2026 INSC 60

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 262 OF 2026
[Arising out of SLP (C) No. 2640 OF 2025]

THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX) AND OTHERS .... APPELLANT(S)

VERSUS

TIGER GLOBAL INTERNATIONAL II HOLDINGS .... RESPONDENT(S)

WITH

CIVIL APPEAL NO. 263 OF 2026
[Arising out of SLP (C) No. 2565 of 2026]
[Arising out of SLP (C) Diary No. 1260 of 2025]

THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX) AND OTHERS .... APPELLANT(S)

VERSUS

TIGER GLOBAL INTERNATIONAL IV HOLDINGS .... RESPONDENT(S)

WITH

CIVIL APPEAL NO. 264 OF 2026
[Arising out of SLP (C) No. 5987 OF 2025]

THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX) AND OTHERS .... APPELLANT(S)

VERSUS

TIGER GLOBAL INTERNATIONAL III HOLDINGS .... RESPONDENT(S)

J U D G M E N T

R. MAHADEVAN, J.

1. Delay condoned.

2. Leave granted. The present appeals arise from a final judgment and common order dated 28.08.2024 passed by the High Court of Delhi at New Delhi[1] in W.P. (C) Nos. 6764, 6765 and 6766 of 2020 and are, therefore, disposed of by this common judgment.

3. For the sake of clarity and systematic analysis, this judgment is divided into the following heads:

[1] Hereinafter referred to as "the High Court"

I. INTRODUCTION

4. The power of an independent Republic to levy and collect tax forms part of its inherent sovereign functions, and such power is circumscribed only by the requirement of being within the *authority of law*. Article 265 of the Constitution of India envisages the same. In a world where nations must necessarily engage

with each other for mutual economic growth through trade, commerce and business, and for reasons of economic policy, international cooperation, and diplomatic balance, the power of each nation is often exercised in tune with such bilateral or multilateral agreements, which do not take away such inherent power but which now stand shaped by the legal framework agreed to between the parties. Having said this, it is for the legislatures to employ their discretion to innovate through the empirical process and in line with treaty obligations, evolve new ways of tapping revenue and placing checks on new methods and devices of tax evasion that may have arisen by abuse of beneficial provisions based on treaties. Here, the Court will have to tread carefully and cautiously to ascertain whether the action of the Revenue is within the contours of law – meaning constitutional, statutory and treaty obligations – in order that fiscal difficulties are addressed by the State in line with its own fiscal wisdom and policy.

4.1. India has developed an extensive network of Double Taxation Avoidance Agreements. Among these, its treaty with Mauritius has been particularly significant, shaping patterns of foreign investment since the early 1980s, and is germane to the present case. The India – Mauritius Double Taxation Avoidance Agreement[2], signed in Port Louis on 24 August 1982 and effective in both jurisdictions from 1983, soon gave rise to what became known as the Mauritius Route. Investors favoured this structure for the beneficial provisions of the

[2] For short, "DTAA"

treaty combined with Mauritius' domestic tax regime. While this significantly helped foreign capital inflows, it also attracted mounting scrutiny. Concerns were raised that the treaty, entered into with the intent to prevent double taxation, was being used to achieve non-taxation, particularly in respect of capital gains. Entities were incorporated in Mauritius solely to take advantage of treaty benefits. This created serious issues of treaty shopping, tax avoidance, and the integrity of the international tax system.

4.2. Over time, judicial and legislative responses were developed to address these challenges. After deliberations, in 2016, India and Mauritius signed a protocol providing that the DTAA would shift away from a residence-based system for the taxation of capital gains to a source-based system, to restore balance and prevent abuse. However, as global investment structures grow increasingly complex, with multi-country reach, interpretational issues continue to surface.

4.3. These issues have once again come before this Court in the present matter, arising out of the taxation of capital gains from the sale of shares of a Singapore-based entity deriving substantial value from its Indian operations. The transactional involvement of the relevant investment entities based in Mauritius raises significant questions as to the reach of treaty protections, the relationship between treaty provisions and domestic tax law, and the principles that must guide the grant or denial of treaty benefits. It is in this legal,

economic, and policy backdrop that the dispute relating to Tiger Global needs to be considered.

II. BRIEF FACTS

5. The respondents – assessees *viz*., Tiger Global International II Holdings, Tiger Global International III Holdings, and Tiger Global International IV Holdings, are private companies limited by shares, incorporated under the laws of Mauritius. They were set up with the primary objective of undertaking investment activities with the intention of earning long-term capital appreciation and investment income. The assessees are regulated by the Financial Services Commission[3] in Mauritius and have been granted a Category I Global Business License[4] under Section 72(6) of the Financial Services Act, 2007, enacted by the Parliament of Mauritius.

5.1. The business of the assessees, according to them, is wholly controlled and managed by their Board of Directors in Mauritius. The assessees claim to have satisfied all the requirements laid down by the FSC in Section 3 of Chapter 4 of the Guide to Global Business, thereby establishing commercial substance in Mauritius. The assessees had three Directors on the Board of Directors, of whom two are Mauritian residents and one is a resident of the United States. They have maintained, and continue to maintain, their principal bank account and accounting records in Mauritius. They have caused their statutory financial

[3] In short, "FSC"
[4] In short, "GBL-I"

statements to be prepared and audited in Mauritius and continue to do so. They have held and continue to hold, office premises in Mauritius since incorporation and have two employees at the same.

