Mauritius tax treaty benefits upheld and clarity given on residency status

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Overview

Pursuant to a favourable tax ruling for Tiger Global Eight Holdings in the Policybazar case, in the Flipkart Singapore case involving Tiger Global International Holdings (the "**Taxpayer**"), the Delhi High Court (the "**DHC**") held that the order dated March 26, 2020 passed by the Authority for Advance Rulings (the "**AAR**") denying capital gains tax benefits to the Taxpayer under Article 13 of the double taxation avoidance agreement between India and Mauritius (the "**Mauritius DTAA**") was patently illegal and untenable.

Background

The Taxpayer is incorporated in Mauritius to undertake investment activities. Tiger Global Management LLC ("**TGM LLC**"), a company incorporated in Delaware, is the Taxpayer's Investment Manager. The Taxpayer has a Tax Residence Certificate ("**TRC**") issued by the Mauritius Revenue Authority, and the Taxpayer's activities are regulated by the Financial Services Commission of Mauritius.

The Taxpayer acquired 23,670,710 shares of Flipkart Singapore between October 2011 to April 2015 (i.e., prior to April 1, 2017), which the Taxpayer sold in 2018 to another non-resident entity based in the Cayman Islands. The Taxpayer contended that the sale of 23,670,710 shares of Flipkart Singapore is not subject to capital gains tax in India under the indirect transfer provisions of the Income-tax, Act, 1961 ("**IT Act**") in light of Article 13 of the Mauritius DTAA read with Section 90 of the IT Act, as per which capital gains derived by a Mauritius tax resident (holding a valid TRC) from the sale of shares of a Singapore company that owns an Indian company is taxable only in Mauritius.

The Indian tax authority (the "**ITA**") disagreed, and the matter reached the DHC.

The DHC's ruling

We have provided below some of the key highlights of the DHC's detailed 224-page order.

- The ITA's finding that TGM LLC is the parent company of the Taxpayer is wholly erroneous as there is no equity participation by TGM LLC in the Taxpayer, and TGM LLC only serves as the Taxpayer's investment manager. Moreover, the Taxpayer has been set up as a pooling vehicle for investments and has aggregated funds from more than 500 investors located in 30 jurisdictions worldwide.

- All the shares of Flipkart Singapore were acquired between October 2011 to April 2015, and the share transfer in question was undertaken on August 18, 2018. Based on the financial statements submitted by the Taxpayer for the period ending December 31 2017, the Taxpayer had incurred an expenditure of US$ 1,063,709 in Mauritius. Further,

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the Taxpayer's total liabilities, including shareholders' equity, for the period ending December 31, 2017 were at US$ 1,764,819,299. From these facts, it cannot be said that the Taxpayer lacked economic substance in Mauritius or that it was domiciled in Mauritius with the sole intention of taking advantage of the Mauritius DTAA.

- A parent entity or a holding company has a legitimate right to exercise oversight and broad supervision over the affairs of its subsidiary. A subsidiary is recognised in law as having a distinct and independent legal persona, which can be disregarded only:

  (i) in the event of fraud,
  (ii) if the subsidiary has been interposed to camouflage sham transactions,
  (iii) if the subsidiary has been created to perpetuate an illegality, or
  (iv) if the subsidiary is a mere puppet of the parent and lacking in economic substance.

- Merely because a parent entity exercises shareholder influence over its subsidiary does not lead to an automatic assumption that the subsidiary is not independent or that it is wholly subservient to the parent entity. In this regard, the DHC highlighted that simply because two members of the Taxpayer's board of directors also happen to be the General Counsel and director, respectively, of TGM LLC, this in itself does not render the Taxpayer as not being an independent entity. Additionally, the DHC negated the ITA's contention that an adverse inference should be drawn on the independence of the Taxpayer because Mr. Steven Boyd, the General Counsel of TGM LLC and a non-resident director of the Taxpayer, had been involved in some of the key decisions on the Taxpayer's board (basis the minutes of such meetings).

- the ITA's allegation that the "real control" of the Taxpayer does not lie in Mauritius is wholly erroneous and without substance, factual support, or legal merit. To substantiate this, the ITA is relying on the fact that a person from the US has been authorised to give instructions for the operation of the Taxpayer's bank account. However, in actuality, it is the Taxpayer's board of directors that has provided this authorization. If the ITA's argument is taken to its logical conclusion, an absurd outcome unintended by law will arise, as every company's board will have to undertake all day-to-day administrative tasks itself in order to demonstrate the board's control over the affairs of the company.

- A transaction can be considered "designed" for the avoidance of tax only if the facts involved in the transaction show that the transaction is not based on sound commercial or business rationale but has been entered into for the purpose of avoidance of tax by illegal or improper means, without any real and genuine business purpose. The DHC found that the ITA had not identified or proven a single fact to establish the artificiality of the transaction undertaken by the Taxpayer. In fact, the sole basis for the allegations made by the ITA was that other intermediate entities owned the Taxpayer, and the ultimately beneficial owners of the Taxpayer were US resident entities. This is of no relevance if the transaction is *prima facie* not found to be designed to avoid payment of

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income tax.

- The mere fact that a Mauritius-based entity is making investments cannot result in a default adverse inference or raise a presumption of illegality. An overall inspection of the data and materials reveals that Mauritius is one of the more favourable jurisdictions for foreign institutional investors seeking to invest in India, and therefore, it is wholly erroneous to presume that investments originating from Mauritius are inherently suspect or should be viewed through a tainted prism.

- The DHC ruled that the issuance of a TRC by the Mauritius Revenue Authority is sacrosanct, and due weightage must be accorded to it because it establishes the TRC holding entity as a *bona fide* entity domiciled in Mauritius to pursue a legitimate business. Thus, the ITA is not justified in doubting the presumption of validity attached to a TRC as it will result in an erosion of faith and trust reposed by contracting states in each other.

- Article 13(3A) of the Mauritius DTAA embodies the intent to ring-fence all transactions consummated prior to April 1, 2017. Therefore, the grandfathering clause in Article 13(3A) must exclude the transaction undertaken by the Taxpayer from the ambit of capital gains tax.

Our comments

Clearly, the ITA's objective is to maximize tax revenue from foreign investors investing through tax-friendly jurisdictions such as Mauritius, Singapore and Cyprus, and in this endeavour, the ITA continues to pursue bulge bracket funds and multinational companies, although eventually, the ITA is unable to substantiate that such offshore entities have been set up solely for claiming tax benefits.

The DHC's ruling is a welcome decision. Various important observations have been made by the DHC, which will assist investors not only in respect of capital gains tax issues, but also against permanent establishment claims made by the ITA on account of foreign directors being on the board of an Indian subsidiary and providing supervisory or bank account signatory services to their shareholders to safeguard the latter's interests.

There is a possibility that the ITA will appeal the DHC decision in the Supreme Court. In this regard, in January 2024, the Supreme Court has stayed another identical DHC ruling in the *Blackstone Partners* case where it was held that TRCs are sufficient for availing benefits under double tax avoidance agreements. This case is pending final hearing and is scheduled to be heard soon. The hope is that the Supreme Court pays heed to the well-drafted and reasoned 224-page order passed by the DHC and affirms the DHC rulings in the Blackstone and Flipkart Singapore cases.

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