

Investment through Mauritius - Is it Still a Valid Ticket to Claim Tax Exemption from Capital Gains?

	NET CHANGE IN VALUE*	ENDING BALANCE	% OF BALANCE
INTERNATIONAL GROWTH	\$29.44-	\$460.02	18.2%
AGGRESSIVE GROWTH	\$16.50-	\$348.59	14.9%
PUTNM ENRG GRO	\$4.70-	\$117.67	4.9%
PUTNM NEW OPRT	\$13.24-	\$252.95	10.5%
GSPC SCI&TECH	\$4.25-	\$117.67	4.9%
INCOME	\$2.54-	\$117.67	4.9%
SOCIAL RESPN	\$2.54-	\$117.67	4.9%
CAP PRESERV	\$2.54-	\$117.67	4.9%
CAPTL CSV	\$2.54-	\$117.67	4.9%
GOVT SEC	\$2.54-	\$117.67	4.9%
INC STBLTY	\$2.54-	\$117.67	4.9%
ST PLUS	\$2.54-	\$117.67	4.9%

Favourable provisions of tax treaty more often than not results in desire to implement the transaction “through a country which has a favourable treaty provisions”. So far as India is concerned, the most glaring tax treaty is treaty between India and Mauritius. When there is a favourable tax treaty between India and Mauritius say compared to treaty between India and US it would be a natural desire of the contracting parties to execute the transactions through Mauritian subsidiary and not directly from US. This is generally called “treaty shopping” i.e. to shop for the most favourable tax treaty. While dealing with issue of treaty shopping, it appears that Indian Supreme Court has approved the concept by observing that “...if it was intended that a national of a third state should be precluded from the benefits of the DTAC, then a suitable term of limitation to that effect should have been incorporated therein” (*Azadi Bachao Andolan 263 ITR 706*). The concept of treaty shopping has been recently dealt with by the Bombay High Court in the case of *Aditya Birla Nuvo Limited & Ors*. In the enclosed article we have analysed the Bombay High Court decision in greater detail and tried to address certain issues dealt by the High Court.

Following is an analysis post the recent ruling of Bombay High Court in the case of *Aditya Birla Nuvo Ltd & Ors*.

Background

Article 13(4) of the India-Mauritius Double Taxation Avoidance Agreement (‘India – Mauritius DTAA’) which provides for right to

taxation of capital gains arising from the alienation of shares in an Indian company only to the State in which the person deriving the gains is a resident. Mauritius Revenue Authorities (‘MRA’) does not levy capital gain taxes on the Mauritian Residents. Ever since the India-Mauritius DTAA came into force on the 6th December, 1983, various

(Contributed by the Committee on International Taxation of the ICAI. Comments can be sent to citax@icai.org)

multinationals have invested in India via Mauritian SPV with the expectations of repatriating profits on sale of such investments without being subjected to tax in India.

By a Circular 682 dated 30-3-1994, the Government of India also clarified that capital gains of any resident of Mauritius by alienation of shares of an Indian company shall be taxable only in Mauritius according to Mauritius taxation laws and will not be liable to tax in India. Further, in order to clarify its position on the sanctity of the Tax Residency Certificate ('TRC') and its relevance in claiming the benefits of the India- Mauritius DTAA, Central Board of Direct Taxes ('CBDT') has issued Circular 789 dated 13-4-2000, reiterating that TRC would constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the DTAA in case of dividend income and capital gains arising to Mauritian companies. The Supreme Court has confirmed the validity of the above referred circular in the case of *Azadi Bachao Andolan* (263 ITR 706).

Subsequent developments

In spite of the clear instructions issued to the Income Revenue Authorities ('IRA') vide circular no 682 and circular no 789, the ITA have in the recent past, denied granting treaty benefits to certain Mauritian companies on the ground of lack of substance. The main contention of the IRA is that the Mauritian companies are shell companies incorporated with no operations and incorporated only with the intention to avail the benefit of the India-Mauritius DTAA. The IRA are also arguing that the real ownership rights/beneficial ownership are held by the holding companies of the Mauritian companies which are tax resident of a third country. These transactions are considered as colourable devices with the real

intentions being treaty shopping and consequently benefit of India – Mauritius DTAA has been denied in certain cases.

