My TRC, My Residency – Raging Battle for Treaty Benefits...

Sep 12, 2023

Alok Pareek

Chartered Accountant

Historically the major chunk of foreign investments have flown in India through the Mauritius route next best the Singapore route, primarily for the tax benefits what these tax treaties provide for.

The key tax benefit is the exemption from capital gains tax in India to the resident of the Mauritius / Singapore, gains which arise on transfer of shares in an Indian concern held by the company tax resident in Mauritius / Singapore.

So, has this been wrongly done? No of course not. India needed investments from the rich, the developed nation, to have the growth trajectory built up. And the purpose has been achieved also with India being considered as a global power now, one of the largest economies in the world! The country and its foreign investors have both benefited over decades.

But with the strong economy now which remained scratch less even during the global recessions, it was the time for India to offer only benefits what other world strong economies offer rather than a luring capital gains incentives regime through the tax treaties.

Also, the world had started moving towards restricting the treaty benefits with GAAR provisions inserted in domestic tax laws and the never like before start of the global project, the BEPS initiatives. Accordingly, India being among the front runners brought amendment in the tax treaties with Mauritius and Singapore (the so called tax heavens) and has put a full stop to the tax exemptions on capital gains for the investments made in India post 1 April 2017.

Although this change in tax regime has not been swallowed by the investors softly but still the government has played very fairly by grandfathering the investments made till 31 March 2017, i.e any capital gains earned on the investments made until 31 March 2017 will still continue to enjoy the tax exemption in India of course upon satisfaction of conditions laid down in the respective tax treaty.

However, as intention of the government was to keep a check on treaty shopping entities, a carve out for claiming these treaty benefits was also incorporated (referred to as Limitation of Benefits) by incorporating that treaty benefits will not be available if affairs of the resident entity were arranged with the primary purpose to take advantage of the benefits of treaty only. For this purpose, certain other criteria like monetary threshold of expenditure to be incurred in Mauritius /Singapore etc have been provided.

Moving ahead from these theory provisions to the practical business world where the TAX RESIDENTS of Mauritius / Singapore in their due course of business naturally, made sale of the investments in India, relying on the benefits conferred under Article 13 and also with due care satisfying the LOB conditions under Article 27A/ 24A of respective tax treaties, were taken by surprise with the notices of tax department challenging the claim of treaty benefits and finally ordering payment of capital gains tax on sale of shares done out of the investments made in India even for the shares acquired before 1 April 2017.

In the recent past months Indian judiciary has pronounced a plethora of judgements dwelling on the issue. The most important ones are:

- Delhi High Court pronouncement in case of Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd [TS-41-HC-2023(DEL)]; and
- ITAT Delhi in a series of cases –
  ✓ India Property (Mauritius) Company II [TS-407-ITAT-2023(DEL)];
  ✓ Reverse Age Health Services Pte Ltd [TS-67-ITAT-2023(DEL)];
  ✓ Sapein Funds Ltd [TS-308-ITAT-2023(DEL)];
  ✓ The Golden State Capital Pte Ltd [TS-500-ITAT-2023(DEL)];
  ✓ Sarva Capital LLP [TS-467-ITAT-2023(DEL)];
  ✓ Saif Ii-Se Investments Mauritius Limited [TS-453-ITAT-2023(DEL)]

So, it's a point to ponder for the investors that what allegations have been made by the tax office when the provisions of tax treaty are unambiguous and the same would have been followed in letter and spirit while making, maintaining and disposing off the investments. The same have been captured below:

- Tax Residency Certificate (TRC) is not the sufficient proof of residency to claim treaty benefits if the substance establishes otherwise
- Substance over form in the business arrangement is to be looked into and provisions of GAAR to be applied
- The investment entity is fiscally transparent and accordingly has no 'liability to tax' in Mauritius, thus benefits of treaty not available
- Mauritius / Singapore entity has been set up as a scheme of arrangement for tax avoidance through treaty shopping
- Investor company in India is a conduit / shell company only with no commercial rationale
- There is no place of effective management in Mauritius
- Owing to the LOB clause, no treaty benefits are available

A look into the above allegations certainly makes the foreign investor nervous holding investments in India through Mauritius / Singapore. However, a read of the above judgements gives some respite that upon duly following the law, the denial of treaty benefits and making payments of capital gains tax is not the final outcome.

In all of the above cited cases, one of the primary allegation made by the revenue in denying the treaty benefit is that the TRC issued by the tax authority of Mauritius / Singapore is not the sufficient document to establish tax residency and thus allow treaty benefits. Hon'ble High Court of Delhi has evaluated and answered this question whether the revenue can go behind the TRC issued by the other tax jurisdiction? And why not, the very foundation for a person to claim tax treaty benefits is tax residency of the resident state.

