Desai Saksena & Associates

20th September, 2024

Friday Tax Alert

From:

Tax Team of Desai Saksena and Associates
Chartered Accountants

CA Varsha Nanwani (Senior Manager - Taxation)
Vikas Jogle (Manager - International Taxation)
CA Neelu Dusseja (Senior Manager – Indirect Taxation)
CA Neha Patel (Manager - Taxation)
CA Ajay Sachani (Manager - Taxation)
Digvijay Hirwani (Assistant Manager - Taxation)
Alok Sharma (Deputy Manager - Indirect Taxation)

Contacts:

If you have any questions or would like to have additional information on the topics covered in this alert, please email one of the following DSA professionals:

- ✓ CA Varsha Nanwani (Senior Manager – Taxation)
  varsha@dsaca.co.in
- ✓ Vikas Jogle (Assistant Manager – International Taxation)
  vikas@dsaca.co.in
- ✓ CA Neelu Dusseja (Senior Manager – Indirect Taxation)
  neelu@dsaca.co.in
- ✓ CA Neha Patel (Manager - Taxation)
  neha@dsaca.co.in
- ✓ CA Ajay Sachani (Manager – Indirect Taxation)
  ajay@dsaca.co.in
- ✓ Digvijay Hirwani (Assistant Manager - Taxation)
  digvijay@dsaca.co.in
- ✓ Alok Sharma (Deputy Manager – Indirect Taxation)
  sharma.alok12@gmail.com

Delhi High Court holds Tax Residency Certificate to be sacrosanct in absence of Fraud/Sham

Facts of the case

Taxpayer, a Mauritian company, was set up with the primary objective of undertaking investment activities with the intention of earning long-term capital appreciation and investment income. The taxpayer has been granted a Category I Global Business License and its activities are regulated by the Financial Services Commission of Mauritius. Further, the taxpayer has received a Tax Residency Certificate from the Mauritius Revenue Authorities.

The immediate shareholders of the taxpayer are also Mauritian companies whose shareholders in turn are private equity funds who had raised funds from several investors across the globe. The indirect shareholders of the taxpayer consisted of almost 500 investors residing in as many as 30 jurisdictions globally. Tiger Global Management LLC (TGM LLC), a company incorporated in Delaware USA, was the taxpayer's Investment Manager. TGM LLC had not placed any investments with the taxpayer and neither TGM LLC nor any of its affiliates have either invested in the taxpayer or the private equity funds that had indirectly invested with them.

The taxpayer had acquired 2,36,70,710 shares of Flipkart Singapore between October 2011 and April 2015. Further, on 9 May 2018, a Share Purchase Agreement (SPA) was executed between Walmart International Holdings, Inc., a Delaware Corporation (purchaser) and the shareholders of Flipkart Singapore (seller) and Fortis Advisors LLC, a Delaware limited liability company (seller's representative). As per the SPA, the sale of the shares held by the taxpayer is approved by the Board in its meeting held on 4 May 2018.

As Flipkart Singapore substantially derived its value from India, the taxpayer approached the Indian Revenue Authorities to issue a nil tax withholding certificate under section 197 of the Income Tax Act, 1961 ("the Act"). However, the Indian Tax Officer declined to issue a nil withholding certificate as it was of the opinion that the taxpayer was not independent in its decision-making with regard to various capital assets held by it. Thereby, the tax authorities issued the Certificate under section 197 of the IT Act directing the Buyer to withhold tax at rates which vary from 6.05% (exclusive of surcharge and cess) on the consideration payable to the taxpayer in respect of the transfer.

On 18 August 2018, the taxpayer transferred their shareholding in Flipkart Singapore to Fit Holdings SARL, a Luxembourg entity. Thereafter the taxpayer approached the Authority for Advance Ruling (AAR) on 19 February 2019 seeking its opinion on the taxability of the transaction in question. AAR came to the conclusion that the transaction was entered into with the intent to derive benefits from the DTAA in a manner which was never intended by the two contracting States and that consequently clause (iii) of the Proviso to Section 245R(2) of the Act would be attracted and thereby rejected taxpayer's application. Aggrieved, the taxpayer filed an appeal before the Delhi High Court.

Observations of the Delhi High Court

While granting the benefit of the DTAA and thereby exempting capital gains from taxation in India, the Delhi High Court made the following observations:

- The entire case as set up against the taxpayer appears to suffer from a wholly erroneous and factually unsustainable premise of TGM LLC being the holding and the parent company. Neither the AAR nor the Indian Revenue Authorities have been able to dislodge or cast doubt on the role and position of TGM LLC as advocated and asserted by the taxpayers.