However, Authority for Advance Rulings ('AAR')/Tribunals have consistently applied the decision of Azadi Bachao Andolan and held that Mauritian companies, holding valid TRCs, are eligible for the benefits given under India – Mauritius DTAA.

- *E* Trade Mauritius Limited* (AAR No 826 of 2009)
- *D B Zwirn Trading No 3 Ltd.* (AAR No 878 of 2010); and
- *Delhi ITAT decision in the case of Saraswati Holding Corporation Inc* (111 TTJ 334)

Bombay High Court ruling in the Case of Aditya Birla Nuvo Ltd. :

In the recent ruling of the Bombay High Court in the case of *Aditya Birla Nuvo Ltd.* ('ABNL') (2011-TII-26-HC-MUM-INTL) (formerly known as Indian Rayon & Industries Limited), New Cingular Wireless

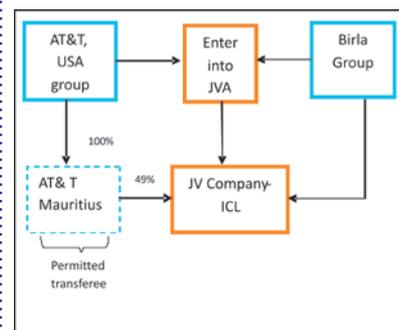
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Services Inc. ('NCWS') and Tata Industries Ltd. ('TIL'), the question of taxability of capital gains in case of sale of shares of Idea Cellular Ltd. (Indian company) held by NCWS through AT&T Mauritius to ABNL and TIL has been dealt with.

Brief facts of the case

- AT&T, USA, represented by its group companies entered into a Joint Venture Agreement ('JVA') with the Birla Group, represented by its group companies to form a Joint Venture company ('JVC') named Birla Communications Limited ('BCL') (later renamed as Birla AT&T Communications Ltd. and eventually Idea Cellular Limited ('ICL')) for carrying on the wireless telecommunication services in India.
- As per the JVA 49% of the equity shares of ICL were to be subscribed and owned by the co-founder- AT&T USA and balance 51% by co-founder- Birla Group. As per the terms of JVA –
 - The shares of the JVC shall be held by the AT&T, USA and Birla Group in their own name or through a 'permitted transferee' (i.e. a 100% subsidiary of the founder company);



- The permitted transferee and the founders were jointly and severally liable for fulfillment of all obligations of the JVA;
- Though the equity shares

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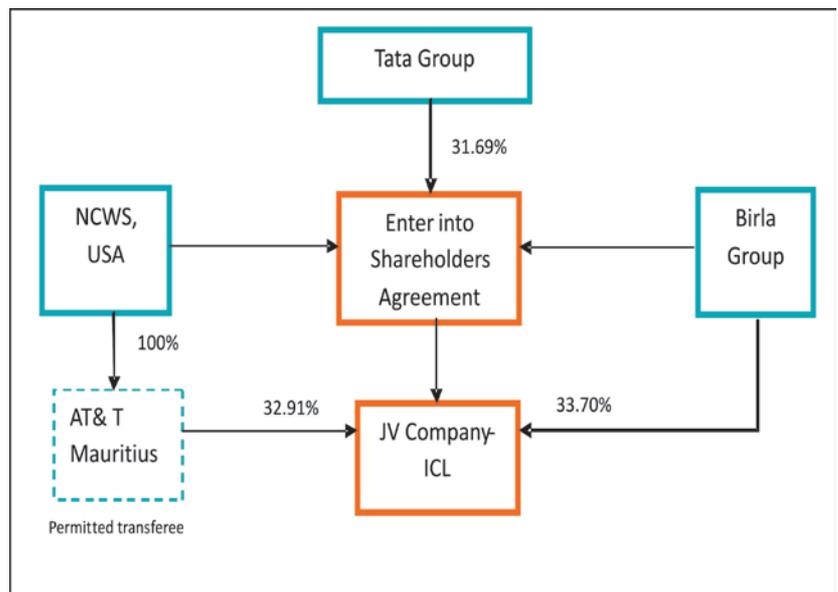
Birla Nuvo Ltd. ('ABNL') (2011-TII-26-HC-MUM-INTL) (formerly known as Indian Rayon & Industries Limited), New Cingular Wireless Services Inc. ('NCWS') and Tata Industries Ltd. ('TIL'), the question of taxability of capital gains in case of sale of shares of Idea Cellular Ltd. (Indian company) held by NCWS through AT&T Mauritius to ABNL and TIL has been dealt with.

