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Indian Tax Ruling Reinforcing Treaty Protection Is a Big Win For Foreign Investors

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In this article, the authors explain how recent court rulings affect foreign direct investments in India and may encourage investor certainty.

The views of the authors in this article are personal and do not constitute legal/professional advice of Khaitan & Co.

Introduction and Background

The sanctity of a tax residency certificate (TRC) as proof of residence and beneficial ownership of shares for availing tax treaty benefits has long been debated in Indian courts. The "Mauritius route" for investments in India has typically been a focal point of scrutiny.

Mauritius has consistently been one of the largest sources of foreign direct investment (FDI) in India. According to data released by India's government,[1] cumulative FDI inflows from Mauritius between April 2000 and March 2024 accounted for 25 percent of total FDI in the country. This makes Mauritius the top source of FDI among nations investing in India. A significant reason for inflows through the Mauritian route for investors has been the India-Mauritius double taxation avoidance agreement, which granted an exemption from capital gains tax on the transfer of shares in Indian companies, rendering these gains taxable only under Mauritius's domestic laws. Because Mauritius did not impose tax on these gains, this arrangement often led to double nontaxation.

However, this benefit was curtailed after a protocol to the tax treaty was introduced effective April 1, 2017, which discontinued the exemption from capital gains tax. The benefit was grandfathered for investments made before this date.

For entities that claimed a capital gains exemption, the Indian revenue authorities frequently challenged the validity of TRCs on the premise that companies with no ties to Mauritius establish Mauritian conduit entities solely to exploit the benefits of the India-Mauritius tax treaty. The Indian government, however, clarified that a TRC issued by a country's tax authority would constitute sufficient evidence to determine the residential status of the taxpayer. The Indian Supreme Court in the landmark decision of *Azadi Bachao Andolan*[2] also upheld the constitutional validity of the circular and affirmed TRCs as a

[1] Department for Promotion of Industry and Internal Trade, "Quarterly Fact Sheet: Fact Sheet on Foreign Direct Investment (FDI) Inflow From April, 2000 to March, 2024" (May 30, 2024).

[2] *Union of India v. Azadi Bachao Andolan*, (2004) 10 SCC 1.

conclusive proof of residency to claim tax treaty benefits. The precedent acknowledged the significance of Mauritius as a source of FDI and reiterated that it was the object and purpose of the India-Mauritius tax treaty to extend these benefits.

While one would have thought that the authoritative pronouncement of the Indian Supreme Court in *Azadi Bachao Andolan* would have ended discussion on the validity of TRCs, the debate was reignited when the Indian courts pierced the corporate veil and denied tax treaty benefits in a few later cases based on their peculiar facts.[3] The potential level of scrutiny by the tax authorities is not only constrained to Mauritius but also to other jurisdictions like Singapore and the Netherlands because of capital gains exemption benefits available under their treaties. Notably, the treaty benefits on dividend income earned by a taxpayer are generally available to a shareholder only if the shareholder is a "beneficial owner" of the dividend income (the "beneficial ownership test"). This test does not apply to the article on capital gains in tax treaties India enters. Indian tax authorities have, however, sought to deny the tax relief on capital gains to investors based on the premise that they are not the beneficial owner of the income.

Recently, in a welcome relief, the negative precedents pronounced by India's Authority for Advance Rulings (AAR)[4] in *Tiger Global International II Holdings*, *Tiger Global International III Holdings*, and *Tiger Global International IV Holdings* have been overturned by the Delhi High Court.[5] These rulings provide a useful guidance on principles of tax avoidance, beneficial ownership, general antiavoidance rules, limitation of benefit clauses, and parent-subsidiary relationships. They also confirm that antiavoidance rules cannot be invoked without clear demonstration of abuse, which reinforces a fair and predictable tax environment for cross-border investments.

