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Authority for Advance Ruling (AAR) denies India-Mauritius treaty benefit on capital gains basis factual evaluation

Recently AAR *vide* an order delivered on 17 February 2020 rejected application filed u/s 245Q of the Income-tax Act, 1961 (Act) denying India-Mauritius treaty benefit on capital gains arising on stake sale in an Indian company

Brief facts of the case:

- M/s Bid Services Division (Mauritius) i.e. BSDM or the applicant, is a Mauritius-based private company, incorporated on 23rd August 2005. BSDM holds a valid Tax Residency Certificate (TRC) issued by Mauritius Revenue Authority (MRA).
- The applicant is wholly-owned subsidiary of Bidvest Service Division (Proprietary) Limited (BSDPL), South Africa. The ultimate holding company is Bidvest Group Limited (BGL or Bidvest), incorporated and listed on South African stock exchange. The effective control and management of the applicant company is situated in Mauritius.
- Airport Authority of India (AAI) selected the applicant in consortium with GVK Airport Holdings Private Limited (GAHPL) and ACSA Global Limited (AGL) as joint venture (JV) partners of Mumbai International Airport Private Limited (MIAL), a company incorporated in India for undertaking development, operation and maintenance activities (OMDA). Shareholders and OMDA agreement was entered between AAI, MIAL and consortium on 4th April 2006.
- The shareholding pattern of MIAL is as under:

Name of the shareholder	% of holding
AAI	26%
GAHPL	37%
BSDM	**27%**
AGL	10%
Total	**100%**

- The applicant entered into a Share Purchase Agreement (SPA) with GAHPL and GVK Industries Limited (GVK) on 1st March 2011 for transfer of its 13.5% stake in MIAL to GAHPL for purchase consideration of US$ 231 million.

Issues for consideration:

The applicant sought ruling on whether gains arising from the transaction of sale of shares to GAHPL pursuant to the SPA would be liable to tax in India having regard to the provisions of Article 13(4) of the India-Mauritius Double Taxation Avoidance Agreement (DTAA).

Key contentions of the taxpayer:

- Revenue authorities cannot question the tax residency status of the taxpayer, as long as the TRC issued by the Mauritian authorities is in existence. Reliance was placed on Circular No 682 and 789 dated 30 March 1994 and 13 April 2000, respectively, issued by the Central Board of

Direct Taxes (CBDT) wherein it was clarified that certificate of residence issued by the Mauritian authorities will constitute sufficient evidence of residence as well as beneficial ownership for applying provisions of the DTAA.

- Reliance was also placed on various judicial precedents including Azadi Bachao Andolan[1], E Trade Mauritius Ltd, AAR ruling in the case of D.B.Zwirn Mauritius Trading No. 3 Limited and Ardex Investments Mauritius Ltd, to support the above contentions. Further, reliance was placed on the apex court's decision in case of Vodafone International Holdings B.V. where the apex court observed that in absence of Limitation of Benefit clause in the India-Mauritius treaty and in view of presence of CBDT Circular no. 789 of 2000 and TRC, the benefits of tax treaty shall be granted at the time of sale/divestment/exit.
- In view of all above decisions and facts of the case, capital gains arising on account of sale of shares of MIAL to GAHPL would not constitute income chargeable to tax in India in view of Article 13(4) of the India-Mauritius DTAA.
- It is general commercial practice on the part of any MNC to be the face of the bid for large and complex projects, so as to highlight the financial and technical competency of the group as a whole. However, while investing in various projects, separate companies i.e. special purpose vehicles (SPVs) are formed for commercial reasons such as for hedging business, geopolitical and economic risk, mobility of investment, ability to raise loan from diverse investments, valuation from growth perspective, tapping global funds etc.
- BSDM was incorporated in Mauritius for commercial reasons as the group was already operating in Mauritius through another entity.
- Without prejudice to other arguments, the beneficial provision of the India-Mauritius treaty cannot be denied in absence of any provision limiting the benefit of the DTAA (as are applicable in the DTAA with the USA or with Singapore) or the provisions of Chapter X-A being in force.
- Section 93 of the Act applies to tax income arising out of transaction, which residents may undertake to externalise the assets, while continuing to enjoy the rights over such income or assets.
- Relying on the observations in the case of Vodafone International Holdings, it has submitted that incorporation of the Mauritian company, immediately prior to investment in the Indian company should not be regarded as an investment for the purposes of tax avoidance and the treaty benefits have been granted in number of cases.

