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### Advance ruling applications for determining chargeability to capital gains tax under India-Mauritius tax treaty not admitted based on facts

The Authority for Advance Rulings rendered its decision that based on facts of the case the transaction in relation to transfer by Mauritian companies of shares held in Singapore company (deriving substantial value from assets located in India) was prima facie for avoidance of tax. Hence, the applications for advance ruling were not admitted.

#### Facts of the case:

- Tiger Global International II Holdings, Tiger Global International III Holdings and Tiger Global International IV Holdings (the taxpayers)<sup>1</sup>, are private companies incorporated in Mauritius.
- The taxpayers were set up with the primary objective of undertaking investment activities with the intention of earning long term capital appreciation and investment income.
- The taxpayers are regulated by the Financial Services Commission in Mauritius and granted a Category 1 Global Business License under section 72(6) of the Financial Services Act, 2007. The taxpayers are tax residents of Mauritius under the Mauritius laws and under the provisions of the India-Mauritius tax treaty.
- The taxpayers held shares of Flipkart Private Limited (FPL), a private company incorporated in Singapore. FPL had invested in multiple companies in India and derived its value substantially from assets located in India.
- On 18 August 2018, the taxpayers transferred FPL's shares to Fit Holdings S.A.R.L. (Buyer), a company incorporated in Luxembourg. These transfers were undertaken as part of a broader transaction involving the majority acquisition of FPL by Walmart Inc., a company incorporated in the USA.
- The taxpayers had filed applications with tax authorities for issuance of a 'Nil' withholding tax certificate before the consummation of the transfer of FPL's shares. The tax authorities vide withholding tax order dated 17 August 2018 (WHT order), held that the taxpayers were not eligible to claim benefit of the India-Mauritius tax treaty, as they were not independent in their decision making, and the control over decision making relating to purchase and sale of shares did not lie with the taxpayers. Accordingly, the tax authorities in the WHT order directed the taxpayers to withhold tax at the rates prescribed therein.

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<sup>1</sup> Tiger Global International II Holdings, In re [2020] 116 taxman.com 878 (AAR – New Delhi)

- Subsequently, the taxpayers, on 19 February 2019, filed applications before the Authority for Advance Rulings (AAR) to determine whether the gains arising from the sale of FPL shares would be chargeable to tax in India under Income-tax Act, 1961 (ITA) read with the India-Mauritius tax treaty?

### **Advance ruling process:**

- The AAR after examining the application for an advance ruling can either allow or reject the application. In case the advance ruling application is allowed, then the case is decided on merits.
- The AAR cannot allow an advance ruling application if the question raised in the application:
  - Is pending before any income-tax authority or appellate tribunal; or
  - Involves determination of fair market value (FMV) of any property; or
  - Relates to a transaction or issue which is designed prima facie for the avoidance of income-tax.

### **Decision of the AAR:**

- The tax authorities had challenged that the applications for advance ruling should not be admitted as all the three conditions were satisfied in the case under consideration:
  - The question raised in the applications was already pending before the income-tax authorities;
  - The applications were filed to determine the FMV of the shares of FPL;
  - Based on facts of the case the transaction was prima facie designed for avoidance of tax.

### **Whether there was any pendency of proceedings?**

- The AAR noted that in the report dated 3 January 2020 the Commissioner of Income-tax had admitted that as on the date of applications, no proceeding was pending against the taxpayers. Further, the Supreme Court in the case of *Asgarali Nazarali Singaporawalla v. State of Bombay*<sup>2</sup> had held that a legal proceeding was pending as soon as it commenced and until it was concluded.
- With respect to the pendency of proceedings due to filing of the withholding tax application, the AAR held that:
  - The proceedings relating to the withholding tax application were concluded on 17 August 2018 on issuance of the WHT order.
  - The amount subject to withholding tax was credited / paid by the taxpayer on 17 August 2018, which was prior to the filing of applications on 19 February 2019. Thus, even if the WHT order was modified the same could not have been given effect to.
  - The CBDT Circular No. 774 dated 17 March 1990 clarified that once the transaction was closed there could be no pending proceeding.

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<sup>2</sup> *Asgarali Nazarali Singaporawalla v. State of Bombay* AIR 1957 SC 503

- Word ‘already pending’ was to be interpreted as pending as on the date of application and not with reference to any future date. Reliance in this regard was placed on the case of Hyosung Corporation v. AAR<sup>3</sup>.
- Thus, the contention of the Revenue that the withholding tax proceedings were pending as on the date of filing of the applications, was not accepted.
- The AAR also held that the provisions of the ITA do not restrict the taxpayer to approach the AAR even though the matter has been examined in the withholding tax proceedings.
- In view of the above, the AAR held that the restriction of admitting an application due to pendency of proceedings did not apply.

