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BACK TO BASICS? | RELEVANCE OF 'BENEFICIAL OWNERSHIP' QUESTIONED WHEN AVAILING CAPITAL GAINS TAX BENEFIT UNDER INDIA - MAURITIUS TAX

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The Mumbai Bench of the Income Tax Appellate Tribunal (Tribunal) in a recent decision¹ has questioned the 'reading in' of the condition of 'beneficial ownership' (as opposed to legal ownership) when determining a taxpayer's eligibility to avail capital gains tax benefits under Article 13 of the India - Mauritius Double Taxation Avoidance Agreement (Treaty).

This question has long been discussed in Boardrooms and classrooms alike. This being the crux of the present case, the Tribunal in its well-reasoned decision has carved out the fundamental issues for the Tax Officer to 're-decide' on.

Facts and Background

Blackstone FP Capital Partners Mauritius V Limited (Taxpayer) was incorporated on 8 June 2006 in the Republic of Mauritius and holds a valid global business license (GBL) and tax residency certificate (TRC). The Taxpayer is a registered foreign venture capital investor (FVCI). In the Indian financial year 2015-16, the Taxpayer sold equity shares of CMS Info Systems Ltd. (Indian Target) to Sion Investment Holdings Pte Ltd. (Singaporean Buyer). The resulting (long term) capital gains arising to the Taxpayer from the said sale transaction worked out to be approximately INR 9005 million.

Such income arising to a Mauritian resident is exempt from capital gains taxation in India under the acclaimed Article 13 of the Treaty so long as basic conditions are satisfied. However, in the present case, the Tax Officer declined to extend the capital gains tax exemption to the Taxpayer stating that the 'real owners' of the sale shares were situated in Cayman Islands (and not Mauritius). The Taxpayer appealed against this adverse assessment order and approached the Tribunal.

Arguments Advanced

The Tribunal's decision provides an overview of the arguments advanced by the Tax Authorities. Their primary reason for declining the application of the Treaty was, *inter alia*:

- (a) Effective ownership of the Taxpayer vested with certain Cayman Island based entities;
- (b) Administrative control of the Taxpayer was retained by the said entities;

¹ *Blackstone FP Capital Partners Mauritius V Ltd v. Deputy Commissioner of Income Tax International Taxation Circle 1 (2) (2)*, Mumbai, ITA Nos. 981 and 1725 / Mum / 2021.

- (c) Source of investment in sale shares was through a remittance made by the said entities;
- (d) The said entities were dominantly involved in the trail of transactions of purchase and sale of the Indian Target; and
- (e) Directions to carry out the sale transaction in question were issued by the said entities.

This, according to the Tax Officer was a fit case to '*piece the corporate veil*' of the Taxpayer and *prima facie* established that the investment in shares was in fact made by the Taxpayer's group entities in the Cayman Islands. The sale transaction undertaken by the Taxpayer was treated as a '*scheme*' designed for the benefit of the said entities. Reliance was placed on precedents² where taxpayers were denied similar Treaty benefits.

The fact that the Taxpayer is a wholly owned subsidiary of Blackstone FP Capital (Mauritius) VA Ltd Cayman Islands led the Tax Officer to conclude that there was no independent existence of the Taxpayer, and its entire activity was controlled and directed by affiliate companies of the Taxpayer.

Tribunal's Verdict

Is 'beneficial ownership' relevant for capital gains? Reviewing the assessment order passed by the Tax Officer, the Tribunal noted that the underlying fundamental assumption in the said order is that the construct of 'beneficial ownership' can be read into the scheme of capital gains taxation set out in Article 13 of the Treaty. Such a rider or condition of 'beneficial ownership' is expressly mentioned in other provisions of the Treaty (*E.g.*: interest income or dividend income) but is conspicuously missing in case of capital gains taxation. This basis for the order passed by the Tax Officer, according to the Tribunal was a 'fallacy', an assumption that cannot be taken for granted and must pass the litmus test of judicial scrutiny. Further, the Tribunal, distinguishing the present case from precedents quoted, was of the view that disentitling taxpayers Treaty benefits on the basis that 'beneficial ownership' is a *sine qua non* of eligibility, especially in the absence of an explicit provision, would be erroneous since treaties are bilaterally agreed and the requirements and intent of each provision have been specifically deliberated.

