

# Tax Hotline

February 09, 2023

## DELHI HIGH COURT QUASHES REASSESSMENT PROCEEDINGS AND UPHOLDS SANCTITY OF TRC!

- Satisfaction of beneficial ownership not required to take benefit under capital gains article under relevant tax treaty
- TRC is statutorily the only evidence required to be eligible for the benefit under tax treaties.
- The tax authorities cannot go behind the TRC issued by the other tax jurisdiction and such an attempt is not tenable in law.

### BACKGROUND

Recently, the Hon'ble Delhi High Court ("HC") exercised its writ jurisdiction and quashed reassessment proceedings initiated by the tax department against Blackstone Capital Partners (Singapore) VI FDI Three Pte Ltd ("Taxpayer")<sup>1</sup>. The HC held that tax department cannot go behind the tax residency certificate ("TRC") issued by the Taxpayer's jurisdiction and considered the TRC as sufficient evidence to claim treaty eligibility, residence status and legal ownership.

### FACTS OF THE CASE

The Taxpayer, a Singapore resident, acquired equity shares of Agile Electric Sub Assembly Private Ltd ("Agile"), a company incorporated in India in two tranches in assessment year ("AY") 2014-15. The Taxpayer subsequently sold all the equity shares of Agile to Igarashi Electric Works Ltd. ("Igarashi") and other parties during the AY 2016-17 ("Transaction"). The Taxpayer claimed that the capital gains arising from the Transaction were not taxable in India in light of Article 13(4) of the India-Singapore Double Tax Avoidance Agreement ("DTAA") based on the TRC. The return of income was processed with no demand. Thereafter, in 2021, notice for re-assessment was issued to the Taxpayer under Section 148 of the Income-tax Act, 1961 ("ITA") for AY 2016-17 by the assessing officer ("AO"). The Taxpayer requested for reasons for reopening of assessment and was supplied with the same (after 8 months of request), stipulating that the genuineness and taxability of the Transaction remained unverified mandating the reopening of the proceedings.

The Taxpayer objected to reopening of the assessment, however, the income-tax department disposed of such objections. Aggrieved by the disposition, the Taxpayer filed a writ petition before the HC.

### DECISION OF THE HON'BLE HIGH COURT

The HC after undertaking a detailed analysis inter-alia held the following:

- Maintainability: On revenue's contention with respect to maintainability of petition, the HC held that the 'reasons to believe' for reopening the proceedings is amenable to writ jurisdiction.
- Recourse to section 147 to extend time period for verification is illegal: The reason for reopening of assessment by revenue authorities was to verify the nature and genuineness of Transaction. In this regard, the HC held that the return of income had been filed by the Taxpayer within the stipulated time with complete particulars as required, and the timeline for verification and seeking clarifications or additional documents had already expired. In such a case, the order for reopening of assessment was held untenable in law.
- Impugned notice issued on borrowed satisfaction held illegal: the AO sought to place reliance upon data extracted from a 3rd party source to initiate the reassessment proceedings. In this regard, the HC held that while information from 3rd party sources can form a basis for investigation but the decision to reopen assessment has to be formed by the AO. The HC noted that reassessment proceedings were initiated based on the information forwarded by the TDS officer of Igarashi without the independent application of mind of the AO. In light of this, the HC held issuance of such a notice to be legally impermissible.
- No close nexus between the material and formation of belief: The HC enunciated that the reasons for reopening proceedings should exhibit that the AO had reached a view after due consideration of all the facts, so as to avoid an arbitrary exercise of power. Further, a close nexus or a live link must be shown to exist between the material available before the AO and the belief that income chargeable to tax has escaped assessment. The HC held that such a link or nexus was missing in the instant case.
- Concept of beneficial ownership under the DTAA was not required for capital gains: The HC held that satisfaction of beneficial ownership was required only qua dividend, interest and royalty.
- Reasons recorded cannot evolve or be allowed to grow with time: Considering that the AO raised additional pleas which did not form part of reasons for reopening of assessment, the HC held that reasons recorded cannot evolve

## Research Papers

### Horizon Technologies

January 21, 2025

### Compendium of Research Papers

January 11, 2025

### FAQs on Setting Up of Offices in India

December 13, 2024

## Research Articles

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

### Key changes to Model Concession Agreements in the Road Sector

January 03, 2025

### The Revolution Realized: Bitcoin's Triumph

December 05, 2024

## Audio

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

### Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### "Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FI18 event in Riyadh

October 31, 2024

### Analysing SEBI's Consultation Paper

**Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996**

September 22, 2024

or be allowed to grow with age and ingenuity. The reasons which are recorded cannot be supplemented by affidavits.

