Authority for advance ruling - Denial of benefit under India-Mauritius tax treaty on capital gains income arising in India

AAR denies beneficial treaty provisions to a Mauritian tax resident in respect of capital gains arising from sale of shares of an Indian company

Recently, the Authority for Advance Rulings (AAR) has denied the applicability of beneficial treaty provisions available to Bid Services Division (Mauritius) Ltd. (i.e. the Applicant)[1], a tax resident of Mauritius, under the provisions of Article 13(4) of the India-Mauritius Double Taxation Avoidance Agreement (India-Mauritius tax treaty) in respect of capital gains arising to the Mauritius shareholder on sale of shares of an Indian company.

The AAR considered the doctrine of substance over form and the lack of commercial reasoning for interposing the Mauritian entity into the arrangement. Accordingly, it ruled that the Applicant is a mere conduit for routing funds from the South African Holding company and was a shell entity created to avoid tax.

Background

The Applicant incorporated in Mauritius is a wholly owned subsidiary of Bid Services Division (Proprietary) Limited, a company incorporated in South Africa. The ultimate holding company is Bidvest Group Limited (Bidvest), a company incorporated and listed in South Africa.

The Applicant in consortium with other partners namely, GVK Airport Holdings Private Limited (GAHPL) and ACSA Global Limited (AGL) entered into joint venture (JV) with the Airport Authority of India (AAI) for undertaking development, operation and maintenance activities at

[1] Bid Services Division (Mauritius) Ltd., In re (AAR NO. 1270 of 2011 dated February 10, 2020)

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Mumbai Airport. The entire process of selecting the JV partner was carried out through an international competitive bidding process by the AAI.

For this purpose, AAI entered into an agreement with Mumbai International Airport Private Limited (MIAL) to undertake the said activities at the airport and to govern the relationship of the JV partners as the shareholders of MIAL. Under such arrangement, the Applicant agreed to subscribe and acquire 27% of the share capital of MIAL.

The Applicant after holding such investment in MIAL for a period of 5.5 years, entered into a Share Purchase Agreement (SPA) on March 1, 2011 with GAHPL, wherein it agreed to sell 13.5% of its holding in MIAL for a consideration of USD 231 Million.

In view of the above facts, the Applicant filed an application with AAR to determine the taxability of the capital gains arising in India from the sale of shares in MIAL.

Contentions put forth by the Applicant

The Applicant being a tax resident of Mauritius[2], was entitled to claim the relief under the India-Mauritius tax treaty. Accordingly, the gains arising on sale of shares of MIAL was taxable only in Mauritius as per Article 13(4) of the India-Mauritius tax treaty. In this regard, reliance was placed on the CBDT circulars[3] which have clarified that Tax Residency Certificate (TRC) constitutes a conclusive evidence for accepting status of resident as well as beneficial ownership for applying the tax treaty[4]. It was also the plea of Applicant that in the absence of Limitation of Benefits (LOB) clause in the tax treaty or General anti-avoidance rules (GAAR) in force, the relief under tax treaty cannot be denied.

Contentions put forth by the Revenue

Inclusion of Applicant, a Mauritian entity, in the Consortium lacked the commercial substance and bonafide business purpose, and thus was a clear design to avoid legitimate Indian taxes. The Mauritius entity (Applicant) needs to be overlooked and the capital gains should be deemed to be income of the ultimate holding company of Applicant i.e. Bidvest. Accordingly, the provisions of India-South Africa tax treaty should be applicable, and capital gains should be taxable in India.

The Applicant was not even in existence for most of the bidding process of the project and was incorporated and brought into the Consortium just two weeks before the submission of the final bid.

[2] Is a holder of Category 1 Global Business License issued by Financial Services Commission, Mauritius and a valid tax residency certificate
[3] CBDT circular no. 682 (30/3/1994) and circular no. 789 (13/4/2000)
[4] Vodafone International BV v. UOI [2012] 341 ITR 1 (SC)

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Emphasis was laid on the provisions of section 93 of the Income-tax Act, 1961 (Act) to deem the capital gains as the income in the hands of Bidvest that had the power to enjoy the income arising to the Applicant.

Since Bidvest is the ultimate holding company of the Applicant and also it has common directors on the board of Applicant, it should be deemed to be the beneficial owner of the income receivable by the Applicant, which in absence of any treaty benefit under the India – South Africa tax treaty, should be taxable in India.