- Despite its position having been duly disclosed in the original application itself and the taxpayer having denied the role ascribed to TGM LLC by the Indian Revenue Authorities, the AAR has erroneously proceeded on the premise that it was the parent and holding company. While proceeding on the basis of a perceived admission, the AAR also failed to verify the facts which were evident from a perusal of the Financial Statements which formed part of its record, and which had duly disclosed the identity of the principal shareholders of the taxpayers.

- The establishment of investment vehicles in tax-friendly jurisdictions cannot be considered to be an anomaly or give rise to a presumption of being situated in those destinations for the purpose of evading tax or engaging in treaty abuse.

- **The principles of substance over form must be considered to be the prevailing norm and the Revenue Authorities are entitled to doubt the bona fides of a transaction only in those situations where it is found that the transaction involves a sham device intended to achieve illegal objectives or formulated based on illegal motives.**

Limitation of Benefits Provision in DTAA

- The DTAA, post its amendment in 2016 and the insertion of Article 27A and with sufficient clarity enumerates the circumstances in which an entity may be denied benefits of Article 13(3B) or where it would be deemed to be a mere shell/conduit company. It defines a shell/conduit company as being **one with negligible or nil business operations or one which fails to exhibit the carrying on of a real and continuous business**. Article 27A not only lays in place a criterion where an entity would be deemed to be a shell or a mere conduit as well as contingencies in which a negative legal fiction would operate and dispel any assumption of that entity being a shell or a mere artifice. The DTAA thus specifically adopts provisions concerned with entitlement to benefits and thus embodies standards and tests that both Countries chose to adopt for the purposes of tackling instances of treaty shopping and abuse.
- Once LOB provisions come to be incorporated in a tax treaty, it would be those provisions which would govern and be determinative of an allegation of treaty abuse or a benefit being illegitimately claimed. The doubts of the Revenue Authorities or the material that it may gather in support of its allegation of abuse would have to be demonstrative of the LOB provision being breached or violated. The right to question the validity or character of a transaction notwithstanding duly articulated LOB provisions being met would have to meet an extremely high, exacting and compelling standard of proof with the onus lying squarely upon the Revenue Authorities to establish that the substance of the transaction clearly warrants the entity being deprived of treaty benefits. These would stand confined to cases of fraud or sham, transactions tainted with illegality and where circumstances unerringly prove that the Countries never intended it to be covered by the beneficial treaty provisions.
- **The TRC as well as the LOB provisions comprised in the DTAA more than adequately, may comprehensively, address themselves to treaty abuse and it would thus be wholly impermissible for the Revenue Authorities to construct additional barriers or qualification standards for the purposes of extending benefits under the DTAA**. This would of course be subject to the limited caveat and narrow confines of fraud, illegal activity or where the transaction is contrary to the underlying objective and purpose of the treaty itself.

Tax Residency Certificate

- It becomes important to note that a **TRC once found to have been issued by the competent authority must be accorded due weightage and its sanctity duly acknowledged.**

- The TRC represents the **first level of certification of the holder being a bona fide business entity domiciled in the residence country**. The issuance of a TRC constitutes a mechanism adopted by the residence country itself so as to dispel any speculation with respect to the fiscal residence of an entity. It therefore can neither be cursorily ignored nor would the revenue be justified in doubting the presumption of validity which stands attached to that certificate bearing in mind the position taken by the Union itself of it constituting sufficient evidence of lawful and bona fide residence.
- **The issuance of a TRC by a country must be considered to be sacrosanct and due weightage must be accorded to the same as it constitutes certification of the TRC holding entity being a bona fide entity having beneficial ownership domiciled in the said country to pursue a legitimate business purpose in the said country.**
- The circumstances under which the Revenue Authorities could pierce the corporate veil of a TRC holding entity is restricted to extremely narrow circumstances of tax fraud, sham transactions, camouflaging of illegal activities and the complete absence of economic substance and the establishment of those charges would have to meet stringent and onerous standards of proof and the Revenue Authorities being required to base such conclusions on cogent and convincing evidence and not suspicion alone. It is only when the Revenue Authorities is able to meet such a threshold that it can disregard the presumption of validity which would be attracted the moment the TRC is produced and Limitation of benefits conditions are fulfilled.

Tiger Global International II Holdings and Others vs. AAR (Income tax and Ors) [W.P.(C) 6765/2020]