5.2. Further, the assessees hold valid Tax Residency Certificates[5] issued by the Mauritius Revenue Authority[6], certifying them to be tax residents in Mauritius for the income tax purposes. On the basis of the same, they claim to be tax residents of Mauritius under the laws of Mauritius and under the DTAA between India and Mauritius for the avoidance of double taxation and the prevention of fiscal evasion.

5.3. The assessees engaged Tiger Global Management[7], LLC, a company incorporated in the United States of America, to provide services in relation to their investment activities. All services provided by TGM, including but not limited to investment sourcing, portfolio stewardship, and observership services, are subject to review and final approval by the Board of Directors of the assessees. TGM does not have the right to contract on behalf of, or bind, the assesses, or take any decisions on their behalf without the approval of the Board of Directors. The assessees also hold valid Permanent Account Numbers issued by the Indian income tax authorities.

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[5] In short, "TRC"
[6] In short, "MRA"
[7] For short, “the TGM"

5.4. The assessees held shares of Flipkart Private Limited[8], a private company limited by shares, incorporated under the laws of Singapore. The total number of shares of Singapore Co. acquired by the assessees is tabulated below:

Sl.No.	Applicant	Number of shares Acquired	Period / date of acquisition
1.	Tiger Global International II Holdings, Mauritius	23,670,710	October, 2011 to April, 2015
2.	Tiger Global International III Holdings, Mauritius	2,282,825	23rd June 2014
3.	Tiger Global International IV Holdings, Mauritius	105,928	24th April, 2012

5.5. Thereafter, Singapore Co. invested in multiple companies in India, and the value of its shares was derived substantially from assets located in India. The assessees transferred shares of Singapore Co. ("Sale Shares") held by them to Fit Holdings S.A.R.L ("Buyer"), a company incorporated under the laws of Luxembourg. These transfers were undertaken as part of a broader transaction involving the majority acquisition of Singapore Co. by Walmart Inc., a company incorporated in the United States of America, from several shareholders,

[8] For short, "Singapore Co."

including the assessees. The details of shares transferred by the assessees and the gross consideration received are as under:

Sl.No.	Applicant	Number of shares sold	Gross consideration received
1.	Tiger Global International II Holdings, Mauritius	14,754,087	USD 1,893,510,103.82 equivalent to INR Rs.13122,02,50,194/-
2.	Tiger Global International III Holdings, Mauritius	1,422,897	USD 181,782,633.10 equivalent to INR Rs.1259,75,36,473.83
3.	Tiger Global International IV Holdings, Mauritius	66,026	USD 8,435,171.44 equivalent to INR Rs.58,45,57,380.79

5.6. Thereafter, the assessees approached the Indian tax authorities by filing applications under Section 197 of the Income Tax Act, 1961[9], seeking certification of nil withholding prior to consummation of the transfer. By notices dated 17.08.2018, the tax authorities informed that the assessees would not be eligible to avail the benefits under the DTAA on the ground that they were not independent in their decision-making and that control over the decision- making relating to the purchase and sale of shares did not lie with them. The tax authorities, accordingly, issued certificates dated 17.08.2018, prescribing a withholding rate in respect of the sale of shares by the assessees as under:

[9] In short, "the Act"

Tiger Global International II Holdings, Mauritius.	Certificate dated 17.08.2018 mentioning the rate of income tax @ 6.05%
Tiger Global International III Holdings, Mauritius.	Certificate dated 17.08.2018 mentioning the rate of income tax @ 6.92%
Tiger Global International IV Holdings, Mauritius.	Certificate dated 17.08.2018 mentioning the rate of income tax @ 8.47%

5.7. Hence, the assessees approached the Authority for Advance Rulings[10] by filing applications under Section 245Q(1) of the Act, seeking an advance ruling on the common question that *"Whether, on the facts and circumstances of the case, gains arising to the assessees (private companies incorporated in Mauritius) from the sale of shares held by them in Flipkart Pvt. Ltd (a private company incorporated in Singapore) to Fit Holdings S.A.R.L. (a company incorporated in Luxembourg) would be chargeable to tax in India under the Act read with the DTAA between India and Mauritius?"*

5.8. The AAR, after providing opportunities to the assessees and upon considering the materials gathered by the Assessing Officer, came to the conclusion that the applications preferred by the assessees relate to a transaction or issue which is *prima facie* designed for the avoidance of income tax and therefore, rejected the same as being hit by the threshold jurisdictional bar to maintainability, as enshrined in proviso (iii) to Section 245R(2).

[10] In short "the AAR"

5.9. Challenging the order dated 26.03.2020 passed by the AAR, the assessees filed W.P.(C) Nos. 6764, 6765 and 6766 of 2020 before the High Court.

5.10. The High Court, *vide* the final judgment and common order dated 28.08.2024, allowed the writ petitions and quashed the AAR's order dated 26.03.2020, after holding that the assessees were entitled to treaty benefits and that their income would not be chargeable to tax in India. Aggrieved by the same, the Revenue has preferred the instant appeals.

III. FINDINGS OF THE AAR AND THE HIGH COURT

6. Before turning to the rival submissions, it would be appropriate to outline the findings of the AAR and the High Court, which culminated in orders favourable to the Revenue and the respondents / assessees respectively.