Ruling of AAR

The AAR while evaluating the purpose for which the Applicant was brought into the Consortium concluded that what in effect has changed is mere routing of the investment funds of Bidvest from Mauritius. Bidvest, an international investment holding company based in South Africa had enough financial muscle and management capabilities to undertake the project on its own, and thus there was no requirement of interposing the Applicant into the Consortium.

Substance over form

The Applicant is just a shell company, without any tangible assets, employees, office space, etc. which was incorporated few days before the bidding. It has no management experts or financial advisers on its pay roll or on hire. The AAR thus failed to appreciate the role of the Applicant in the JV as it neither had any commercial nor any economic rationale.

The AAR opined that if the entity claims treaty benefit it must establish the economic rationale and substance for treaty entitlement. The AAR remarked that Mauritius, unlike London or New York, is not a known financial centre or a vibrant business hub, nor can it boast of being a seat of civil aviation experts. While further analysing the role of the Applicant in the JV, the AAR analysed that the project could not have been operated without the presence of other two consortium members, being GAHPL and AGL. But the project could have survived without the Applicant, and the funding could have been provided directly by Bidvest from South Africa. The AAR said that the real role served by the Applicant was just of a conduit for routing funds for its South African based holding companies. It did not create any value in the business of JV and merely kept noting and endorsing the decisions of the parent company without any contribution.

Commercial or Economic Rationale

In view of the facts and submissions on record, the AAR held that the Applicant could not provide any rationale for interposing the entity right before the end of the final bidding process. It had no independent sources of funds or income nor had any fiscal independence. The

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submission of the Applicant that it assisted in doing business or providing support for the project also could not be substantiated. Merely holding a TRC cannot prevent enquiry by the tax department. The crucial issue was whether the Applicant was introduced in the Consortium for merely availing the tax benefit available under the India-Mauritius tax treaty.

Further, refuting the arguments of the Applicant that even if obtaining tax treaty benefits is seen as the sole objective of the arrangement, in the absence of LOB provisions and look through provision in the India-Mauritius tax treaty, the treaty benefit cannot be denied. The AAR relying on the Apex court's decision in the case of Vodafone International Holdings BV (supra)concluded that since the peculiar facts point towards a tax avoidance device, it is open to the tax department to discard the device and take into consideration the real transaction between the parties. Accordingly, the India-Mauritius tax treaty benefit was denied and the transaction was held to be taxable in India. The other contentions put forth by the Revenue such as application of section 93 andnon-supply of certain documents were not dealt by the AAR.

Dhruva Comments

Availability of tax benefits to Mauritius entity under the tax treaty has been a subject matter of intense litigation over the years with the tax department closely evaluating the commercial expediency, beneficial ownership and substance requirements before affording any relief under the tax treaty. The AAR in the instant case has disregarded the clarification of the CBDT circular No. 789 to treat TRC as the conclusive evidence of beneficial ownership, as also affirmed by the Supreme Court in case of Azadi Bachao Andolan (supra).

The AAR has applied the anti-abuse rules as emanating from various judicial precedents and has laid heavy emphasis on the Supreme Court's observation in case of Vodafone International Holdings BV (supra) that it is important to look at the legal nature of the transaction in its entirety and holistically; a dissecting approach should not be adopted. It is to be noted that the AAR has disregarded the fact that general anti-abuse rules provided under the Act are applicable from April 1, 2017 onwards and investments prior to April 1, 2017 as per amended India-Mauritius tax treaty, have been grandfathered.

It is interesting to note that though India-Mauritius Tax Treaty is not a Covered Tax Agreement under the framework of the Multilateral Instrument for implementing BEPS measures, it seems that treaty benefits of Mauritius shareholders are being denied on a case by case basis depending on the commercial facts and substance demonstration.

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The Ruling also throws light on how the commercial nature of each and every transaction can be closely scrutinized by the tax authorities, which puts more onus on the taxpayers to back up transactions with a proper commercial reasoning.

Though the decision of AAR is pronounced in the peculiar facts of the Applicant's case and would be binding only on the Applicant and tax authorities (unless challenged in a writ petition), it may have persuasive value in case of taxpayers having similar arrangements; and may add support to the contentions raised by the tax department.

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