Key contentions of Revenue authorities:

- The AAI had issued an 'Invitation to Registrar an Expression of Interest' (ITREOI) on 17 February 2004. In response to the AAI's ITREOI, the GVK-SA consortium filed its EOI on 20th July 2004. GVK partnered with SA Airport Operators (SA). SA is a JV of three entities viz. ACSA, Old Mutual Life Assurance Company (South Africa) Ltd (Old Mutual) and the BGL.
- The GVK-SA consortium did not include BSDM (i.e. Mauritius entity) as one of the members during the bidding process but brought in just before filing of Technical and Financial bid (TaF). In fact, BSDM was incorporated just two weeks prior to the submission of binding bid by GVK-

[1] Union of India vs Azadi Bachao Andolan (2003) (263 ITR 706) (SC); E*Trade Mauritius Ltd. (AAR No. 826 of 2009) (2010); D.B. Zwirn Mauritius Trading (AAR No. 878 and 879 of 2010) (2011); Ardex Investments Mauritius Ltd., In Re (AAR No.866 of 2010) (2011); Vodafone International Holdings B.V. vs. Union of India (2012) 17 taxmann.com 202

SA consortium. No prior approval was taken by the consortium regarding substitution of BGL with BSDM, at any stage, before the submission of the bid.

- Other arguments taken for supporting no treaty benefit:
  - For undertaking project efficiently, Mumbai or South Africa could have been best alternatives. Only advantage of Mauritius was to avail tax benefits.
  - Inclusion of BSDM lacked commercial substance and bona fide business purpose, but was clear design to avoid paying legitimate tax to the Indian government;
    Based on analysis and invocation of Section 93, capital gains arising is deemed as income in the hands of the ultimate holding company. BGL acquired the rights by virtue of which it has the power to enjoy income of non-resident BSDM. BGL had full powers to take decisions on the utilisation of the income received or receivable by BSDM;
  - Out of four directors of BSDM, two Mauritian directors had no real powers and the other two common with its holding company, represented BGL. They were citizens of South Africa;
  - Parent gave commitment to provide funds needed by BSDM;
  - BSDPL received loans / advances from Bidvest and BSDM received loans / advances from BSDPL;
  - Reference to judgements[2] where courts have looked into the substance of a transaction if it can be established that the transaction is a sham.
- As per the India-South Africa DTAA, the capital gains on share sale is taxable in India. If BGL was not interposed, the Bidvest group would have to pay capital gain tax in India on the share sale transaction. The shares of JV were bought in the name of applicant though the beneficial owners were the holding companies in South Africa. There is clear misuse of the treaty and hence treaty benefit should be denied.

Ruling by the Authority:

- AAR considered the arrangement as mere routing of funds of Bidvest group to Mauritius. It considered BSDM as a shell company incorporated just few days prior to transaction without any tangible assets, employees, office space etc. BSDM had no management experts or financial advisers on its payroll or on hire. Further, Mauritius unlike London or New York, is not a known financial centre or a vibrant business hub from where capital can be sourced at cheaper rates or top-quality professional engineers / consultants could be employed.
- The applicant is unable to provide economic, commercial rationale for interposing of entity such as hiring finance professional for arranging finance, have collaterals for raising finance, provide meeting ground where active discussions could take place, etc. It didn't even discuss critical needs of project in the Board meeting.
- The shares of the joint venture were bought in the name of applicant though the beneficial owners were the holding companies in South Africa. The applicant kept on noting and endorsing decisions of the holding company in the Board meetings without any contribution or discussion about the decision making process. Merely holding of TRC cannot prevent an enquiry if it can be established that the interposed entity was a device to avoid tax.

[2] Consolidated Finvest and Holdings Ltd [2014]; CIT v Wipro Ltd [2014]; DIT v Copal Research Ltd., Mauritius [2014]; CIT v Panipat Woolen and General Mills Co. Ltd [1976]; AAR ruling of Seedworks Holdings Mauritius [2017]; Vodafone International Holdings B.V. vs. Union of India (2012) 17 taxmann.com 202

- BSDM has no independent sources of funds or sources of income nor has any fiscal independence. All the funds are with the holding companies. The applicant has no tangible assets, business activities except for owning the shares of the JV. Subjecting the facts to various tests - fiscal nullity test, commercial / business substance test, look-at principle test, investment participation test, time duration test, business operations period in India test - the applicant fails the tests being a tax avoidance device where the dominant purpose of interposing is to avoid taxes in India.
- Considering the facts in totality and discussed in preceding paras, AAR did not see any commercial or economic rationale or ease of doing business in incorporating the applicant in Mauritius and interposing it in the JV. It observed that once it is established that the Mauritian company is interposed as a device, it is open to the tax department to discard the device and take into consideration the real transaction between the parties.
- AAR held that the applicant is not entitled to benefit under Article 13(4) of Indo-Mauritius DTAA.

Comments:

- In the context of availing the capital gains exemption under the India-Mauritius DTAA, the position that the exemption can be claimed by merely producing the TRC issued by the Mauritian authorities, is well established by the CDBT Circular as well as by a series of judgements of the Supreme Court and AAR. In this ruling, while the AAR has acknowledged this principle, it has also observed that exceptions are possible in certain situations such as interposing entities as a tax avoidance device.
- Revenue authorities have conducted a detailed enquiry into the purpose, board, funding, assets, timing etc. while determining eligibility to tax treaty. Taxpayers will be well advised to consider this while determining eligibility to tax treaty benefits.