(A) AAR

6.1. After noting the organisational structure of the Respondents, the AAR held that they were part of Tiger Global Management LLC, USA, and were held through its affiliates via a web of entities based in the Cayman Islands and Mauritius. On facts, the AAR found that the overall control and management of the respondent companies did not lie with their Board of Directors in Mauritius, and that the authority to operate bank accounts for transactions above USD 2,50,000 was vested with Mr. Charles P. Coleman. Although the principal bank account of the respondents was maintained in Mauritius, no local person based in Mauritius was authorised to sign cheques on behalf of the Directors.

According to the AAR, Mr. Coleman, who was not based in Mauritius, was appointed as the signatory for the Mauritius bank account, and he was declared as the beneficial owner in the application for a GBL-I filed with the Mauritius FSC. He was also the authorised signatory for the immediate parent companies, Tiger Global Five Percent Holdings and Tiger Global Six Percent Holdings. He was further noted to be the sole Director controlling the ultimate holding companies, Tiger Global PIP Management V Limited and Tiger Global PIP Management VI Limited. Though the decisions for investment or sale were formally taken by the Boards of Directors of the respondent companies, the AAR concluded that real control over transactions exceeding USD 2,50,000 was exercised by Mr. Coleman through the non-resident Director, Mr. Steven Boyd. On this basis, it was held that the "head and brain" of the companies, was not in Mauritius and, therefore, their control and management were situated outside Mauritius, in the USA. Referring to the financial statements filed with the applications, the AAR found that the respondents had made no investment other than in the shares of Flipkart, and therefore concluded that the real intention behind obtaining the TRCs was to avail the benefit of the DTAA.

6.2. The AAR further observed that the exemption granted to a resident of Mauritius applied only to capital gains arising from the alienation of shares of an Indian company. In the present case, however, the capital gains arose from the sale of shares of a Singapore Co., and hence, the transaction did not qualify for exemption under the Mauritius Treaty. The AAR also held that the objective

of the DTAA was to provide exemption only for gains arising from the transfer of shares of an Indian company, and that such exemption was never intended for the transfer of shares of a company not resident in India. Furthermore, the AAR held that there was no foreign direct investment made by the respondent companies in India and, therefore, no question of participation in investment arose. As there was neither any business operation in India nor any taxable revenue generated, the AAR concluded that the transaction was a preordained arrangement created for the purpose of tax avoidance. It was therefore held that the transaction was *prima facie* designed for avoidance of tax and qualified as an "arrangement" under the law. Accordingly, the bar under clause (iii) of the proviso to Section 245R(2) of the Act was found to be applicable.

6.3. The AAR found that though the assessees contended that the transaction involved in the present case was a sale of shares *simpliciter* undertaken between two unrelated independent parties, which could not be considered as being designed for avoidance of tax, the same was too simplistic to be accepted. The precise question raised in the applications was the chargeability of capital gains on the sale of shares under the Act read with the DTAA between India and Mauritius. Capital gain is not dependent on the mere sale of shares. As per the mechanism of computation of capital gains, the cost of acquisition of shares is to be reduced from the sale price of shares. Therefore, in the mechanism of capital gains computation, what is relevant is not only the sale of shares but also the purchase of shares. Thus, the entire transaction of acquisition as well as sale

of shares, as a whole, is required to be examined, and a dissecting approach by examining only the sale of shares, as suggested by the assesses, cannot be adopted. The AAR observed that the design for avoidance of tax may be a long-drawn process. The AAR also noted from the Notes to Financial Statements that the principal objective of the assessees was to act as investment holding companies for a portfolio investment domiciled outside Mauritius. The investment made by the assessees in the Singapore Co., with an Indian subsidiary, was with a prime objective of obtaining benefits under the DTAA between Mauritius and India, and between Mauritius and Singapore. The AAR further noted that the assessees were part of Tiger Global Management LLC, USA, and were held through its affiliates via a web of entities based in the Cayman Islands and Mauritius. Though the holding subsidiary structure might not be conclusive proof of tax avoidance, the purpose for which the subsidiaries were set up does indicate the real intention behind the structure.

6.4. According to the AAR, the fact that the assessee companies were set up for making investments in order to derive benefits under the DTAA between Mauritius and India was an inescapable conclusion. The assessees had not explained why Mr. Charles P. Coleman, who was not based in Mauritius, was appointed to sign the cheques on the Mauritius bank account. Further, Mr. Charles P. Coleman was the beneficial owner, as disclosed by the assessees in the application form for a GBL-I filed with the Mauritius FSC. Mr. Coleman was also the authorised signatory for the immediate parent companies of the

assessees *viz.*, Tiger Global Five Percent Holdings and Tiger Global Six Percent Holdings, and was the sole Director of the ultimate holding companies, Tiger Global PIP Management V Limited and Tiger Global PIP Management VI Limited. Thus, the appointment of Mr. Charles P. Coleman as the authorised signatory of bank cheques above the prescribed limit could not be considered a mere coincidence. While the decisions for investment or sale were taken by the Boards of Directors of the assessees, the real control over decisions involving any transaction over USD 2,50,000 was exercised only by Mr. Charles P. Coleman. He was thus controlling the decisions of the Boards of Directors of the assessees through the non-resident Director, Mr. Steven Boyd, who was accountable to him. Therefore, the AAR concluded that the head and brain of the companies and, consequently, their control and management were situated not in Mauritius but outside, particularly in the USA.