can be issued in the name of permitted transferee, all rights in respect of the said equity shares of the JVC like voting rights, right of management, right to appoint the management, right of sale or alienation etc were vested with the founder company;

- The Share Certificate of equity capital issued in the name of the permitted transferee shall carry an endorsement to the effect that the sale of the said shares shall be subject to terms of the JVA.
- 49% of the shares of JVC i.e. ICL were allotted to AT&T, Mauritius, a 100% subsidiary of AT&T, USA as a permitted transferee.
- AT&T, Mauritius was neither a party to the JVA nor was it obliged to make payment for the shares allotted as permitted transferee. Yet it had made the payment to discharge the liability of AT&T, USA in respect of the shares subscribed for by it.
- In December 2000, a Shareholder's Agreement ('SA') was entered into between the

Birla Group, AT&T Wireless Group (represented by AT&T Wireless Services Inc., USA) and Tata Group wherein it was agreed to merge the Tata Cellular Limited into ICL and shareholding was restructured according to the SA.

- In October 2004 Cingular Wireless LLC USA acquired shares of AT&T Wireless Services Inc. USA and renamed it as New Cingular Wireless Services Inc., USA ('NCWS').
- Revised shareholding in accordance with Shareholder's agreement and post acquisition of AT&T by Cingular Wireless is as under:



- Later in July 2005, NCWS has transferred its shares in ICL to Birla Group (ABNL) and Tata Group (TIL).
- ABNL has applied and obtained NIL withholding certificate from the IRA for the remittance of USD 150 million to AT&T Mauritius.
- On the other hand, TIL has purchased the shares of AT&T Mauritius from NCWS (successor of AT&T, USA) for USD 150 million.
- On the same date of receipt of proceeds from ABNL by AT&T

Mauritius, the proceeds were paid to NCWS as dividend and repayment of loan obtained from NCWS.

Issues before the High Court

- a) Taxability of capital gains in India in respect of profits arising to AT&T Mauritius on sale of shares of ICL to ABNL in view of favourable tax treaty between India and Mauritius;
- b) Whether ABNL can be considered as an agent of NCWS/ MMM Holdings in accordance with provisions of Section 163 of the Act;
- c) Sanctity of NIL withholding certificate issued by the IRA;

- and
- d) Taxability of transfer of shares of AT&T Mauritius

Assessee's contentions

- **Transfer of shares in ICL by AT&T Mauritius to ABNL**
 - Gains arising or accruing to AT&T Mauritius is not taxable in India in view of Article 13(4) of the India-Mauritius DTAA read with CBDT Circulars Nos 682 and 789 - placing reliance on UOI vs. Azadi Bachao Andolan (supra).

- Once the IRA has admitted that income has accrued and arisen in India, Section 9 would not apply and consequently question of recovering tax on basis of deemed income from ABNL as representative assessee of non-resident does not arise as interpreted in *Eli Lilly and company (I) P Limited (312 ITR 225)*.
- Once certificate under Section 195 is issued by the IRA authorising remittance to be made without deduction of tax at source, it cannot now go back on the certificate and seek to recover tax.
- The IRA, while accepting that AT&T, Mauritius is the legal owner of the shares of ICL, questioning whether NCWS is the real owner of the said shares itself amounts to lifting of the corporate veil which is not permissible in view of the decision of the Supreme Court in the case of *Azadi Bachao Andolan (supra)*.

■ **Transfer of shares of AT&T Mauritius to TIL by NCWS & MMMH**

- The acquisition of shares of AT&T, Mauritius does not mean acquisition of shares of ICL held by AT&T Mauritius as shares of ICL continue to be held by AT&T Mauritius even after the shares of AT&T Mauritius were acquired by TIL.
- NCWS have not transferred any capital asset situated in India and no income accrue or arise or is deemed to accrue or arise in India to NCWS and MMMH which can be taxed in India and consequently recovering tax from NCWS or from TIL as agent of NCWS and MMMH does not arise at all.

