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Delhi HC upholds Mauritius tax treaty benefits for shares acquired before April 1, 2017

Background

In a recent landmark decision, the Delhi High Court ruled in favor of Tiger Global, a Mauritius-based entity, in a case involving the sale of shares in Flipkart Singapore to Walmart. The core issue was whether the India-Mauritius Double Taxation Avoidance Agreement (DTAA) protected Tiger Global from capital gains tax in India, given that the shares were acquired before April 1, 2017.

Case Summary

Tiger Global had sought a nil withholding tax certificate, arguing that their transaction was grandfathered under Article 13(3A) of the India-Mauritius DTAA, thus exempting them from capital gains tax. The tax authorities, however, denied this, suspecting tax avoidance. They mandated a 10% tax withholding instead. The case was brought before the Authority for Advance Rulings (AAR), which sided with the tax authorities. However, the Delhi High Court overturned this ruling, emphasizing that establishing an investment vehicle in Mauritius should not automatically imply tax evasion. The court upheld the validity of the Tax Residency Certificate (TRC) from Mauritius, provided there is no evidence of fraud or sham transactions.

Way Forward

This ruling provides significant relief for foreign funds registered in Mauritius and relying on treaty protection especially for shares acquired before 2017. However, the battle might not be over, as the Income Tax Department is expected to appeal the decision before the Supreme Court. The outcome of this case will have wide-reaching implications for foreign investors and the future of treaty protections in India.

Timeline of Events

October 2011 – April 2015
Tiger Global entities (II, III, IV Holdings) acquire shares in Flipkart Singapore

May 2016
The Protocol for Amendment of the dia-Mauritius DTAA is signed, introducing :icle 13(3A) and the grandfathering clause

April 1, 2017
Effective date for Article 13(3A) of the DTAA. Shares acquired before this date are protected under the grandfathering clause

May 9, 2018
A Share Purchase Agreement is executed between Walmart and the shareholders of Flipkart Singapore

August 2, 2018
Tiger Global applies for a nil withholding tax certificate from the tax authorities

August 17, 2018
The tax authorities reject the nil withholding tax certificate and instead require a 10% tax withholding

August 18, 2018
Tiger Global entities transfer their shareholding in Flipkart Singapore to Walmart

February 19, 2019
Tiger Global files an application before the AAR seeking confirmation of their tax exemption claim

March 26, 2020
AAR rejects Tiger Global's application, ruling tha the transaction was designed for tax avoidance

May 16, 2024
Delhi High Court reserves its judgment on Tiger Global's petitions challenging the AAR ruling

August 28, 2024
Delhi High Court delivers its judgment, overturni the AAR ruling and upholding the benefits of the India-Mauritius DTAA for Tiger Global

1. Background and Factual Narrative

- **Acquisition of Shares**

  Tiger Global entities based in Mauritius acquired shares in Flipkart Singapore between October 2011 and April 2015. These acquisitions were made well before the critical date of April 1, 2017, which is when the India-Mauritius DTAA was amended to introduce Article 13(3A). This provision grandfathered transactions completed before this date, meaning capital gains on shares acquired before this date would not be taxable in India.

- **Sale to Walmart**

  In May 2018, Tiger Global entered into a Share Purchase Agreement with Walmart, which eventually led to the sale of its shares in Flipkart Singapore. The sale was completed in August 2018, and Tiger Global sought a nil withholding tax certificate from Indian tax authorities, arguing that the transaction was exempt from capital gains tax under the DTAA.

2. Points of Litigation

- **Application for Nil Withholding Certificate**

  Tiger Global applied for a nil withholding tax certificate, asserting that their transaction fell under the DTAA's grandfathering clause. However, the tax authorities denied this application, issuing a certificate that required Walmart to withhold tax at a rate of 10% plus surcharge and cess.

- **Rejection by AAR**

  Following the transfer of shares, Tiger Global sought an advance ruling from the Authority for Advance Rulings (AAR) to confirm their exemption from tax. The AAR, however, rejected their application, concluding that the transaction was designed to avoid tax. The AAR's ruling was based on the premise that the structure of Tiger Global's investments through Mauritius was primarily aimed at benefiting from the DTAA, rather than having substantial commercial substance.