6.5. Though the assessees contended that the holding structure of the applicants has no relevance in determining whether the transaction was *prima facie* designed for avoidance of tax, the AAR held that it was not the holding structure alone that was relevant; rather, the holding structure coupled with the *prima facie* management and control of the holding structure, including the management and control of the applicants, were relevant factors for determining the design for avoidance of tax. Further, the real management and control of the assessees were not with their respective Boards of Directors, but with Mr.Charles P. Coleman, the beneficial owner of the entire group structure. The

assessee companies were only "see-through entities" to avail the benefits of the DTAA.

6.6. The AAR also pointed out that it is a settled principle that a treaty is to be interpreted in good faith. The context and purpose of the treaty must be determined on the basis of the preamble and annexures, including the agreement, subsequent agreements regarding the interpretation of the terms of the treaties, and relevant international rules applicable to the agreement. Circular No.682 dated 30.03.1994 issued by the Central Board of Direct Taxes[11] had clarified that any resident of Mauritius deriving income from the alienation of shares of Indian companies would be liable to capital gains tax only in Mauritius, as per the Mauritius tax law, and would not have any capital gains tax liability in India. It was evident from this Circular that what was exempted for a resident of Mauritius was capital gains derived from the alienation of shares of an Indian company. In the present case, capital gains had not been derived from the alienation of shares of any Indian resident; rather, the assessees sought relief in respect of capital gains arising from the sale of shares of a Singapore Co. The Protocol for Amendment of the Convention for Avoidance of Double Taxation between India and Mauritius was signed on 10.05.2016, which provided that taxation of capital gains arising from the alienation of shares acquired on or after 01.04.2017 in a company resident in India would be on a source basis with effect from the financial year 2017-18. At the same time,

[11] For short, “CBDT”

investments made before 01.04.2017 were grandfathered and not subject to capital gains tax in India. Thus, even under the amended DTAA between India and Mauritius, what was not taxable was capital gains arising from the sale of shares of a company resident in India.

6.7. Therefore, the AAR found that exemption from capital gains tax on the sale of shares of a company not resident in India was never intended under either the original or the amended DTAA between India and Mauritius. In view of the clear stipulations in the DTAA, the assessees were not entitled to claim the benefit of exemption of capital gains on the sale of shares of a Singapore Co. and hence, failed on merits as well as on the ground of treaty eligibility. The assessees disputed the contention of the Revenue that tax residency in Mauritius was established only to take advantage of the DTAA. They submitted that Mauritius' comprehensive tax treaty network with various countries, and not just India, facilitated efficient asset management and competitive returns for their investors. According to them, the mere fact of obtaining a TRC to avail treaty benefits does not render the transaction a colourable device for tax avoidance. It had been held by this Court in ***Vodafone International Holdings BV v. Union of India***[12] that the DTAA and Circular No.789 dated 13.04.2000 would not preclude the Income Tax Department from denying treaty benefits in suitable cases. It was further held that the Department is entitled to examine the

[12] (2012) 6 SCC 613 (3 Judge Bench)

entire transaction as a whole, and if it is established that the Mauritian company was interposed as a device, it would be open to the Department to discard the device and subject the real transaction to tax.

6.8. The AAR further found that though tax residency was claimed to have been established to take advantage of Mauritius' treaty network with various countries and not just India, in effect, the entire investment made by the assessees was only in the Singapore Co. in respect of which the benefit of the DTAA was being claimed. All three assessees had made no investment other than in the shares of Flipkart. Thus, the real intention of the assessees was to avail the benefit of the DTAA. Accordingly, the AAR concluded that the assessees failed to satisfy the yardsticks laid down by this Court in *Vodafone*. There was no foreign direct investment made by the assessee companies in India, and therefore, no participation in investment arose. The assessees had invested in shares of Flipkart, a Singapore Co., and thus, the immediate investment destination was Singapore and not India. Consequently, the assessees also failed on other parameters, *viz*., the period of business operation in India, generation of tax revenue in India, timing of exit, and continuity of business on such exit. In the absence of any strategic foreign direct investment in India, there was neither any business operation in India nor any taxable revenue generated. Thus, the arrangement was held to be a preordained transaction created for the purpose of tax avoidance.

6.9. Ultimately, the AAR held that the question raised in the applications filed under Section 197 was *prima facie* designed for avoidance of tax. Though the assessees contended that the shares of the Singapore Co. derived their value substantially from assets located in India and that they were eligible to claim benefit under Article 13(4) of the DTAA, the fact remained that what was transferred were shares of the Singapore Co. and not of an Indian company. The objective of the DTAA was to allow exemption of capital gains only on the transfer of shares of an Indian company, and any such exemption in respect of shares of a company not resident in India was never intended by the legislature. Further, the actual control and management of the assessees were not in Mauritius but in the USA with Mr. Charles P. Coleman, the beneficial owner of the entire group structure. Accordingly, AAR Nos. 04/2019, 05/2019 and 07/2019 were dismissed, with the AAR holding that the transaction in respect of which the ruling was sought was *prima facie* designed for avoidance of tax and fell within clause (iii) of the proviso to Section 245R(2) of the Act. In view thereof, the AAR held that it was not obliged to render findings on the merits of the question whether the assessees were entitled to the benefits of the DTAA between India and Mauritius in respect of the sale of shares of Flipkart, a private company incorporated under the laws of Singapore, or on the taxability of capital gains arising therefrom. The assessees had sought to derive benefit from Article 13(3A) of the DTAA, contending that acquisitions of shares prior to 01.04.2017 stood grandfathered and that gains arising therefrom were exempt

from taxation. As the shares of Flipkart, Singapore, had been admittedly acquired prior to 01.04.2017, the assessees claimed exemption from capital gains tax. The AAR rejected the claim, holding that the assessees were mere conduit companies, lacking commercial substance, and were disentitled to claim DTAA benefits.