Arguments by the IRA

- The real owner of the shares of ICL was NCWS/MMMH (both residents of USA) and not AT&T Mauritius who have transferred the shares of ICL; therefore the India-Mauritius DTAA would not apply.
- Certificate under Section 195 of the Act was obtained by ABNL by suppression of material facts and misrepresentations. Reliance was placed on the letter by the Grasim Industries Limited representing Birla Group to NCWS which clearly mentioned Birla Group's intention to purchase shares of ICL subscribed to by NCWS.
- There is no lifting of corporate veil but simply determining as to who should be regarded as the owner of the shares of ICL.

Observations of the High Court

Taxability of capital gains earned by AT&T Mauritius in India:

- Capital gains arising to AT&T USA (succeeded by NCWS) on sale of shares of ICL to IBNL would be liable to tax in India and beneficial provisions of India-Mauritius DTAA would not be applicable.
 - AT&T Mauritius is holding the shares as permitted transferee only;
 - As per the JVA, AT&T USA was to carry on the business in India by subscribing to the shares of ICL;
 - Right to appoint directors, voting rights, right of sale/alienation etc vests with AT&T USA and not with AT&T Mauritius;
 - AT&T Mauritius, the permitted transferee, was bound by the JVA and could not independently exercise any of the rights linked with the shareholding;
 - As per JVA/SA sale of

shares by AT&T Mauritius can be effected only with the consent of NCWS – agreement for sale of shares was executed by AT&T Mauritius and NCWS;

- As AT&T Mauritius is not the “owner” of the shares in ICL, provisions of India-Mauritius DTAA would not apply.

Whether ABNL can be considered as an agent of NCWS:

- After relying on the decision of Supreme Court in the case of *Eli Lilly & Co (312 ITR 325)*, High Court observed that Section 9 of the Act is a combination of a machinery provisions and charging provisions.
- Thus, income accruing or arising in India would be deemed to accrue or arise in India in accordance with provisions of Section 9(1) of the Act and hence can be assessed in the hands of NCWS or ABNL, as an agent of the non – resident, under Section 163 of the Act.

Sanctity of NIL withholding certificate issued by the IRA:

- The High Court observed that

Treaty shopping is only a symptom of a more fundamental

development: the globalisation of markets has allowed multinational corporations effectively to transcend the jurisdiction of tax authorities whose sovereignty remains welded at the national level. There is no real domestic remedy for problems that jump multiple national borders. Concurrently, given the current fissures on the international scene, there is little prospect for a prompt solution at the international level. ☞

in the present case, certificate under Section 195 of the Act was issued by relying on the statements made by Indian Rayon (now known as ABNL) to the effect that the shares it had agreed to purchase belonged to AT&T Mauritius.

- It was held that in the facts of the present case, the certificate obtained by Indian Rayon by furnishing incorrect facts and by making misleading statements would not preclude the IRA from initiating the proceedings under Section 163 of the Act.

Taxability of transfer of shares of AT&T Mauritius:

- It was observed that TIL cannot be said to be unaware of the fact that the shares of ICL held by AT&T Mauritius did not belong to AT&T Mauritius because TIL was party to SA, wherein all

The reading of the case of *Aditya Birla Nuvo Ltd.* (supra) clearly indicates that the High Court has analysed the JVA and the Shareholders Agreement entered into by the parties of the case and pronounced its decision based on the facts peculiar to the transactions entered into by them. The High Court has carried out a balancing act and without dealing with the ratio laid down by Supreme Court in the case of *Azadi Bachao Andolan* held that in the given facts, the shares were subscribed and owned by AT&T USA (succeeded by NCWS) and therefore the question of applying the India-Mauritius DTAA does not arise and hence the ruling of *Azadi Bachao Andolan* does not hold true. ☺

rights in respect of the shares of JVC to be issued after the SA was to vest in AT&T USA and not with AT&T Mauritius. In the Share Purchase Agreement, it is recorded that the sale of shares of AT&T Mauritius in favour of TIL would take place only after the sale of shares of ICL in favour of Indian Rayon takes place so that on the date of transfer of shares of AT&T Mauritius, only 50% of the ICL shares remain in the name of AT&T Mauritius.

- The High Court held that the prima facie opinion of the Revenue that the transaction between TIL and NCWS/MMMH for sale and purchase of shares of AT&T Mauritius was a colourable transaction and in fact the transaction was for sale and purchase of ICL shares by NCWS to TIL cannot be said to be devoid of any merit.