The High Court held that Revenue cannot go behind the TRC issued by the other tax jurisdiction as the same is sufficient evidence to claim treaty eligibility, residence status, legal ownership and accordingly there is no capital gain taxable for the investor in India.

The High Court has relied on the Judgement of Hon'ble Punjab & Haryana High Court in the case of Serco BPO [TS-484-HC-2015(P & H)] holding that TRC is sufficient to claim relief under the tax treaty and observed that the said ruling has been accepted by the Revenue as the same was not challenged before the Supreme Court. Thus, the High Court has held that the TRC is statutorily the only evidence required to be eligible for the benefit under the tax treaty and the Revenue's attempt to question and go behind it is wholly contrary to the Government's consistent policy and repeated assurances to Foreign Investors. Here the High Court has also commented positively on press release dated 1st March, 2013 wherein the government had held out to the investors at large that tax treaty benefits would be granted solely on the basis of TRC issued by the resident country (Mauritius / Singapore under discussion now).

On the issue of Indian revenue authority disregarding the TRC the High Court has made a very important observation that the that Singaporean authorities had granted the TRC after a detailed analysis of the documents, and the Indian authorities cannot disregard the same as doing the same would be contrary to international law.

The Delhi ITAT in the series of above cases has also followed the above cited Judgement of High Court and has negated the order of revenue.

While reaching to the above conclusion, the High Court / ITAT have carried out a detailed analysis of Articles of the Mauritius / Singapore tax treaty, circulars issued by the CBDT. Here important one is the circular No. 789 dated 13.04.2000, specifically, with reference to India-Mauritius DTAA clearly stating that once, the TRC has been issued by the competent authority of the other tax jurisdiction, it will be treated as a sufficient proof in so far as tax residency status is concerned. This circular has also been upheld by Supreme Court in the famous case of Azadi Bachao Andolan [TS-5-SC-2003], wherein the Supreme Court has held that where the TRC has been issued by the competent authority of the other country, it will demonstrate the tax residency of the entity and the concerned entity would be eligible to avail the benefits under India-Mauritius tax treaty.

One of the grounds for denying treaty benefit has been cited that the taxpayer is not ‘liable to tax’ in Mauritius by virtue of the exemption provided in domestic tax law of Mauritius. The tax courts have cited the Supreme Courts verdict in case of Azadi Bachao Andolan wherein it has been made clear that the ‘liable to taxation’ and ‘actual payment of tax’ are two different aspects. Merely because tax exemption under certain specified head of income including capital gain from sale of shares has been granted under the domestic tax laws of Mauritius, it cannot lead to the conclusion that the entities availing such exemption are not liable to taxation. Thus, the treaty benefits are available to the Mauritius / Singapore tax resident companies.

On the issue of application of GAAR by tax authority on the investments made through Mauritius / Singapore, it has been held that GAAR cannot be applied to transactions as these are with gains below the monetary limit of INR 3 Crore and the Cutoff date 1 April, 2017 for making such investments is also satisfied.

Coming the other important allegation by tax officer that the doctrine of substance over form is to be applied to deny the treaty benefits. The judiciary has held that this doctrine is prior to the codification of domestic GAAR and the legislators were conscious enough by providing exceptions to the application of GAAR [monetary limit of INR 3 Crore + Cutoff date 1 April, 2017 for making such investments]. Thus, the same cannot applied to deny treaty benefits (cases where threshold was not attracted).

On the issue of alleging the investor companies as “Shell” or “conduit” the courts have held that the evaluation of LOB cause by the Mauritius / Singapore revenue authority is sufficient and only then the TRC has been issued.

So, in view of the above detailed explanatory orders, while disposing the investments made in India from Mauritius / Singapore prior to 1 April 2017, it is important to follow the proper hygiene as provided under the LOB clause of the respective tax treaties / conditions prescribed in the domestic tax laws of these countries. To name a few, maintaining adequate expenditure threshold, maintaining proper office in the country sufficient enough to reflect management of funds from these countries; maintaining resident directors in respective countries; regular conduct of board meetings from those countries with proper records of the same; maintain proper books of accounts with required filings of audited financials with the regulators out there; and most IMPORTANTLY obtaining TRC for each year in the due time lines provided under laws of respective country. A due diligence of this should also be carried out at regular intervals rather than clearing dust on files only when the investments are sold. A following of the above in spirit in accordance with the guidance provided by the Indian judiciary can ensure safety of investments from the payment of undue capital gains tax for the investments made in India upto 31 March 2017.

Views expressed by the author are in personal capacity and are in no way linked with the organization the author is associated with.