6.10. In conclusion, the AAR held that the entire arrangement entered into by the assessees was intended to claim benefits under the DTAA in a manner not contemplated by the lawmakers and constituted an arrangement for avoidance of tax in India. Consequently, the bar under clause (iii) of the proviso to Section 245R(2) of the Act was held to be squarely applicable, and the applications filed by the assessees were rejected.

(B) HIGH COURT

6.11. On the preliminary objections raised by the Revenue, the High Court found that the Commissioner of Income Tax[13], after referring to a detailed examination conducted by the Department during the Section 197 certification process, had concluded that the question of chargeability of capital gains and the identification of the beneficial owner, upon piercing the corporate veil, had already been determined. In light of the same, and in the absence of any change in factual circumstances, the CIT had urged the AAR to reject the applications made by the respondents. The High Court observed that the tone and tenor of

[13] For short, "CIT"

the observations and findings of the AAR that the respondents were set up only for making investments in order to derive benefits under the DTAA, that the head and brain were not situated in Mauritius, that Mr. Charles P. Coleman exercised control over the respondents, etc., did not appear to be tentative or based on a preliminary or *prima facie* examination. Rather, they reflected a conclusive determination. It also noted that both the CIT and the AAR had reached definitive findings, the effect of which would constrain subordinate authorities from ignoring or bypassing such conclusions.

6.12. The High Court further found error in the AAR's conclusion that TGM LLC was the holding or parent company of the respondents. It held that neither the CIT nor the AAR had succeeded in rebutting the consistent stance of the respondents that TGM LLC functioned merely as an investment manager and had no equity participation in the respondents. No evidence was presented to show that TGM LLC had contributed any funds or that monies were repatriated to TGM LLC from the respondents. The High Court further held that the respondents could not be dismissed as entities lacking economic substance. They were structured to operate as pooling vehicles for investments and held GBL-I under Mauritian law. Their investor base comprised more than 500 investors from over 30 jurisdictions, and their assets and liabilities reflected significant economic activity, with total liabilities and shareholders' equity amounting to over USD 1.76 billion, and a net increase in shareholders' equity from operations exceeding USD 267 million. The High Court further observed

that the transfer of shareholding in question took place in 2018 as part of a broader global transaction involving Walmart Inc. The strategy of pooling investments through the respondents was found to be a prudent commercial decision, as it allowed efficient capital deployment rather than requiring each investor to act individually. The High Court concluded that the period of investment in the Flipkart Singapore holding entity exceeded a decade and when viewed in conjunction with the expenditure incurred in Mauritius, these factors collectively dispelled any notion that the respondents lacked economic substance.

6.13. On the question of control and decision-making, the High Court observed that while a parent or holding company may exercise supervisory functions over its subsidiaries, including by appointing directors or authorising key decisions, such influence does not render the subsidiary a mere puppet unless there is evidence of fraud, sham, or complete lack of independence. The mere presence of Directors connected with the TG Group, such as Mr. Charles P. Coleman and Mr. Steven Boyd, did not justify an inference of subservience or loss of independent agency. After taking note of the Board resolutions in detail, the High Court found that they reflected decisions taken collectively by the full Board. Though Mr. Coleman was authorised to approve expenditures exceeding USD 250 million, such authority was conferred by a collective decision of the Board and required countersignature by Group C Mauritian-based Directors. The key Directors, such as Mr. Moussa Taujoo, Mr. Mohammad Akshar

Maherally, and Mr. Steven Boyd, were also signatories to the constitutional documents, akin to memoranda of association. The High Court further found that the minutes of Board meetings, when read holistically, evidenced deliberative and collective decision-making rather than unilateral action. The fiduciary role of the investment manager was also noted as a legitimate basis for certain Board placements. Thus, the High Court held that the respondents' Boards could not be said to have been deprived of autonomy or reduced to subservient bodies.

6.14. On the issue of beneficial ownership, the High Court reiterated the principle of "substance over form," holding that beneficial ownership presupposes a scenario where the ostensible recipient or holder of income has no control or discretion over such income and merely acts as a conduit or administrator for another. The High Court further held that in the present case, no evidence had been led by the Revenue to demonstrate that the respondents were contractually or legally obligated to pass on the gains from the share transfer to TGM LLC, or that they acted on its behalf. The argument that the respondents lacked beneficial ownership was therefore found to be baseless, resting solely on conjecture and not supported by material evidence.

6.15. The High Court, relying on the decisions of this Court in ***Union of India v. Azadi Bachao Andolan***[14] and ***Vodafone*** reiterated that the mere fact that an entity is located in Mauritius, or that investments were routed through that

[14] (2004) 10 SCC 1

jurisdiction, cannot by itself lead to an adverse inference. The High Court further found that Mauritius has long been recognised as a favourable investment destination and that "treaty shopping" *per se* is not impermissible unless it is clearly shown to be a device for tax evasion or contrary to the intent of the treaty. The issuance of a TRC by the Mauritian authorities was held to be sacrosanct and to establish a presumption of legitimate tax residency and beneficial ownership. The High Court held that such certification is to be respected by the Revenue, and any attempt to pierce the corporate veil must be grounded in compelling evidence of tax fraud, sham transactions, or complete absence of economic substance. It is only when the Revenue is able to meet such a threshold that it can disregard the presumption of validity that arises the moment a TRC is produced and the Limitation of Benefits conditions are fulfilled.