Some Interesting Findings of the High Court

- The High Court has distinguished the facts of *Azadi Bachao Andolan* with facts of the present case. High Court observed that –
“In the present case, it is AT&T USA which has entered in to the JVA for the purpose of carrying on business in India. It is AT&T USA which has subscribed to and owned 49% equity shares (later on reduced to 32.91%) of the JVC under the JVA. It is at the instance of AT&T USA the shares subscribed were issued in the name of its 100% subsidiary as a permitted transferee. It is AT&T USA as a shareholder of the JVC, entered into a Shareholders Agreement wherein the shareholding was reduced with the induction of the Tata Group. It is AT&T USA which has agreed with the other joint venture partner that

*irrespective of issuance of the shares in the name of a permitted transferee, all rights relating to those shares including the right to sell the shares shall vest in AT&T USA. Therefore, in the facts of the present case, where the investments are made by AT&T USA and not by AT&T Mauritius, the ratio laid down by the Apex court in the case of *Azadi Bachao Andolan* (supra) would not apply.”*

- In reply to the contention of the ABNL that the amount received by AT&T USA were not sale proceeds but dividend income and return of loan advanced, the High Court held that –
“The argument that the amount received by NCWS was not the sale proceeds but represented the dividend income and return of loan advanced by NCWS to AT&T Mauritius cannot prima facie be accepted, because, under the JVA the liability to pay for the equity shares was on AT&T USA and if AT&T USA discharges that liability by a device of advancing loan to AT&T Mauritius and paying through AT&T Mauritius, then it is open to the assessing officer to discard the device and take into consideration the real transaction between the parties.”
- Regarding the contention of the Assessee that piercing of the corporate veil is invalid in view of the decision of the UOI vs. *Azadi Bachao Andolan* (supra), the High Court observed that –
“Thus, in the facts of the present case, the capital gains is sought to be taxed in the hands of NCWS (successor to AT&T USA) not as a shareholder of AT&T Mauritius but on account of the direct investment in India made by AT&T USA as a joint venture partner under the JVA. In these circumstances, it cannot be said

that the Revenue is trying to lift the corporate veil to find out the real owners of the shares but the Revenue is seeking to tax NCWS, because investment in the shares of the JVC made by the predecessor of NCWS viz. AT&T USA by subscribing to the shares of the JVC under the JVA and on sale of the said shares, capital gains have accrued to NCWS."

- Regarding ownership of shares by NCWS/AT&T Mauritius, High Court has observed that - "AT&T USA as a joint venture partner under the JVA, had subscribed to the shares of the JVC is evident from the fact that AT&T USA was a party to the Shareholders agreement as a shareholder of the JVC. Even in the Shareholders Agreement, it is recorded that AT&T USA is carrying on business in India through its subsidiary AT&T Mauritius. Indian Rayon and TIL were parties to the Shareholders Agreement. Therefore, Indian Rayon (Birla Group), TIL (Tata Group) and NCWS (successor to AT&T USA) cannot contend that AT&T Mauritius was the owner of the ICL, especially when they were the joint venture partners of the JVC and the ICL shares were allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA, as per the terms of the JVA / Shareholders Agreement. The fact that in the Shareholders Agreement it is recorded that AT&T USA represents the AT&T Wireless Group and that the Shareholders Agreement permits AT&T Mauritius as a member of the AT&T Wireless Group to pay for the balance equity shares of the JVC, does not in any way alter the ownership rights over the shares of ICL subscribed to by AT&T USA and allotted in the name of AT&T Mauritius as

a permitted transferee of AT&T USA".

Summary

- Income earned by AT&T Mauritius on sale of shares of ICL is in substance income of AT&T USA (succeeded by NCWS) and would be subject to tax in India.
- AT&T USA (succeeded by NCWS) is the real owner of the shares of ICL and hence benefit of India-Mauritius DTAA is not applicable in the given case.
- Lower withholding certificate obtained by suppressing relevant facts are not binding.
- Indian payer can be held as agent of overseas seller in accordance with the provisions of Section 163 of the Act, when the income earned by overseas assessee is subject to tax in India.

What is Next...