Brief Facts

The taxpayer in this case is an entity incorporated in Mauritius: Tiger Global. It was incorporated in 2011 as an investment holding company. The immediate shareholders of Tiger Global were Mauritius-based entities, with its indirect shareholders being private equity funds that raised capital from approximately 500 investors across 30 jurisdictions globally. The entity's investment manager was Tiger Global Management LLC (TGM), a Delaware-based firm. Also, Tiger Global held a category 1 global business license issued by Mauritius and had obtained a valid TRC from Mauritian authorities.

Tiger Global had acquired shares of Flipkart Private Ltd., a Singaporean entity, before April 1, 2017, which indirectly held significant investments in India. In 2018 Tiger Global sold these shares to Walmart. Tiger Global sought an exemption from capital gains tax, claiming the shares were acquired before April 1, 2017, and thus eligible for the grandfathering provision under the tax treaty.

However, the AAR disputed the claim on the basis that the entire transaction was entered into to benefit under the India-Mauritius Tax Treaty. Further, the AAR also held that the tax treaty benefit is available only for selling shares of an Indian company; selling shares of a company that is a nonresident of India was never contemplated under the India-Mauritius treaty.

Tax Authority's Arguments Before High Court

At the high court level, the tax authorities emphasized that the benefits of the India-Mauritius tax treaty were not available to the taxpayers because of the lack of economic substance and the alleged abuse of the treaty for tax avoidance purposes. The broad reasons based on which the tax authorities sought to disentitle the treaty eligibility claim were:

- **Conduit entity:** The tax department submitted that Tiger Global was merely a "façade" for TGM since the principal control vested with TGM. The tax authorities further contended that Flipkart Singapore

[3] *Aditya Birla Nuvo Limited v. DDIT*, (2011) 12 taxmann.com 141 (Bombay); *AB Mauritius, In re*, (2018) 90 *taxmann.com* 182 (AAR — New Delhi); *Tiger Global International II Holdings*, [2020] 116 *taxmann.com* 878 (AAR — New Delhi).

[4] *Tiger Global International II Holdings*, [2020] 116 *taxmann.com* 878 (AAR — New Delhi).

[5] *Tiger Global III Holdings v. Authority for Advance Rulings*, (2024) SCC OnLine Del 5987.

was interposed for investment only to obtain treaty benefits.

- **Beneficial ownership and lack of control in Mauritius:** The authorities contended that Tiger Global was not the true beneficial owner of the income earned from the sale of shares. The tax authorities emphasized the role of Charles Coleman (who was designated as the beneficial owner of Tiger Global and has significant influence over the group's U.S. entities) in controlling and managing the operations, including specific authority for bank transactions beyond specified thresholds, and that the Mauritian directors were "mere puppets."

  The tax authorities pointed out that Tiger Global's management and control were not genuinely in Mauritius. They submitted that key decisions were made by individuals based in the United States, including the company's investment manager, Tiger Global Management LLC.
- **GAAR:** The tax department invoked GAAR provisions as well, asserting that the entire structure and transaction were aimed at avoiding tax liability in India and undertaken to obtain benefits from the tax treaty.

A Reaffirmation of Treaty Protection

The Delhi High Court found in favor of Tiger Global and held that it is eligible to claim benefits of the treaty. The key takeaways from the ruling are below.

Sanctity of TRC

The Delhi High Court emphasized that a TRC issued by the competent authority must be considered sacrosanct because it certifies the entity's bona fide status and beneficial ownership in a contracting state. Doubting the validity of a TRC without strong evidence would undermine the mutual trust between contracting states, and the tax authorities are not justified in questioning it. The tax authorities are precluded from doubting the validity of a TRC in the absence of tax fraud, sham, or illegal activities.

Entitlement to Benefits Under Tax Treaties

Tax treaties are reciprocal arrangements, negotiated based on economic and political considerations. Tax authorities are precluded from deploying grounds of disqualification because the contracting states have already adopted standards like the limitation on benefits clause in the treaties to dissuade treaty abuse.

Jurisdiction of Investor

The Delhi High Court noted that investments from low-tax jurisdictions, like Mauritius, do not *ipso facto* lead to adverse inference. Citing the significant inflows from Mauritius over decades because of its liberalized exchange controls, favorable investment climates, and prevailing socio-political stability, the Delhi High Court expressed confidence in the Mauritius route and concluded that treaty shopping or abuse cannot be presumed solely because the investor is based in a tax-friendly jurisdiction.

