

TRC sufficient evidence for accepting status of residence as well as beneficial ownership for applying India-Mauritius tax treaty

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In brief

In a recent decision, the Punjab & Haryana High Court has held that a Tax Residency Certificate (TRC) issued to a Mauritian company by the Mauritian Tax Authorities shall be sufficient evidence of its residency in Mauritius, and accordingly, the Mauritian company would be eligible for relief under the India-Mauritius double taxation avoidance agreement (tax treaty).

In detail

Facts

- ABC Limited¹, the petitioner, and I Co were companies incorporated in India in the years 2002 and 2007 respectively.
- F Co1 and F Co2 were companies incorporated in Mauritius in the years 2004 and 2006 respectively which held 66.29% and 12.75% shares in I Co respectively.
- During the Financial Year (FY) 2011-12, the petitioner entered into a transaction with F Co1 and F Co2 for the purchase of shares in I Co.
- The transfer of shares resulted in capital gains in the hands of F Co1 and F

Co2 which were claimed as not liable to tax in India under the provisions of the India-Mauritius tax treaty.

- F Co1 and F Co2 had obtained a TRC from Mauritian Tax Authorities.
- Considering the provisions of the India-Mauritius tax treaty, the petitioner (i.e. the buyer) was of the view that no tax was required to be withheld under section 195 of the Income-tax Act, 1961 (the Act).
- Accordingly, the petitioner filed an application with the Authority for Advance Ruling (AAR) seeking an advance ruling on the following questions:
 - Whether capital gains arising in the hands of F Co1 and F Co2 would not be chargeable to tax in India having

regard to Article 13(4) of India-Mauritius tax treaty read with section 90(2) of the Act?

- Whether the petitioner (i.e. the buyer) was not required to withhold tax under the provisions of the Act while making the payment of sale consideration?
- AAR declined to give a ruling on the aforementioned application (after hearing the case several times) on the basis of a *prima-facie* finding that the transaction in question was designed for the avoidance of income tax.

Issue

Whether AAR was right in holding that the transaction

¹ TS-484-HC-2015; [2015] 60 taxmann.com 433 (Punjab & Haryana)

was designed for avoidance of tax and therefore, the consideration received by F Co1 and F Co2 was taxable in India and accordingly, the petitioner was liable to withhold tax in respect of such consideration?

Revenue's contentions

- The benefit under the India-Mauritius tax treaty should not have been allowed considering the following:
 - F Co1 and F Co2 did not carry on any business in Mauritius and accordingly could not be considered as residents of Mauritius
 - The real beneficiaries of the transaction i.e. the shareholders of F Co1 and F Co2 were not residents of Mauritius and therefore, the TRC issued by the Mauritian Tax Authorities was irrelevant and of no consequence
 - F Co1 and F Co2 was not required to pay any taxes in Mauritius
 - This was a clear case of treaty shopping

Petitioner's contentions

- The petitioner submitted that the transaction was not designed for avoidance of tax and accordingly relief under the India-Mauritius tax treaty should be allowed to the petitioner.

Punjab & Haryana High Court Ruling

- There was not a "single finding of fact" in relation to Revenue's contention that the transaction was designed for the avoidance of income tax in India.
- The intention to acquire the shares of I Co by F Co1 was present almost since the inception of I Co. F Co1 ran and managed I Co for a

period of over six years. There was nothing which suggests that the investment was only with a view to generate profit from the sale of such shares.

- Once a TRC had been issued by the Mauritian Tax Authorities, a failure to accept the same would be an indication of breakdown in the faith reposed by the Government of India in the Government of Mauritius.
- Further reliance was placed on the decision of the Supreme Court (SC) in the case of *Azadi Bachao Andolan*² wherein it was held that:
 - Based on the harmonious reading of section 4, 5 and 90 of the Act, provisions of tax treaty would override the provisions of the Act
 - Circulars issued by the Central Board of Direct Taxes (CBDT) were binding on all the officers and employees employed in the execution of the Act
 - Circular No. 682/1994 reiterated the provisions of the India-Mauritius DTAA that income derived by a Mauritian resident from alienation of shares in an Indian company would be liable to capital gains tax only in Mauritius
 - Circular No. 789/2000 clarifies that the TRC issued by the Mauritian Tax Authorities would constitute sufficient evidence of residency as well as beneficial ownership of the

Mauritian entity for applying the tax treaty

- "Liable to tax" was not the same as "pays tax" and relying on the OECD Model Convention, 1977, the argument that double taxation could be avoided only when tax was actually paid in one of the contracting states could not be accepted.
- Further while analysing the issue of legality of "Treaty-Shopping" (i.e. an act of a resident of a third country to take advantage of fiscal treaty between two contracting states) the SC held that if the intention of policy makers was to preclude the resident of a third State from the benefits of tax treaty between two contracting states, then a suitable limitation of benefit to that effect should have been incorporated in the tax treaty (as in the case of Indo-US tax treaty). The SC further held that entering into a treaty and terms and conditions thereof were the sovereign functions of a state and thus such decisions and their legality should have been left to the policy makers.
- The High Court further brought to notice the provisions of the proposed sub-section 5 to section 90 (proposed to be introduced *vide* Finance Bill, 2013) which stipulated that a TRC would be a necessary but not sufficient condition for claiming relief under the tax treaty. However, the sub-section was never implemented, since it would have affected the validity of Circular No. 789/2000 issued by the CBDT.

² Union of India and another v. Azadi Bachao Andolan (2004) 10 SCC 1

- The Finance Ministry, through a clarification dated 2 March 2013, also clarified that the TRC produced by a resident of a contracting state would be accepted as evidence of residency in that contracting state and the Income-tax Authorities in India would not go behind the TRC and question the TRC holder's resident status.

The takeaways

The Punjab & Haryana High Court reversed the AAR ruling in the petitioner's case and held that a TRC issued by the Mauritius Tax Authorities was sufficient evidence of residency, and accordingly, relief for capital gains tax available under the India-Mauritius tax treaty to a Mauritius resident having a valid TRC could not be denied.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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