- Requirements of Limitation of Benefit ("LOB") clause stood satisfied: On perusal of the audited financial statement of the Taxpayer and an independent chartered accountant's certificate, the HC held that the Taxpayer was satisfying the LOB condition provided in the DTAA.
- Respondent-revenue cannot go behind the TRC: The HC categorically enunciated that "it is a fundamental rule of international taxation that every nation has a sovereign right to impose tax on the global income of its residents and on income that accrues or arises within its territorial limits", and that the "respondent's attempt in seeking to question the TRC is wholly contrary to the Government of India's repeated assurances to foreign investors." The HC referred to various provisions of the DTAA, Section 90 of the ITA, judicial decisions and CBDT Circulars to interpret that the Taxpayer was eligible to the benefits of the DTAA. The HC further noted that the TRC is statutorily the only evidence required to be eligible for the benefit under the DTAA. The HC thus conclusively ruled that the tax authorities cannot go behind the TRC issued by the other tax jurisdiction and such an attempt is not tenable in law.

**NDA ANALYSIS**

The decision of the HC is a big win for the Taxpayers and foreign investors. It is common for the tax department to challenge availability of benefit under tax treaty. While most tax treaties have been amended to provide India the right to tax capital gains income from transfer of equity shares, tax department has often challenged availability of benefit under tax treaty even in cases where investment has been grandfathered. In order to make such challenge, typically, the tax department would either initiate withholding tax proceedings on the buyer or initiate assessment / reassessment proceedings on the sellers (depending on statutory limitations).

The instant case emanates from challenge by the Taxpayer to the reasons provided by the tax department for initiation of reassessment proceedings. The HC has succinctly laid several important principles with respect to reassessment proceedings. Considering that the Taxpayer had made all disclosures with respect to investment in Agile and the Transaction and the expiry of time period for verification/ seeking clarifications, the HC held that recourse to section 147 is untenable. The HC also considered the documentary evidence (like Form 10K filed by the Blackstone group in USA) shown by the tax department and concluded that there was no link between such material and formation of such belief. While provisions with respect to reassessment proceedings have undergone substantial change post Finance Act, 2021, the principles laid down by the HC should still hold importance.

In relation to beneficial ownership, the HC clarified that satisfaction of 'beneficial ownership' is not required to claim exemption under Article 13 of the DTAA. Tax authorities often deny tax treaty benefits alleging that the taxpayer is not the beneficial owner of capital gains income. The HC has rightly pointed out that the language of the Article 13 (capital gain) of the DTAA does not necessitate the fulfilment of the beneficial ownership test for availing its benefit.

This is in line with the recent decision by the Mumbai ITAT<sup>2</sup>. Nevertheless, the HC noted that the tax department had not been able to prove that the Taxpayer was a tax resident of USA or was controlled or managed from USA. The fact that the Taxpayer had maintained appropriate documents and was managed by its board of directors from Singapore worked in its favour.

Importantly, the HC has categorically upheld the sanctity of the TRC issued by Singaporean tax authorities. The HC relied on the Supreme Court decision in case of Azadi Bachao Andolan<sup>3</sup> wherein TRC was held to be conclusive evidence for determining the status of residence and beneficial ownership of an asset under the tax treaty. The HC decision is yet another decision wherein the court has followed the ratio laid down in landmark cases like Azadi Bachao and Vodafone<sup>4</sup>.

Considering the high risk of challenge and amendment to certain tax treaties pursuant to the multilateral instrument, while existence of TRC may be a starting point for claiming benefits under tax treaty, it is equally important to ensure appropriate substance in form of employees, presence and documentation. Further, it is also very important to have a strong commercial rationale for structuring transactions in a certain manner and recording such rationale in minutes.

— Ipsita Agarwalla & Ashish Sodhani

(The authors would like to acknowledge and thank Saumya Sinha (student, National University of Study and Research in Law, Ranchi) for her contribution to this hotline.)

You can direct your queries or comments to the authors

<sup>1</sup> Blackstone Capital Partners (Singapore) VI FDI Three Pte Ltd vs ACIT; Neutral Citation Number 2023/DHC/000634

<sup>2</sup> Blackstone FP Capital Partners v. DCIT ITA Nos. 981 and 1725/Mum/202

<sup>3</sup> Azadi Bachao Andolan v. Union of India [2003] 263 ITR 706 (SC)

<sup>4</sup> Vodafone International Holdings B.V. vs. Union of India and Anr., (2012) 6 SCC 613

**DISCLAIMER**

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.