6.16. The High Court further noted that both *Azadi Bachao Andolan* and *Vodafone* were decided before a statutory framework on tax residency had been formally enacted. Circular No. 789 of 2000 had clarified that a TRC issued by Mauritius would suffice for determining both fiscal residence and beneficial ownership, including for capital gains. Noting that a subsequent attempt to dilute this position via the Finance Bill, 2013, by proposing that a TRC would not be sufficient to claim treaty benefits, was abandoned, and that a press release dated 01.03.2013 reaffirmed that tax authorities were not to go behind

the TRC, the High Court held that this reiterated the legal sufficiency of the TRC.

6.17. As far as the Limitation of Benefits[15] clause introduced in the DTAA is concerned, the High Court held that such clauses are specifically designed to address treaty abuse and are determinative in such inquiries. Once LOB provisions are satisfied, the Revenue cannot erect additional barriers or invoke vague suspicions. Any challenge to treaty benefits in the face of a satisfied LOB clause must meet an extremely high threshold and be based on evidence of fraud, sham, or intent to defeat the Treaty. The High Court further held that the LOB clause had been inserted into the DTAA in the backdrop of the introduction of Chapter XA in the Indian Income Tax Act, and Article 27A of the DTAA expressly grandfathered all transactions relating to shares acquired prior to 01.04.2017. This demonstrated a clear intent by both Contracting States to align treaty protections with domestic legislation while preserving the benefit of grandfathering. The High Court also noted that in *Azadi Bachao Andolan*, it was held that once the DTAA was recognised as intended to override the provisions of the Act, it would be impermissible for national courts to lift the veil of incorporation.

6.18. With regard to Article 13(3A) of the DTAA, the High Court concluded that the said Article represented the intent of the Contracting States to ring-fence and exempt capital gains arising from the sale of shares acquired prior to

[15] For short, "LOB"

01.04.2017. Article 13(3B) introduced separate tax rates for gains arising from shares acquired after that date. The absence of a tax rate for pre-2017 transactions under Article 13(3B) strongly evidenced the intention to exclude such gains from tax, aligning with the Treaty's overarching purpose. Domestic rules, such as Rule 10U under Chapter XA, could not override or dilute this treaty protection. In particular, the Revenue's reliance on Rule 10U(2) to defeat grandfathering under Article 13(3A) was rejected. The High Court held that the phrase "without prejudice" in Rule 10U(2) signified that it would apply only in scenarios not already addressed by Rule 10U(1)(d), and thus could not be used to nullify the grandfathering clause.

6.19. Lastly, the High Court found the AAR's interpretation of Article 13(3A) to be legally unsound and held that the AAR had erroneously concluded that the sale of shares in a Singapore company would not fall under Article 13(3A), on the premise that it applied only to shares of Indian companies. The High Court rejected this view, noting that the shares sold derived substantial value from underlying Indian assets, thereby satisfying the test for indirect transfers. Accepting the AAR's view would nullify the treaty protections and defeat the purpose of the grandfathering clause, especially since the acquisition occurred prior to the critical date. The High Court thus concluded that the respondents' transactions were grandfathered under the DTAA, and the Revenue could not circumvent these provisions through domestic law or administrative reinterpretation. In effect, the High Court held that the transaction was not

designed for avoidance of tax and stood grandfathered by virtue of Article 13(3A) of the DTAA. Accordingly, the High Court allowed the Writ Petitions filed by the respondents and quashed the AAR's Order.

6.20. The High Court also found that investments emanating from Mauritius are not a recent phenomenon. The first DTAA was signed at Port Louis on 24.08.1982 and came into effect from 01.04.1983 and 01.07.1983 in the two countries, respectively. The last Protocol for amending the provisions of that treaty was signed on 10.05.2016, as could be seen from the data available on the portal of the Department for Promotion of Industry and Internal Trade, which captures foreign direct investment into the country between April 2000 and March 2024. The High Court further found that Circular No. 682 constituted the first significant clarification rendered by the Board in the context of Article 13 of the DTAA and the taxation of capital gains. Paragraph 3 of Circular No. 682 unequivocally declared that gains derived by a resident of Mauritius from the sale or transfer of shares would be taxable only in that country. Circular No. 682 further proclaimed that even if a resident of Mauritius were to derive income from the alienation of shares of Indian companies, such income would be liable to capital gains tax only in Mauritius, in accordance with the tax laws prevalent in that country. Therefore, it was held that such an entity would not face a capital gains tax liability arising or accruing in India.

6.21. The High Court further considered that the above Circular was followed by Circular No. 789 which clarified the position of the Revenue with respect to

TRCs issued by authorities in Mauritius, such certificates constituting sufficient evidence for the purposes of ascertaining the status of residence as well as the application of principles of beneficial ownership. Circular No. 789 clarified that the test of residence flowing from a TRC would also apply in respect of income from capital gains on the sale of shares. Circular No. 789 reiterated the stand taken in Circular No. 682, holding that a resident of Mauritius would not be subjected to capital gains tax arising in India consequent to the sale of shares under Article 13(4) of the DTAA. Of equal significance were certain proposed amendments to the Act.