- **Petition to Delhi High Court**

  Dissatisfied with the AAR's ruling, Tiger Global filed writ petitions in the Delhi High Court, challenging the rejection. They argued that the transaction was legitimate and complied with the provisions of the DTAA.

3. Key Legal Provisions and Arguments

- **India-Mauritius DTAA - Article 13(3A)**

  Article 13(3A) of the India-Mauritius DTAA, introduced by the 2016 Protocol, was central to the case. This article subjects capital gains arising from the alienation of shares acquired on or after April 1, 2017, to tax in India. However, shares acquired before this date were "grandfathered," meaning they were exempt from capital gains tax in India.

- **GAAR Applicability**

  The tax authorities attempted to invoke the General Anti-Avoidance Rule (GAAR), which allows tax authorities to deny tax benefits if they believe the primary purpose of a transaction is to obtain a tax advantage. The AAR accepted this argument, claiming that the structure of the investment through Mauritius was aimed at avoiding Indian taxes. However, the High Court found that GAAR was not applicable in this case because the shares were acquired before the critical date, and there was no evidence of sham or fraudulent activity.

- **TRC Validity**

  A key point in the judgment was the validity of the Tax Residency Certificate (TRC) issued by Mauritius. The Delhi High Court emphasized that a TRC, unless there is evidence of fraud or a sham transaction, should be considered sacrosanct and must be given due weight. The court rejected the tax authorities' attempt to disregard the TRC based on their suspicion of tax avoidance.

4. Delhi High Court's Judgment

- **Rejection of AAR's Findings**

  The Delhi High Court overturned the AAR's ruling, stating that the assumption of tax avoidance based solely on the use of a Mauritius-based investment vehicle was unfounded. The court ruled that the establishment of such a vehicle should not automatically imply tax evasion or treaty abuse. The court found that the transaction was conducted with commercial substance and was not merely a conduit for tax avoidance.

- **Economic Substance**

  The court analyzed whether Tiger Global entities had sufficient economic substance in Mauritius. It concluded that the entities were not mere conduits but served a genuine commercial purpose. They were legitimate pooling vehicles for investments, held valid TRCs, and complied with the Limitation of Benefits (LOB) clause in the DTAA. Therefore, the court ruled that the economic substance of the entities was valid and substantial.

- **GAAR Inapplicability**

  The court ruled that GAAR could not be applied retrospectively to transactions where the shares were acquired before April 1, 2017. Since the shares were acquired before the amendment, the transaction was protected under the DTAA's grandfathering clause.

5. Implications and Way Forward

- **Relief for Foreign Funds**

  This judgment is a significant relief for foreign funds that rely on treaty protections, particularly those based in Mauritius. It reaffirms the importance of respecting TRCs and the protections offered by the India-Mauritius DTAA.

- **Potential Appeal**

  The judgment notes the possibility of the Income Tax Department appealing this decision before the Supreme Court. The outcome of such an appeal could have wide-reaching implications for international investments and tax planning strategies involving DTAA protections.

6. Conclusion and Takeaways

- **Sanctity of TRC**

  The court's ruling underscores the importance of the TRC as a document certifying the bona fide status of an entity unless there is clear evidence of fraud or a sham transaction. This is a crucial precedent for similar cases in the future.

- **Legal Precedents Set**

  The case sets important legal precedents in the interpretation of DTAAs and the application of anti-avoidance rules like GAAR. It highlights the need for a balanced approach in assessing the commercial substance and purpose of transactions involving foreign entities.

Overall Impact

This judgment is a major win for foreign investors relying on treaty protections. It provides clarity on the application of DTAAs and the limitations of GAAR in cases where transactions are backed by genuine commercial substance. However, the potential appeal to the Supreme Court means that this issue may continue to evolve, making it a crucial case to watch for future developments in international tax law.

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