Tax Hotline

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MUMBAI TRIBUNAL: TRC IS SUFFICIENT EVIDENCE OF BENEFICIAL OWNERSHIP

- Tribunal holds that a valid TRC is evidence of not just residence of taxpayer but also it being the beneficial owner of income.
- CBDT Circular 789/2000 relied upon by Tribunal to extend the benefit of presumption of residence and beneficial ownership in the case of interest income as well.
- Tribunal also holds a Mauritius resident taxpayer need not carry out banking activity in India as well in order to avail of the benefit of the exemption from Indian taxes under Article 11(3)(c) of the Treaty.

Recently, in the case of *HSBC Bank (Mauritius) Ltd. v. Deputy Commissioner of Income-tax (IT)-2(2)(2), Mumbai,*[1] the Mumbai Bench of the Income Tax Appellate Tribunal (the "**Tribunal**") held that a valid Tax Residence Certificate ("**TRC**") held by a Mauritius taxpayer would constitute sufficient evidence of the taxpayer being the beneficial owner of the income being earned by it for the purposes of the India Mauritius Double Taxation Avoidance Agreement (the "**Treaty**").

FACTS

HSBC Bank (Mauritius) Ltd. is a limited liability company which is incorporated, registered and a tax resident of Mauritius (the "**Taxpayer**"). The Taxpayer had earned interest income of INR 950 million (approximately) from investments in Indian debt securities. Relying upon Article 11(3)(c) of the Treaty,[2] the Taxpayer claimed an exemption from Indian taxes in respect of this income. However, the said exemption was denied by the tax authorities on the ground that the requisite conditions prescribed in Article 11(3)(c) of the Treaty were not fulfilled by the Taxpayer as:

i. the interest was not "*derived*" by the Taxpayer;
ii. that interest was not "*beneficially owned*" by the Taxpayer; and
iii. that the Taxpayer ought to be carrying on *bona fide* banking business, which it did not.

On an appeal by the Taxpayer to the Tribunal, the Tribunal passed an order dated December 16, 2016, by way of which it agreed with the Taxpayer's contentions with respect to points (i) and (iii) above. However, with respect to the condition of beneficial ownership, the Tribunal remanded the issue to the file of the Assessing Officer. This was contested by the Taxpayer by way of a Miscellaneous Application under Section 254(2) of the Income Tax Act ("**ITA**") and the Tribunal recalled its decision so far as it pertained to the issue of "*beneficial ownership*" through its order dated January 10, 2018.

ISSUE:

The limited issue before the Tribunal was to consider whether the Taxpayer was the beneficial owner of the interest income earned by it and hence, eligible to claim the benefits of Article 11(3)(c) of the Treaty.

TRIBUNAL'S RULING:

Article 11(3)(c) of the Treaty prescribes that interest income arising in India shall be exempt from tax in India provided it is derived and beneficially owned by any bank carrying on a bona fide banking business which is resident of Mauritius.[3]

The Taxpayer relied on the Circular No. 789/2000 dated April 13, 2000 (the "**Circular**") issued by the Central Board of Direct Taxes ("**CBDT**") which, prescribed that wherever a TRC is issued by the Mauritian authorities, such a TRC will constitute sufficient evidence for not only accepting the status of residence, but also the beneficial ownership in order to apply the provisions of the Treaty.[4]

The Taxpayer drew the attention of the Tribunal to the judgment of the Hon'ble Supreme Court of India

in the case of *Union of India* v. *Azadi Bachao Andolan*,[5]. It was also pointed out that the Ministry of Finance through its Press Clarification dated March 1, 2013 has clarified that the Circular continues to be in force.

The Tribunal had to consider whether the Circular could be relied upon by the Taxpayer considering the fact that it had been issued specifically in the context of income by way of dividend and capital gains arising from the sale of shares. In this regard, the Tribunal referred to the judgment of the Hon'ble Bombay High Court in the case of *DIT* v. *Universal International Music B.V*,[6] where a company incorporated under the laws of Netherlands and holding a valid TRC issued by the Netherland authorities was considered to be the beneficial owner of the royalty income received from the Indian company on the basis of the Circular, even though the income in this case was in the nature of royalty income (and not dividends or capital gains). Accordingly, the taxpayer in this case was held to be entitled to the benefits of Article 12 of the Double Taxation Avoidance Agreement between India and Netherlands.

Relying upon the above mentioned judgment of the Bombay High Court, the Tribunal held that the Circular would equally apply even in the instant case where the issue concerned the Taxpayer's eligibility to avail benefits of the Treaty in respect of the interest income derived by it.

The Tribunal also referred to a decision of its Chennai Bench in the case of *Hyundai Motor India Ltd.* v. *Dy. CIT*.[7] where the Chennai Tribunal held a Mauritius bank to be the beneficial owner of interest income.

CONCLUSION:

This is a very welcome judgment for non-resident taxpayers as the Tribunal has clearly held that as long as the taxpayer is able to produce a valid TRC, it should be considered as sufficient evidence not just of the residence of the taxpayer but also of the taxpayer being the beneficial owner of the income in question. Further, the Tribunal also decided to allow the benefit of the Circular to interest income despite the Circular being limited to income from capital gains and dividends.

The ruling will be especially relevant for debt investments from Mauritius, in light of the amendments to the Treaty in 2016, due to which interest is subject to a lower withholding tax of 7.5%.

While the instant case is with respect to interest earned by a Mauritius bank, the same reasoning should also hold good for investments by institutional investors. Interestingly, one of the arguments raised by the revenue in this matter was the fact that the Taxpayer was only carrying out the activity of a Foreign Institutional Investor (FII) in India. In an earlier order dated December 16, 2016, the Tribunal had also held that merely because the Taxpayer was not carrying out any banking activity in India would not disentitle it to claim the benefit of Article 11(3)(c) of the Treaty as long as it was carrying out banking activities in Mauritius. The Tribunal noted that in order to be eligible for this exemption, the Treaty does not require a Mauritius entity to carry out banking activity in India as well. The Tribunal agreed that the Taxpayer being a bank, is allowed to invest in India as a FII after receiving requisite registration from SEBI and carrying out such activity cannot be considered as being mala fide in nature.

– Shashwat Sharma & Shipra Padhi
You can direct your queries or comments to the authors

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[1] [2018] 96 taxmann.com 544 (Mumbai - Trib.)

[2] Article 11(3) of the Treaty is reproduced below as follows:

"*Interest arising in a Contracting State shall be exempt from tax in that State provided it is derived and beneficially owned by:*
(a) the Government or a local authority of the other Contracting State ;
(b) any agency or entity created or organised by the Government of the other Contracting State ; or
(c) any bank carrying on a bona fide banking business which is a resident of the other Contracting State."

[3] Ibid.

[4] The CBDT Circular 789 clarifies as follows:

"*2. ..... It is hereby clarified that wherever a Certificate of Residence is issued by the Mauritian Authorities, such Certificate will constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the DTAC accordingly.*"

[5] [2003] 263 ITR 706

[6] [2013] 214 Taxman 19 (Bom.)

[7] [2017] 81 taxmann.com 5

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