Delhi High Court holds the Tax Residency Certificate as 'sacrosanct' while it overturns AAR ruling in case of Tiger Global

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Summary

The Delhi High Court (HC), in a recent judgement[1], has overturned the ruling issued by the Authority for Advance Ruling (AAR) in 2020, wherein the AAR had denied the benefit of grandfathering provisions under the India-Mauritius Double Taxation Avoidance Agreement (DTAA or Tax Treaty). The transaction under consideration on which the DTAA benefits were denied by the AAR was on the transfer of shares of Flipkart Singapore by Tiger Global International II, III, and IV Holdings (taxpayer/petitioner) on the grounds that the entities under question were conduit entities. The AAR further stated that the transaction lacked commercial substance and was prima facie designed via the Mauritius route for the avoidance of tax.

Following a writ petition by the Tiger Global International Holdings entities against the AAR ruling, the HC has issued its decision in favour of the petitioner companies, holding that the establishment of an investment vehicle in a tax-friendly jurisdiction cannot be presumed to be a case of tax evasion or treaty abuse.

Further, the HC also emphasised that the tax residency certificate (TRC) issued by a foreign jurisdiction must be considered sacrosanct. It was also stated that the TRC, combined with compliance with the limitation of benefit (LOB) clauses in a DTAA, serves as sufficient evidence of the commercial substance of the foreign entity. The HC has highlighted the limited circumstances under which the corporate veil of a TRC-holding entity may be pierced by the tax authorities, viz. perpetration of fraud, sham transactions, illegal activities, absence of economic substance, etc.

Background

- The taxpayer/petitioner[2] was a private company incorporated in Mauritius, with its principal office also situated in Mauritius. It had been set up with the primary objective of undertaking investment activities and the underlying objective of earning long-term capital appreciation and investment income.

- The immediate shareholders of the petitioners[3] were also Mauritius-based companies whose shareholders were private equity funds, who had raised funds from over 500 investors across 30 jurisdictions globally.

- The petitioner companies acquired shares of Flipkart Singapore between October 2011 and April 2015. Flipkart Singapore, in turn, held shares in Flipkart India and derived its value substantially from the assets located in India.

- In May 2018, the petitioner companies entered a share purchase agreement with Walmart International Holdings, Inc., to sell the controlling stake in Flipkart Singapore. Accordingly, the petitioner approached the tax authorities to grant a 'nil' withholding tax certificate[4] because such shares were acquired before 1 April 2017, and hence, they would not be taxable. This is in light of the TRC held by the petitioner and the DTAA provisions[5].

- The tax authorities rejected the aforesaid application because the taxpayer did not possess the independent decision-making power to purchase and sell the said shares. Accordingly, it was not entitled to avail the benefits under the DTAA. The tax authorities issued 197 certificates, directing the buyer to withhold tax @ 10%[6].

- In August 2018, the petitioners transferred part of their shareholding in Flipkart Singapore to Fit Holdings SARL, a Luxembourg entity, and approached the AAR, seeking its opinion on the taxability of the transaction in question.

[1] Tiger Global International III Holdings versus The Authority for Advance Rulings (Delhi HC [W.P.(C) 6764 to 6766/2020 & other connected matters
[2] Tiger Global International II Holdings (the salient facts of W.P. (C) 6765/2020 have been considered for the sake of brevity)
[3] Tiger Global International II Holdings, Tiger Global International III Holdings, Tiger Global International IV Holdings
[4] Under section 197 of the Income-tax Act, 1961 (the Act)
[5] Article 13 of the amended India-Mauritius DTAA (wherein shares acquired before 1 April 2017 were provided to be grandfathered and hence, gains arising on transfer of such shares to be exempt from tax)
[6] Plus surcharge and applicable cess

