

Tax Hotline

May 24, 2022

BENEFICIAL OWNERSHIP TEST CANNOT BE READ INTO ARTICLE 13 (CAPITAL GAINS) OF THE INDIA-MAURITIUS TAX TREATY, WITHOUT SPECIFIC LANGUAGE TO SUCH EFFECT

- The ITAT sets aside the assessment order denying benefits to a resident of Mauritius under Article 13 of India-Mauritius tax treaty, on account of the resident not being the *beneficial owner* of capital gains.
- Without express language to such effect, the test of beneficial ownership cannot be read into Article 13 of the India-Mauritius tax treaty.
- Matter remitted back to the assessing officer to determine whether beneficial ownership test applies to Article 13 and if yes, whether the taxpayer meets the test.

Recently, the Mumbai bench of the Income Tax Appellate Tribunal (“ITAT” or “the Tribunal”) in the case of *Blackstone FP Capital Partners v. DCIT*¹, while remitting the matter regarding availability of benefits under the India-Mauritius tax treaty (“Treaty”) to the assessing officer (“AO”) noted that Article 13 of the Treaty does not expressly provide for the fulfilment of the beneficial ownership test in order to be entitled for treaty protection. The ITAT held that the AO incorrectly proceeded on an underlying presumption that for the benefits under Article 13 of the Treaty to be available, the Taxpayer is required to be the beneficial owner of the capital gains (a requirement which is not embedded into the language of Article 13 itself).

FACTS

The assessee was a company incorporated in Mauritius holding a Global Business License (“Taxpayer”) issued by the Financial Services Commission, Mauritius. The Taxpayer had a ‘tax residency certificate’ (“TRC”) from the Mauritian Revenue Authority and was a registered foreign venture capital investor with the Securities and Exchange Board of India.

The Taxpayer earned long-term capital gains (in 2015) from transfer the shares held in an Indian company, CMS Info Systems Limited, to a Singaporean company named Sion Investment Holdings Private Limited. The Taxpayer sought relief under Article 13(4) of the Treaty which grants residuary taxing rights solely to the country of residence.

The AO based on the information received from the tax authorities of Mauritius and Cayman Islands, the AO concluded the Taxpayer is a wholly-owned subsidiary of the Cayman Island entity, with no independent existence and that its activities (including the present sale of shares) were entirely controlled by the parent entity. The AO went onto hold that the entire arrangement of buying and selling shares was for the benefit of the Cayman Island entity and thus, found this to be a fit case to lift the corporate veil.

In this regard, the AO relied on the judgment of the Bombay High Court (“HC”) in *Aditya Birla Nuvo Limited v.*

*DDIT*² and the decision of the Authority for Advance Ruling (“AAR”) in the case of *AB Mauritius, In Re*³ to conclude that the beneficial ownership of the shares does not rest with the Mauritian company and thus, it is ineligible for the benefit of Article 13(4) of the Treaty. The decision of the AO was confirmed by the Dispute Resolution Panel, and thus the assessee preferred the present appeal before the ITAT.

RULING BY THE TRIBUNAL

The Tribunal on appeal set aside the AO’s order and directed the AO to decide the fundamental issue as to whether the principle of beneficial ownership can be read into the scheme of Article 13 of the Treaty on the following basis:

- The AO incorrectly proceeded on the assumption that the principle of beneficial ownership of the capital gains can be read into the scheme of Article 13 of the Treaty (without explicit language in Article 13 to such effect) without providing any specific and cogent reasons in support of such inference.
- Unlike Article 10 and Article 11 of the Treaty (pertaining to the taxation of interest and dividends), Article 13 does not expressly necessitate the fulfilment of the beneficial ownership test for availing its benefit. Thus, in the absence of a specific provision to that effect, the principle of beneficial ownership cannot be simply assumed or inferred in the scheme of Article 13 of the Treaty.
- The omission of the beneficial ownership test from certain provisions of a tax treaty may not be inadvertent or unintentional.⁴
- Reading the principle of beneficial ownership into Article 13 of the Treaty, without specific provision providing for it could amount to rewriting the Treaty rather than a permissible interpretation of the Treaty. Treaties are the subject

