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No capital gains tax on transfer of shares held in Indian companies : Supreme Court decision in the case of Azadi Bachao Andolan upheld

Background

- In the case of Dynamic India Fund[1] (the applicant), the Authority for Advance Rulings (AAR) analysed whether income arising from the sale of shares of an Indian company by the applicant, a company resident in Mauritius, would be taxable in India.

Facts

- The applicant is a company incorporated in Mauritius with the intention to invest in growing sectors in India. It is registered with the Securities Exchange Board of India (SEBI) as a foreign venture capital investor.
- The applicant holds a valid tax residency certificate (TRC) from Mauritius and does not have a permanent establishment (PE) in India.
- The control of affairs of the applicant lies in Mauritius and decisions are taken by the board of directors from Mauritius.

[1] Dynamic India Fund I, *In re* [TS-513-AAR-2012]

- The applicant is a wholly owned subsidiary of Dynamic India Fund II (DIF II), another company based in Mauritius. DIF II pools funds from investors all over the world and invests it as capital into the applicant.

- The applicant invested funds in the shares of Indian companies and units in India. It holds shares with the intention to generate long-term capital appreciation. These shares have been reflected as investment in its books.

Issue

- The applicant sought an advance ruling to determine its taxability in India on the transfer of shares held in Indian companies.

Assessee's contentions

- As a tax-resident of Mauritius, the applicant is entitled to claim the benefit of the India-Mauritius Double Taxation Avoidance Agreement (tax treaty).

- Article 13 of the tax treaty governs this transfer and the gains arising on such a transfer is taxable only in Mauritius and not in India.

- The applicant relied on the decision of the Supreme Court (SC) in the case of Azadi Bachao Anodolan[2]

Revenue's contentions

- Only 4 out of the 55 investors were from Mauritius and this was a case of routing the investments through Mauritius so as to evade tax.
- Out of 5 directors of the applicant, only two were from Mauritius and the other three were from India. Decisions were taken by the board of directors from India.
- As the gains on transfer are not actually taxed in Mauritius, the provisions of the tax treaty would not apply.

AAR ruling

The AAR held as follows:-

- There is no material on record to show that routing of investments by the applicant through Mauritius is really a scheme for tax avoidance in India.

- There is inadequate material on record to support the contention of the revenue authorities that decisions of the applicant were taken from India. Accordingly, it is not possible to accept the contention of the revenue authorities that the control of the applicant is situated in India.

- Even though the capital gains are not actually taxed in Mauritius, the SC decision in the case of Azadi Bachao Andolan (above) is binding on the authority.

- In the light of the above, it was held that under Article 13 of the tax treaty, capital gains arising on the transfer of shares held in Indian companies would not be taxable in India and that the buyer of the shares had no obligation to withhold tax under the Income-tax Act, 1961.

[2] Union of India *v.* Azadi Bachao Anodolan [2003] 263 ITR 706 (SC)

Conclusion

A Mauritius resident holding a valid TRC and not having a PE in India would not be liable to tax in India in respect of gains arising on the transfer of shares held in Indian companies under the tax treaty.

It is pertinent to note that the AAR observed that since the implementation of General Anti-Avoidance Rule (GAAR) provisions has been deferred to assessment year (AY) 2014-15, it has no relevance at present and can be dealt with by the revenue authorities as and when it comes into force. The ruling seems to inadvertently suggest that the requirement of obtaining a TRC containing prescribed information applies from AY 2014-15 instead of AY 2013-14.

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