- The AAR rejected the application described above on the following grounds:
  - The management and control of petitioner companies was in the hands of their holding company - Tiger Global Management LLC (TGM LLC). The authorisation to operate the bank accounts for transactions beyond a certain limit was with an individual (Charles P. Coleman) who represented TGM LLC, and the other Board members[7] were mere puppets.
  - The DTAA's objective was to provide capital gains tax benefits to gains arising from the transfer of shares of an Indian company. However, the benefit could not be extended to the transfer of shares of a Singapore company.
  - The AAR further concluded that the application for the AAR ruling relates to a transaction or issue that is designed prima facie for the avoidance of income tax, as the transaction was entered into with the intent to derive benefits from the DTAA, which was not intended by the lawmakers and such an arrangement was nothing but an arrangement for avoidance of tax in India. Accordingly, the transaction attracted specified provisions[8] of the Act, wherein the AAR could be dismissed.

- The petitioner filed a writ petition before the HC against the aforesaid ruling of the AAR.

Key observations made by HC

Management and control of petitioner companies and lack of economic substance

- The HC noted that TGM LLC was merely the investment manager with no equity participation or investments made by it in the petitioner companies. The HC held that the AAR appears to have made this conclusion merely because the petitioners did not dispute the role and functions assigned to TGM LLC (e.g., signing of cheques, etc.).

- The HC held that the concept of beneficial ownership would be attracted if it could be established that the holder of income had no control over the income and merely held the same until it was instructed to deploy that income to another entity.

- The HC noted that none of the funds invested in the petitioners originated from TGM LLC. The funds were received from over 500 investors across global jurisdictions, and the Mauritius companies acted as the fund-pooling vehicle. The AAR could provide no reasons that could cast doubt on the role and position of TGM LLC (as an investment manager)as disclosed by the petitioners.

- The HC further highlighted that generally, a parent or a holding company would have a legitimate right to exercise oversight and broad supervision over the affairs of its subsidiaries, which could take the form of seats on the Board of directors (BoD), the appointment of key managerial personnel (KMP), auditing of affairs, etc. Accordingly, two Tiger Global Group members on the petitioner's Board does not mean the other Board members are mere puppets.

- Further, the court noted that the Board resolutions revealed that the decisions were undertaken collectively by the petitioner's BoD. Though Charles P. Coleman was authorised to permit expenditures exceeding USD 250 million, the power thus conferred was a decision taken by the BoD as a whole, and such decisions were required to be countersigned by the Mauritian-based directors. Accordingly, the petitioners' BoD cannot be deprived of independent decision-making powers.

- The HC noted that petitioner companies operated as investment pooling vehicles, aggregating the funds from more than 500 investors worldwide. Further, the petitioner incurred expenditures exceeding the threshold prescribed under the LOB clause of DTAA[9]. Therefore, the petitioner companies cannot be said to lack economic substance.

Position on investments made via Mauritius route

- The HC opined that mere routing of investments through Mauritius-based entities could not lead to an adverse inference of presumption of illegality or a colourable transaction. The HC also noted that Mauritius was one of the most favourable jurisdictions for foreign institutional investors seeking to invest in India because of its proximity to India and the vast array of agreements it had entered with various nations across the globe.

7 That were residents of Mauritius
8 Clause (iii) of the proviso to Section 245-R(2) of the Act
9 Article 27A of the tax treaty

- The HC referred to various judgements (including decisions in the *Azadi Bachao Andolan*[10], *Vodafone case*[11], *etc.)* and mentioned that it would be wholly erroneous to presume that investments originating from Mauritius were inherently suspect and that a bonafide commercial purpose could guide the establishment of offshore companies. Establishing investment vehicles in tax-friendly jurisdictions cannot be presumed to have been set up to avoid taxes or engage in treaty abuse.

- The HC also stated that Action 6 of the Base Erosion and Profit Shifting Action Plan, and the principles of the Organisation for Economic Cooperation and Development Commentary on Article 29, revealed that treaties incorporate the disentitlement provisions to deprive persons who were not intended to fall under the ambit of the treaty indirectly availing those benefits.

