiliate entities based in Cayman Island and Mauritius. While the holding-subsidiary structure is not a conclusive proof for tax avoidance, the purpose for which the Taxpayers were set up does indicate that the real intention behind the structure was to avail the benefits of the Tax Treaty.

Taxpayers' funds were ultimately controlled by the personnel of the US entity. The real management and control of the Taxpayers is not with its Board of Directors, but with the US entity's founder who is the beneficial owner of the entire group.

The Taxpayers had not made any other investment other than investment in the shares of S Co. The Taxpayers were only a "see through entity" set up to avail the benefits of the Tax Treaty.

In the instant case, the gains have been derived from transfer of S Co shares and not Indian company shares. The protocol amending the Tax Treaty as well as Circular No. 682 dated 30 March 1994 suggests that the intent of the treaty is only to protect transfer of Indian company shares and not the transfer of S Co shares which is the subject matter under this application.

Even if the S Co derived its value substantially from assets located in India, the fact remains that what transferred was the shares of a S Co and not the transfer of Indian company shares and hence the exemption provided under the treaty in respect of indirect transfer is not available in the facts of the case.

Our comments

The controversy regarding the capital gains benefit under the India-Mauritius Tax Treaty has been a matter of debate before various appellate forum.

The conclusion of AAR that the case is of tax avoidance is based on assessment of the facts of the case, control and management of the Taxpayers was located outside Mauritius and that the Taxpayers were see-through entities whose ultimate beneficiary was a US resident.

It may be noted that the AAR ruling is binding only on the applicant and not on others. However, the IRA may use the observations of the AAR while determining the eligibility of the Tax Treaty benefits.