6.22. After hearing the parties and placing reliance on the judgment in *Vodafone,* the High Court held that the order of the AAR dated 26.03.2020 suffered from manifest and patent illegalities. The view taken therein with respect to the transaction in question was found to be wholly untenable and unsustainable. Consequently, its conclusion that the impugned transaction was designed for tax avoidance was held to be arbitrary and incapable of being sustained. In the opinion of the High Court, the transaction stood duly grandfathered by virtue of Article 13(3A) of the DTAA. Accordingly, the High Court allowed the writ petitions, quashed the AAR's order dated 26.03.2020, and affirmed the assessees' contention that the transaction was not designed for avoidance of tax, thereby entitling them to all consequential reliefs.

IV. CONTENTIONS OF THE PARTIES

(A) ON BEHALF OF THE APPELLANTS

7. Mr. N. Venkataraman, learned Additional Solicitor General appearing on behalf of the appellants – Revenue, submitted that both the TDS Officer and the AAR had expressed only a *prima facie* view of the matter. The order dated 17.08.2018 passed under Section 197 of the Act merely prescribed a tentative and provisional rate of deduction of tax at source and did not amount to a conclusive determination of tax liability. Likewise, the AAR while observing that the transaction appeared *prima facie* to involve tax avoidance, expressly refrained from rendering any final determination. Despite this, the High Court proceeded to adjudicate the issue on merits, which was impermissible.

7.1. The learned Additional Solicitor General further submitted that under Article 4(1) of the DTAA, Indian tax authorities are entitled to examine whether the assessee is a resident of the other Contracting state, namely, Mauritius, by applying the domestic law of that State. As the source State vested with sovereign taxing powers, India retains the authority to determine taxability under its domestic law.

7.2. It was further urged by the learned Additional Solicitor General that a DTAA merely allocates taxing rights between Contracting States and does not involve abdication or surrender of sovereign taxing power. Reliance was placed on *Klaus Vogel on Double Taxation Conventions (3rd Edition)*, which clarifies that residence under a DTAA must be determined according to the domestic law

of the alleged State of residence, and such determination may be independently examined by the tax authorities of the other Contracting State.

7.3. The learned Additional Solicitor General contended that the source country, having the primary right to tax income arising within its jurisdiction, must retain authority to examine treaty abuse. The authority to grant treaty benefits and the power to examine abuse operate in distinct legal spheres. Grant of treaty benefits does not divest the source State of its power to examine whether the transaction is abusive or lacking in commercial substance.

7.4. It was submitted by the learned Additional Solicitor General that the transaction involves sale of shares of a Singapore company deriving substantial value from assets located in India, thereby rendering India the source State. The transaction constitutes an indirect transfer taxable under Section 9(1) read with Explanations 4 and 5, introduced by the Finance Act, 2012, which codify the "look-through" principle. Once taxability under domestic law is established, the question of availability of DTAA relief arises, including whether production of a TRC is conclusive and whether the substance test operates independently as an anti-abuse principle.

7.5 The learned Additional Solicitor General submitted that a TRC constitutes only *prima facie* evidence of residence and cannot override the principle of "substance over form." The test of control and management is central to examining genuineness of residence and the *bona fides* of the transaction. Reliance was placed on commentaries of the Organisation for

Economic Cooperation and Development[16] *and Klaus Vogel* as well as the decisions of this Court in *Azadi Bachao Andolan* and *Vodafone*.

7.6. It was further contended by the learned Additional Solicitor General that the "substance" test is not a test for treaty entitlement *per se*, but an independent anti-abuse safeguard. Reference was made to Sections 73(2)(b) and 73A of the Mauritius Income Tax Act, which recognise control, management, and the Place of Effective Management[17] as determinative of residence, even prior to October 2018.

7.7. The learned Additional Solicitor General pointed out that the Mauritian statutory regime mandates control and management within Mauritius, which is *pari materia* with Section 6(3) of the Indian Income Tax Act. Section 71 of the Financial Services Act, 2007 also requires a Global Business Licence holder to be managed and controlled from Mauritius, with the criteria being non-exhaustive.

7.8. Further, it was contended by the learned Additional Solicitor General that issuance of a TRC does not foreclose inquiry into actual control and management or application of "substance over form". Treaty benefits may be denied where capital gains arise in India but escape taxation elsewhere due to absence of capital gains tax. Reliance was placed on *Vodafone*, particularly its

[16] For short, "OECD"
[17] For short, "POEM"

recognition of Judicial Anti-Avoidance Rules and the distinction between "influencing power" and "persuasive power".

7.9. The learned Additional Solicitor General submitted that Circular No. 789 was a policy measure intended to provide certainty to FIIs and similarly placed investors. It does not extend to business investments or indirect transfers. Circular No. 1 dated 10.02.2003 is also silent on indirect transfers.

7.10. It was submitted by the learned Additional Solicitor General that Sections 90(4) and 90(5), inserted by the Finance Act, 2012, do not render a TRC conclusive. This interpretation ignores the simultaneous introduction of GAAR under Chapter X-A. Rule 10U notified in 2013 further operationalised GAAR.

7.11. The learned Additional Solicitor General also referred to Section 97(1)(c) and Rule 10U to demonstrate that only limited categories of FII-related investments are excluded from GAAR scrutiny. Business investments and indirect transfers are not insulated.

7.12. It was further contended by the learned Additional Solicitor General that Sections 90(4) and 90(5) do not confer immunity from GAAR. Section 90(2A) expressly provides that GAAR overrides DTAA benefits where impermissible avoidance arrangements are found.