#### Whether the case involved determination of FMV?

- The AAR held that the current case did not relate to determination of FMV on the following basis:
  - The current issue was relating to chargeability of gains to tax in India. It was not relating to valuation of FPL shares or computation of capital gains.
  - The exercise of valuation of shares and the computation of capital gains was required to be undertaken only if the gains were taxable in India.

#### Whether transaction / issue was designed prima facie for avoidance of tax?

- The AAR held the following in relation to the scope of evaluation of a transaction / issue designed prima facie for avoidance of tax:
  - While tax avoidance itself was not impermissible, the question was whether the transaction was designed prima facie for availing an unintended benefit?
  - At the stage of admission of an advance ruling, the requirement was not to conclusively establish that there was tax avoidance; rather it was to be demonstrated that prima facie the transaction or the issue was designed for avoidance of tax.
  - The question in the current case was with respect to chargeability of capital gains and purchase and sale of shares, both were relevant for computing capital gains. Thus, the entire transaction of acquisition and sale of shares was to be looked at as a whole to determine if there was a prima-facie case of avoidance of tax.
- The AAR noted and held the following :
  - The principal objective of the taxpayers was to act as an investment holding company for a portfolio investment domiciled outside Mauritius.
  - Control and management did not mean day-to-day affairs of the business but meant the head and brain of the company.

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<sup>3</sup> Hyosung Corporation v. AAR [2016] 66 taxmann.com 217 (Del)

- The authority to operate bank account of the taxpayers for transaction above US\$ 250,000 was with two personnel who were not on the Board of Directors of the taxpayer and was required to be countersigned by one of the Mauritius-based directors.
- The said two personnel were key personnel of the Tiger Global group and were managing and controlling the affairs of the entire organisation structure.
- Thus, the funds were ultimately controlled by the two personnel.
- While the Board of Directors of the taxpayers took the decision for investment or sale but the real control over the decision was with one of the two personnel managing and controlling the affairs of the entire organisation structure.
- In view of the above, the head and brain of the taxpayers and consequently their control and management was not situated in Mauritius, but in the USA.
- The AAR held that the holding structure coupled with prima facie management and control of the holding structure (including the taxpayers) were relevant factors to determine avoidance of tax. Considering that real management and control of the taxpayers was with Mr. Coleman, the AAR held that the taxpayers were only see-through entities for availing the benefits of the India-Mauritius tax treaty.
- The AAR held the following with respect to the eligibility of the taxpayers to benefits under Article 13 of the India-Mauritius tax treaty:
  - A treaty was to be interpreted in good faith. The context and purpose of the treaty was to be determined on the basis of preamble, annexure, subsequent agreement, relevant international rules applicable to the treaty.
  - As per the clarification issued by the CBDT vide Circular No. 682 dated 30 March 1994, a Mauritian tax resident was exempted from the gains on alienation of shares of an Indian company.
  - The taxpayers had transferred shares of Singapore Company and not that of an Indian company.
  - The India-Mauritius tax treaty (original as well as amended vide Protocol signed on 10 May 2016) never intended to exempt from capital gains tax, the sale of shares of a company not resident in India.
  - In view of the above, the taxpayers were not entitled to claim benefit of exemption from capital gains on the sale of FPL shares.
- The AAR relied on the decision of the Supreme Court in the case of Vodafone International BV v. UOI<sup>4</sup> and held that in the absence of any direct investment in India, the arrangement was pre-ordained transaction created for tax avoidance, since:
  - The immediate investment destination of the taxpayers was Singapore as investments were made in FPL;

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<sup>4</sup> Vodafone International Holding BV v. UOI [2012] 341 ITR 1 (SC)

- In absence of foreign direct investment (FDI) in India, the taxpayers did not have business operation or taxable revenue in India.

In view of the above, the AAR held that the issue involved in the question raised in the advance ruling applications, was designed prima facie for avoidance of tax and the third restriction on admission of an advance ruling applied. Thus, the AAR rejected admission of the taxpayers' applications.

#### **Comments:**

- This ruling lays down an important principle that the control and management of a company does not mean control over the day-to-day affairs of the business, but the head and brain of the companies, i.e. the persons who are the ultimate decision makers.
- The ruling also lays down the principle that the holding structure coupled with prima facie management and control of the holding structure, are relevant factors to determine avoidance of tax.
- The taxpayers may want to evaluate the impact of this ruling to the facts of their case. It may be pertinent to note that an advance ruling is binding only on the applicant and the tax authorities in respect of the relevant transaction. It only has a persuasive value in the case of other taxpayers.



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