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- of heavily negotiated positions between the tax authorities of countries, and as such cannot be expanded by way of judicial interpretation.
- The approach of the authorities below seems to be fundamentally altering the criterion under which a person is entitled to the benefits of a treaty provision, thus frustrating and negating the certainty and predictability sought to be achieved by the tax treaty partners.
 - The tax treaties are replete with choices but once these choices are consciously made by two willing partners these choices cannot be unilaterally nullified on the basis of perceptions about some underlying notions of what would constitute good public policy. The principle of *pacta sunt servanda* as enshrined in Article 26 of Vienna Convention on the Law of Treaties⁵, requires the parties to a treaty to respect the negotiated bargain. With regard to tax treaties, any violation of this approach will come at a huge cost of tax uncertainty.
 - The Canadian Supreme Court in *Her Majesty v. Alta Energy Luxembourg SARL*⁶ declined to read a requirement of sufficient substantive economic connection into Article 13 of the Canada-Luxembourg tax treaty (materially similar to Article 13 of the Treaty) and noted that “beneficial ownership is utterly foreign to Article 13”.
 - In so far as AOs reliance on the Bombay HC’s decision in case of *Aditya Birla Nuvo Limited (supra)* is concerned, the ITAT noted that the assessee itself claimed that it qualifies the requirement of beneficial ownership and did not contest that the test of beneficial ownership is not applicable to Article 13 of the Treaty. Thus, the decision of the HC proceeded on this basis, and the ITAT ruled that it cannot be considered as an authority on the proposition that the beneficial ownership test can be read into Article 13 of the Treaty.
 - The decision of the AAR in the case of *AB Mauritius (supra)* proceeded on the assumption that the test of beneficial ownership is a condition precedent to avail the benefit of Article 13 without analyzing the issue (which the ITAT in the present case has found to be an incorrect approach). Furthermore, the ITAT noted that the AAR ruling is not a binding precedent upon the Tribunal anyway.

ANALYSIS

While the ITAT makes it clear that beneficial ownership cannot be seen as a rider for availing benefits under Article 13 of the Treaty, remanding the matter to the AO seems to be unwarranted and is likely to prolong litigation on the issue. It is unclear why the Tribunal despite being the final fact-finding authority, did not find merit in examining the facts of the case in further detail and putting an end to the controversy. Having said this, the decision of the Tribunal reiterates several well-established principles on treaty interpretation.

The concept of beneficial ownership was first introduced through the 1977 version of the OECD Model Tax Convention (“**OECD MTC**”), into Articles 10, 11, and 12 of the OECD MTC (and modified subsequently through various amendments to the OECD MTC and its Commentary). However, neither the OECD MTC nor its commentaries define the term beneficial owner. The lack of a clear, uniform and an internationally accepted definition of beneficial owner makes the concept vague and open to interpretation. Even the Indian Income-tax Act, 1961 does not offer any guidance on meaning of the term beneficial owner. Therefore, any attempt to interpret the term ‘beneficial owner’ should be made in the context (considering the legislative history and intent of the provision) in which the term is used in tax treaties.

In terms of Article 10 (dividend), the OECD MTC states that the direct recipient of dividend should not be the “beneficial owner” if the recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. It further specifically excludes persons who receive dividends as representatives or agents, as well as continuous companies whose decision-making powers are so narrow that they appear to be merely trustees or administrators in the interests of the parties concerned, not being entitled to use the dividend income. However, the commentary also states that the fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that benefit under the tax treaty should be granted. It specifically provides that benefit under Article 10 of the tax treaty should not be granted in cases of abuse of this provision.⁷ It is a settled that benefit to tax treaty should not be provided in cases where granting of such benefit amounts to abuse of tax treaty provision. This principle is further strengthened by introduction of the principal purpose test (“**PPT**”) under several tax treaties pursuant to the multilateral instrument. Having said this, it is important to analyze whether deemed inclusion of the ‘beneficial ownership’ test is required under the capital gains article in tax treaties to prevent abuse of such provision (despite inclusion of PPT under tax treaties).⁸