Interpretation of treaties: While the Tribunal has not expressly ruled that 'beneficial ownership' is irrelevant to Article 13 of the Treaty, it has remanded the matter to the Tax Officer. The decision, however steers towards helpful and well-established principles of Treaty interpretation which would render the notion or any assumption of 'beneficial ownership' being entirely irrelevant and unnecessary in context of the capital gains tax provisions under the Treaty.

Key points that are noteworthy in this regard include:

- (a) Reading a beneficial ownership test (when it is not embedded in the Treaty) amounts to rewriting the Treaty provision. Reliance was placed by the Tribunal on notable practitioners and well-recognised commentaries to support this premise;
- (b) The approach adopted by the Revenue Authorities seems to be fundamentally altering the criteria for entitlement to Treaty benefits, thus frustrating and negating the certainty and predictability sought to be achieved by such treaties; and

² See *Aditya Birla Nuvo Limited v. DDIT*, (2011) 12 taxmann.com 141 (Bom); *AB Mauritius In Re*, (2018) 90 taxmann.com 182 (AAR).

- (c) The fact that treaty provisions reflect negotiated bargains between countries is fundamental to ensure tax certainty and predictability and to uphold the principle of pacta sunt servanda (Article 26 of the Vienna Convention on the Law of Treaties which states that every treaty in force is binding upon the parties to it and must be performed by them in good faith).

What is 'beneficial ownership'? Simply put, beneficial ownership indicates the right to receive income from property, exercise rights despite not legally owning the said property. The Tribunal in its decision insists on the Revenue Authorities giving a categorical finding on the connotations of 'beneficial ownership' vis-a-vis treaties. Noting that there is huge debate globally on the meaning of the term, the Tribunal stated that a tax authority should not at a whim decide what the term connotes. Therefore, ascertaining the meaning of the term was held fundamental, necessitating an examination with categorical findings as to how the requirements of 'beneficial ownership' are / should be satisfied in the present case.

Comments

In the past, the requirement of 'beneficial ownership' of shares, in addition to having valid residency, has been a ground to deny taxpayer treaty benefits. The concept in a capital gains tax context, especially in case of the Treaty, has been perceived to be rather nebulous since pronouncements have relied on tax avoidance concepts vaguely. While the Tribunal has remanded the matter to the Tax Officer, strong legal and well-established principles on treaty interpretation have been provided to show the way.

As in this case, the investment structure adopted by the Taxpayer *per se* is fairly typical across industry. Treaty entitlement issues have already been discussed in granular detail and blessed by the Supreme Court of India in the *Azadi*³ ruling read in conjunction with the famed Circular no 789 dated 13 April 2000 issued by the Central Board of Direct Taxes. However, it has been consistently observed that it is a struggle for a Mauritian resident to obtain the capital gains tax benefit under Article 13(4) of the Treaty despite well settled jurisprudence on the issue. The said Circular relates not only to capital gains but also dividend income (which has a requirement of beneficial ownership) causing some confusion on the Mauritian residency requirement vis-à-vis Treaty entitlement. This, along with the fact that Tax Authorities in several instances have used the concept of a 'sham' transaction interchangeably with that of 'beneficial ownership' to deny taxpayers the capital gains tax exemption further confounds the issue of Treaty entitlement.

One hopes that with this decision and its razor focus on whether 'beneficial ownership' is relevant when discussing capital gains tax exemption under the Treaty and what the concept signifies, the question is resolved comprehensively, avoiding any more heartburn to taxpayers.

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³ *Union Of India And Anr v. Azadi Bachao Andolan And Anr* (2004) 10 SCC 1.

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