Economic Substance

Tiger Global, *inter alia*, (i) operated as a pooling vehicle for investments; (ii) held a category 1 global business license in Mauritius; (iii) aggregated funds from more than 500 investors located across 30 jurisdictions worldwide; and (iv) incurred expenditure in Mauritius above the limits specified under the treaty's LOB. Because of this, it cannot be regarded as an entity with no economic substance.

Piercing the Corporate Veil: Parent-Subsidiary Relationship

Piercing the corporate veil cannot be assumed merely because a subsidiary is established in a tax-friendly jurisdiction. Such actions are justified only in rare cases like attempts to perpetuate fraud, camouflaging shams, or illegal transactions. Only when this threshold is met can the presumption of validity attached to a TRC and compliance with LOB conditions be disregarded. Just because the parent exercises shareholder influence over its subsidiary, it should not lead one to draw an adverse inference of the latter being a mere puppet.

Role of Board of Directors

The role of Coleman, who was authorized by the taxpayer's board to act on its behalf, did not undermine the independent authority of the board, which made all key decisions. The Delhi High Court further noted that having some directors based in the United States or affiliated with Tiger Global's U.S. entities did not, by itself, indicate control by U.S. entities. Also, the requirement for Coleman to coauthorize payments above a certain threshold was a board-approved measure and should not be viewed adversely.

Beneficial Ownership

The Delhi High Court held that the concept of beneficial ownership applies only when the income holder lacks control over the income it receives and is obligated to transfer it to another entity. Without any contractual or legal obligation to transmit revenue to TGM, the beneficial ownership cannot be doubted.

Grandfathering Under GAAR

The Delhi High Court also affirmed that domestic GAAR's grandfathering benefit applies to investments made before April 1, 2017, under which Tiger Global's current transaction is not subject to GAAR provisions.

Protocol Under India-Mauritius Treaty

While the decision is a welcome relief for nonresident shareholders investing in India, this year, a protocol to amend the double taxation avoidance agreement between Mauritius and India has been entered into, under which a benefit under the treaty will not be granted if it is reasonable to conclude that one of the principal purposes of the arrangement or transaction is to directly or indirectly benefit from the treaty. The provisions of this protocol are akin to the principal purpose test found in Indian treaties amended under the multilateral instrument. Abusive practices which multinational groups engage in, with no real substance in Mauritius, are anticipated to be subject to intense scrutiny once the provisions of this protocol are effective.

Given that the decisions of Indian courts were rendered when the provisions of the new protocol were not effective, the binding nature of those rulings on later cases must be reevaluated.

Conclusion

While the ruling pertains to the India-Mauritius treaty, it provides helpful insights for interpreting exemptions and treaty protections under other tax treaties as well.

The ruling by the Delhi High Court in *Blackstone Capital Partners*[6] also upheld the sanctity of TRCs, but it was challenged before the Indian Supreme Court, which has granted a stay. Its judgment in this case is eagerly awaited and we expect that this oft-litigated issue is rested once and for all, providing tax certainty to investors.

The Delhi High Court's ruling in *Tiger Global* is a landmark decision that provides clarity on the application of tax treaties and reinforces an important principle for treaties to be interpreted in good faith. It offers reassurance to the investing community of multinational companies, financial sponsors, and private equity investors, ensuring that legitimate investors can rely on international tax treaties without fear of arbitrary denial by tax authorities. We expect this decision to boost investor confidence and foster a more stable, predictable tax environment in India, especially in light of the uncertainty caused by the Indian Supreme Court's recent stay in *Blackstone* concerning the India-Singapore tax treaty. With the Indian Supreme Court set to hear the case soon, all eyes are on the potential implications this ruling could have on the established principles of tax treaty eligibility. ■

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[6] *Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd. v. ACIT*, (2023) 146 *Taxmann.com* 569 (Delhi).