In so far as Indian jurisprudence is concerned, the issue of beneficial ownership is a much-debated issue. Despite the clarification provided by the Circular No. 789⁹ that a TRC constitutes sufficient evidence for accepting the status of residence as well as beneficial ownership specifically in context of the Treaty, tax authorities have time and again challenged availability of treaty benefits by challenging beneficial ownership. The validity of Circular 789 was upheld by the Supreme Court of India in *Azadi Bachao Andolan v. Union of India*,¹⁰ and has been relied on by several Courts in a plethora of other judgements ever since.¹¹

Specifically, in the context of the Treaty, the amendment in 2017 sought to grant India the right to tax future capital gains arising from Indian exits and to provide protection to investments made prior to April 2017 from capital gains tax levy in India. However, in recent times, even the grandfathered investments from Mauritius seem to be under increased scrutiny from Indian tax authorities alleging such transactions to be sham in nature or to be undertaken to avoid / evade tax in India.

The decision by the Tribunal is likely to add fuel to these cases. Despite holding that beneficial ownership test cannot be read into Article 13 of the Treaty as it would amount to re-writing of the Treaty provisions, it is very odd that the Tribunal remitted the matter back to the AO to make a finding on this issue. Considering that the Tribunal remitted the substantial issue regarding application of beneficial ownership principle to Article 13 to the AO, it appears that the Tribunal did not find merit in discussing Circular 789 or the fact that the investment made by the Taxpayer was grandfathered under the Treaty.

The decision by the Tribunal is likely to keep the taxpayers in a fix, where at one hand, the Tribunal reiterates the principles of tax certainty, good public policy and good faith interpretation of tax treaties, on the other hand, the

Tribunal refrains from providing a decisive ruling on the issue at hand. Having said this, considering the limited jurisprudence in India with respect to interpretation of the term 'beneficial owner', it will be interesting to see how the AO determines whether Article 13 of the Treaty has to satisfy the beneficial owner test.

– Arijit Ghosh & Ipsita Agarwalla

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You can direct your queries or comments to the authors

¹ ITA Nos. 981 and 1725/Mum/2021.

² [(2011) 12 taxmann.com 141 (Bom)].

³ [(2018) 90 taxmann.com 182 (AAR)].

⁴ In this regard, the ITAT noted the conclusion by Professor Philip Baker in his consulting paper to the UN Committee of Experts on International Cooperation on Tax Matters wherein the Professor stated that "*there was ultimately only limited support for inserting beneficial ownership in article 13*".

⁵ The Article reads, "Every treaty in force is binding upon the parties to it and must be performed by them in good faith".

⁶ [2021 SCC 49- judgment dated 26th November 2021].

⁷ 2017 OECD Commentary (full version), Commentary on Article 11 (at Para 12.4 and Para 12.5)

⁸ Please note that the Treaty is not modified by the PPT as Mauritius has not notified the Treaty as a covered tax agreement

⁹ Dated April 13, 2000

¹⁰ [2003] 263 ITR 706 (SC)

¹¹ For example, *In re, E*Trade Mauritius Limited*, [2010] 324 ITR 1 (AAR); *Dynamic India Fund I*, AAR 1016/2010 dated July 19, 2012; *DB Swim Mauritius Trading*, [2011] 333 ITR 32 (AAR); *In re, Ardex Investments Mauritius Ltd.*, [2012] 340 ITR 272 (AAR); *In re, SmithKline BeechamPort Louis Ltd.*, [2012] 3408 ITR 56; *In re, Castleton Investment Ltd.* [2012] 348 ITR 537

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