- It also stated that it would be erroneous to characterise legitimate business activities undertaken by entities as constituting treaty shopping merely because it was situated in a favourable tax jurisdiction[12].

- The HC held that the circumstances under which the tax authorities could pierce the corporate veil are limited, such as tax fraud, sham transactions, camouflaging of illegal activities, and the complete absence of economic substance.

Sanctity of TRC and grandfathering of shares acquired before 1 April 2017 under India-Mauritius DTAA

- The HC highlighted that the issuance of a TRC by the competent authority must be sacrosanct, as it establishes certification of the TRC-holding entity as a bonafide entity, having beneficial ownership domiciled in a country to pursue a legitimate business. The tax authorities would not be justified in doubting the validity of a TRC, as it would result in the erosion of faith and trust reposed by countries in each other.

- The HC drew reference to the clarification issued by the Central Board of Direct Taxes (CBDT)[13] , which clarifies that the TRC issued by authorities in Mauritius constitutes sufficient evidence to ascertain the status of residence as well as the application of principles of beneficial ownership to avail benefits under the DTAA.

- The HC also noted that the amendment proposed by Finance Bill 2013 (which provided that TRC is not a sufficient condition for claiming treaty benefit) was not enacted. Consequently, the Ministry of Finance clarified[14] that the TRC would be accepted as adequate evidence for the benefit of the treaty, and the tax authorities would not question its validity.

  The HC stated that the DTAA aims to protect transactions completed before 1 April 2017[15]. The tax treaty[16] sets tax rates for transactions between 1 April 2017 and 31 March 2019 but does not set rates for capital gains from the shares acquired before 1 April 2017, indicating an intent to exclude these gains from taxation. Thus, the grandfathering clause excludes the petitioners' transaction from capital gains tax.

The tax authorities argued that tax benefits from arrangements made before 1 April 2017 would still be subject to General Anti Avoidance Rules (GAAR)[17]. However, the HC disagreed, stating domestic tax laws cannot override treaty provisions.

HC ruling

The HC concluded that the AAR's ruling, which deemed the transaction as tax avoidance, was clearly flawed and unsustainable. The transaction is protected by virtue of the grandfathering provisions of the DTAA. Consequently, the court

[10] Union of India v. Azadi Bachao Andolan [2004] 10 SCC 1
[11] Vodafone International Holdings B.V. v. Union of India & Anr. [2012] 6 SCC 613
[12] Cadbury Schweppes Plc and another v Inland Revenue Commissioners [2006] 3 WLR 890; Burlington Loan Management DAC v Revenue and Customs Commissioners [2024] UKUT 152 (TCC)
[13] Circular No 789/ 2000 dated 13 April 2000
[14] Press Release dated 01 March 2013
[15] Article 13(3A) of the tax treaty
[16] Article 13(3B) of the tax treaty
[17] Rule 10U(2) of the Income tax rules, 1962

quashed the AAR's ruling, affirming that the transaction was not designed for tax avoidance, and granted the petitioners all consequential reliefs.

Our comments

In the aforesaid case, the Delhi High Court's decision is a welcome one and a relief for the multinational groups and funds that have historically made investments in India through Mauritius.

The legitimacy of the investments routed through jurisdictions seen as tax-friendly jurisdictions has been affirmed, as long as they are not sham or fraudulent. This provides certainty to foreign investors who claim treaty benefits and creates a conducive environment for foreign investments in India. The court also referred to the Supreme Court's decision in the case of *Azadi Bachao Andolan*. This ensures the continuity of principles enunciated and reposes the confidence of investors.

While the availability of capital gains tax benefit under the tax treaty would need to be analysed based on specific facts of each case (viz. commercial substance of the overseas entity holding Indian shares, control, and ownership of the overseas entity, etc.), consistency established by this ruling is significant.

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