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MAURITIUS SELLER NOT "BENAMI" SHAREHOLDER, RULES AAR – CAPITAL GAINS ON SALE OF INDIAN TARGET NOT TAXABLE IN INDIA

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Background

The Authority for Advance Rulings (AAR) pronounced its ruling on the application of the India Mauritius Double Taxation Avoidance Agreement (DTAA), holding that the disposal by a Mauritian resident of its Indian investment would not be subject to tax in India.

The AAR held that, in the absence of compelling evidence to the contrary, a valid Tax Residency Certificate (TRC) and Category 1 Global Business License (GBL-1) are sufficient for a Mauritian entity to avail benefits of the DTAA.

Facts

Becton Dickinson (Mauritius) Limited (BD Mauritius) is a company incorporated in Mauritius and part of the 'BD Group', with its holding company Becton Dickinson and Company located in USA (BD USA). BD Mauritius holds 100% of the share capital of Becton Dickinson India Private Limited (BD India), an Indian company. As part of a group restructuring exercise, BD USA incorporated a subsidiary in Singapore, Becton Dickinson Holdings Pte Limited (BD Singapore). BD Mauritius proposed to sell the shares of BD India to BD Singapore and as consideration for the sale, BD Mauritius was to receive shares of BD Singapore.

BD Mauritius approached the AAR to ascertain whether the capital gains arising on the sale of BD India shares by it to BD Singapore would be chargeable to tax in India in its hands, under Article 13 of the DTAA.

As part of its application, BD Mauritius stated that (i) it is a company incorporated in Mauritius, holds a valid TRC and is hence a resident of Mauritius; (ii) Circular 789 dated 13 April 2003 issued by the Central Board of Direct Taxes provided that a TRC would constitute sufficient evidence to establish the residential status of a Mauritian entity and the said circular was upheld by the Supreme Court (SC) in the *Azadi Bachao Andolan* case; and (iii) as per Article 13(4) of the DTAA, capital gains should only be taxable in Mauritius.

Submissions of the Income Tax Authorities (ITA)

Focussing its attention on a few peculiar facts, the ITA refuted BD Mauritius' position and argued that the capital gains should be taxable in India since the transaction was *prima facie* designed for tax avoidance.

- *Acquiescence by board of BD Mauritius, not decision making*

- The ITA argued that the decision for transfer of shares was taken by BD USA and not by the board of directors of BD Mauritius.

- From a perusal of a 'note' in the financial statements of BD Mauritius, the ITA noted that the sale of shares by BD Mauritius to BD Singapore was to align BD USA's corporate structure in a way that is consistent with its evolving business strategy.

- The ITA contended that since BD Mauritius had not undertaken an analysis about the merits of the transfer, the decision to transfer shares had in fact been made by BD USA to which BD Mauritius had merely acquiesced.

➢ *BD Mauritius was not the 'beneficial owner' of the shares:* The ITA contended that even though BD Mauritius may be the legal holder of BD India's shares, its board was open to dictation by BD USA and BD Mauritius was only a named owner and not the beneficial owner of the shares.

➢ *Credibility challenged*: The ITA noted that while the agreement for transfer of shares stated the date as 30 March 2012, as per the financial statements of BD Mauritius the shares were transferred on 28 March 2012. The ITA accordingly contended that either the agreement or financials were made up and doubts were raised on the credibility of the process.

➢ *'Impermissible Avoidance Arrangement':*

- The ITA argued that the transaction was an 'impermissible avoidance arrangement', it created rights and obligations which are not ordinarily created between persons dealing at arm's length, results in misuse and abuse of the provisions of the DTAA and the Income-tax Act, 1961 (IT Act), lacks commercial substance and is not ordinarily employed for bona fide purposes.

- The ITA contended that BD Mauritius had mislead the AAR by stating that the consideration received by it for the sale was shares of BD Singapore, whereas the financial statements of BD Mauritius recognised a profit of approximately USD 50 Million.

- Further fuelling the argument were BD Mauritius' acts of waiving an earlier loan granted by it to BD USA and granting a fresh loan at 1% interest to BD USA, with no explanation in its financial statements. As per the ITA, the shifting of profits made it clear that BD India is not considered as a separate and independent entity by BD USA, is merely a conduit company and BD Mauritius is thus not the beneficial owner of shares or the sale consideration.

- Accordingly, the ITA argued that a tax avoidance scheme was devised to make profit in a low tax jurisdiction and transfer the same to the holding company.

➢ BD Mauritius did not have a place of effective management in Mauritius since had no employees or office in Mauritius.

Decision of the AAR

The AAR ruled in favour of BD Mauritius and held that capital gains on the sale of shares of BD India by BD Mauritius to BD Singapore would not be chargeable to tax in India in light of Article 13 of the DTAA.

Importantly, the AAR noted that BD Mauritius held a valid TRC and GBL-1 and is a tax resident of Mauritius. With respect to BD Mauritius' place of management and control, the AAR noted that, as per Mauritian law requirements, BD Mauritius was administered

by a management company and hence had no employees. It however had two resident Mauritian directors, a principal bank account, accounting and registered office in Mauritius.

Further, the AAR took note that the investment in BD India was funded out of BD Mauritius' own share capital and funds were transferred through banking channels from its own bank accounts.

With respect to the sale of BD India's shares, the AAR agreed with BD Mauritius' explanation that it had not been instructed to transfer its shares in BD India to BD Singapore by BD USA. The AAR has clarified that there was nothing wrong in BD Mauritius following the policy of its holding company. The AAR added that when the holding company provides funds to its subsidiary, the holding company would be involved in important decision making (such as investment making) to ensure that the activities of the subsidiary are in consonance with the overall goal of the holding company.

Relying on judicial precedents, the AAR concluded that BD Mauritius cannot be treated as a fly by night operator. It did not find substance in the ITA's allegations that BD Mauritius was a *benami* shareholder / name lender and that the actual owner of the shares was BD USA. The AAR positively held that BD Mauritius was the legal owner of the shares and had entered into the transaction of sale backed by its board resolution and received sale consideration.

Comments

This decision is another addition to the list of positive precedents concerning exits from Indian companies by Mauritian residents. A key take away from this ruling is the emphasis on facts and having one's house in order. Apart from clearly setting out the applicable law, the ruling goes one step forward and recognises the practicalities of a holding-subsidiary relationship, most Mauritian based investments and allows room for the parent's role.

An interesting point that emerges from this decision (though not discussed by the AAR) is the ITA's argument around the transaction being an 'impermissible avoidance arrangement', a concept introduced by the General Anti Avoidance Rules (GAAR) with effect from 1 April 2017. Interestingly, the ITA has set out all the criteria laid down under Section 96 of the IT Act (defining an "impermissible avoidance agreement") as being attracted to the transaction under question. As previously mentioned, GAAR was made applicable only with effect from 1 April 2017 and investments made prior to this date are grandfathered by GAAR. The ITA's invocation of these principles in an application admitted before the AAR in 2015 is surprising and unprecedented.

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