The reading of the case of Aditya Birla Nuvo Ltd. (supra) clearly indicates that the High Court has analysed the JVA and the Shareholders Agreement entered into by the parties of the case and pronounced its decision based on the facts peculiar to the transactions entered into by them. The High Court has carried out a balancing act and without dealing with the ratio laid down by Supreme Court in the case of Azadi Bachao Andolan held that in the given facts, the shares were subscribed and owned by AT&T USA (succeeded by NCWS) and therefore the question of applying the India-Mauritius DTAA does not arise and hence the ruling of Azadi Bachao Andolan does not hold true.

■ Is Azadi Bachao Andolan still valid?

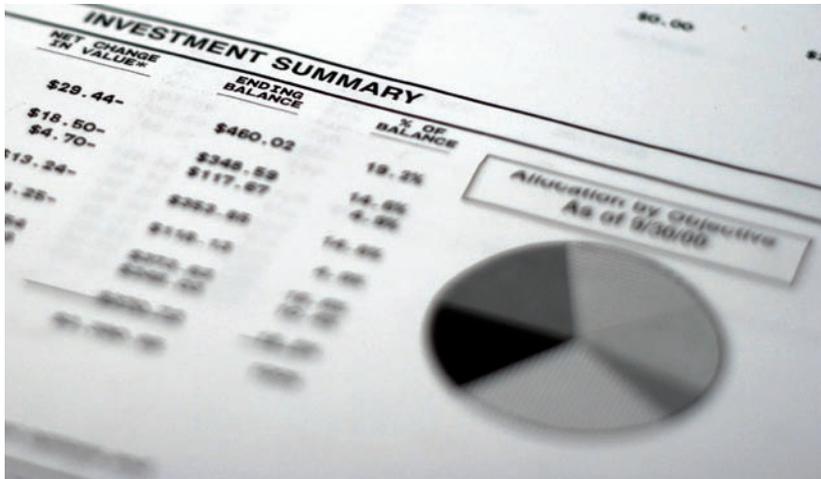
As explained earlier, in the case of Azadi Bachao Andolan, the Supreme Court has followed CBDT Circular no. 789 and

Readers will recall the decision of the Bombay High Court in the case of Vodafone International Holding B.V. (Vodafone). In the given case Vodafone has purchased shares of another non-resident company, which indirectly was holding a controlling stake in an Indian Company. In the given case, Bombay High Court held that the said transaction would be subject to Indian tax law, since the dominant purpose of the transaction was to acquire the controlling interest in an Indian Company. Currently, hearing before the Supreme Court is going on in the Vodafone's case and clarity is awaited from the apex court. ☺☺

held that holding a valid TRC is a sufficient compliance for application of India-Mauritius DTAA. The same still holds good post the decision of the Bombay High Court, as in the given case the High Court has held based on the specific facts and circumstances, investment has been made by AT&T USA and not by AT&T, Mauritius and hence decision of Azadi Bachao Andolan is not applicable. Thus, in the facts and circumstances where the Mauritius Company can demonstrate that it is the real owner of the investments made in India, it is still possible to argue that the Supreme Court ruling is applicable and benefits of India-Mauritius DTAA cannot be denied.

■ Vodafone Decision...

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■ Treaty Re-negotiation

The IRA is in negotiations with the Government of Mauritius to amend the India-Mauritius DTAA with a specific emphasis to incorporate Limitation of Benefits clause so as to ensure shell/conduit companies are not entitled to the Tax Treaty benefits. However, nothing substantial has happened till date in this regard.

■ Direct Tax Code

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To conclude...

The ruling is a significant setback for the tax payers. Though the observations of the court is in

Cross-border tax structures periodically optimise available tax treaty benefits having regard to the differences between various bilateral tax treaties. Structures that take advantage of such differences in bilateral treaties (e.g., holding companies situated in advantageous jurisdictions) may, however, be under attack by IRA under treaty shopping principles. Though it is expected that Supreme Court's decision in the case of Vodafone may give better clarity on the issues, it seems that end to the litigation with the IRA is far far away. ”

respect of writ jurisdiction, and not a final ruling on merits, the same will have a significant impact on the IRA's approach in dealing with cross-border transactions. The IRA will try to look through the overall structure of the operations while determining real owner of investments in India. Further, onus is now placed on the tax payer in connection with the level and nature of information/disclosures/documentations to be submitted while obtaining the lower withholding certificates.

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