7.13. The learned Additional Solicitor General pointed out that the scheme of the Act demonstrates a cohesive and deliberate framework to ensure that treaty benefits are extended only to genuine arrangements and not to those designed solely to obtain tax advantages. Circular No. 789 cannot override GAAR or Section 90(2A). *Azadi Bachao Andolan* and *Vodafone* both affirm that while a TRC is relevant, it is not conclusive, and authorities may examine the real nature of the transaction. According to the learned Additional Solicitor General, if a transaction is genuine, taxing rights vest in Mauritius. If abusive, treaty protection stands denied and the transaction is taxable under Indian domestic law.

7.14. Further, it was contended by the learned Additional Solicitor General that after the 2017 amendment to Article 13, direct transfers are governed by Articles 13(3A) and 13(3B), while indirect transfers fall under Article 13(4), which contains no LOB or grandfathering. The present transaction involves an indirect transfer and thus falls outside Articles 13(3A), 13(3B) and Article 27A.

7.15. With regard to the question whether tax avoidance ought to be addressed under the DTAA or under domestic law, the learned Additional Solicitor General submitted that the LOB clause introduced with effect from 01.04.2017, operates in a narrow and specific field. The LOB clause denies the benefit of Article 13(3B) to shell or conduit companies by prescribing objective criteria for such determination. It constitutes a Specific Anti Abuse Rule (SAAR) incorporated

within the Treaty itself to counter treaty abuse. However, it was urged that the said provision has no application to the present case, as it applies only to direct transfers, whereas the transaction in question involves an indirect transfer. Consequently, neither Article 27A nor Articles 13(3A) or 13(3B) are attracted. Upon the 2017 amendment, direct transfers are governed by Article 13(3A), while indirect transfers fall exclusively within Article 13(4). As Article 13(4) is not subject to any LOB provision, it was contended that once treaty abuse is established in respect of such transaction, the DTAA ceases to govern the transaction and the matter must necessarily be tested under the Income Tax Act, 1961.

7.16. Proceeding on the premise that treaty benefits may be denied in cases of treaty abuse, the learned Additional Solicitor General next addressed the independent applicability of GAAR under Chapter XA post 01.04.2017, irrespective of when the underlying investment was made. It was submitted that Chapter XA is deliberately framed as an overreaching anti-abuse regime. Section 95 opens with a non-obstante clause empowering the Revenue to declare an arrangement as an impermissible avoidance arrangement notwithstanding anything contained elsewhere in the Act. This overriding character is further reinforced by Section 100, which provides that the provisions of Chapter XA shall apply "in addition to, or in lieu of, any other basis for determination of tax liability." These provisions, it was urged,

demonstrate that GAAR operates as a supervening anti-abuse code whose efficacy cannot be diluted by interpretative carve-outs.

7.17. It was further submitted by the learned Additional Solicitor General, that the transaction under consideration, according to the Respondents themselves, took place during FY 2018–19 relevant to AY 2019–20 well after GAAR came into force. In this context, reference was made to Section 97(1)(b)(iv) which deems an arrangement to lack commercial substance if it is structured through one or more persons in a manner that disguises the value, location, source, ownership or control of funds. Similarly, Section 97(1)(c) treats as lacking substance an arrangement involving the location of an asset, transaction, or residence of a party primarily for obtaining a tax benefit. Reliance was placed on *Vodafone* wherein this Court recognised the continued applicability of JAAR. It was submitted that these doctrines have since been statutorily codified through GAAR which is precisely why GAAR was not accorded blanket grandfathering. Had GAAR been wholly grandfathered, it would have immunised transactions that were, even under pre-existing jurisprudence, open to scrutiny for tax avoidance. Hence, the plea that all investments stand insulated from GAAR merely by reason of temporal precedence was characterised as unsustainable.

7.18. Addressing Rules 10U(1) and 10U(2), the learned Additional Solicitor General contended that the argument that every purchase of shares prior to

01.04.2017 constitutes an "investment" immune from GAAR, even where the transfer occurs thereafter, is fundamentally flawed. It was submitted that Chapter XA is not confined to passive investments but extends to business structures and arrangements lacking commercial substance. Section 97 enumerates arrangements that are deemed to lack substance. Acceptance of the Respondents' interpretation would enable abuse structures put in place before 01.04.2017 to escape scrutiny by the simple expedient of labelling themselves as "investments"– a result expressly cautioned against by the Shome Committee.

7.19. It was therefore, submitted by the learned Additional Solicitor General that once GAAR came into effect with effect from 01.04.2017, any income-earning transaction forming part of an arrangement must undergo scrutiny under Chapter X-A, regardless of whether the underlying investment or structure originated prior to that date. Rule 10U is intended to give legislative expression to this position. While Rule 10U(1) enumerates four categories of exclusions from GAAR, Rule 10U(2) specifies the circumstances in which GAAR would apply even to arrangements linked to pre-2017 investments. Thus, where a transaction is found to be an impermissible avoidance arrangement, Rule 10U(2) operates to attract GAAR notwithstanding the vintage of the initial investment. Conversely, if the assessee successfully rebuts the statutory presumptions under Sections 96 and 97, the exclusion under Rule 10U(1)(d) would apply.

7.20. The learned Additional Solicitor General further highlighted that the deliberate use of distinct expressions in Rule 10U, namely "arrangement" in Rule 10U(1)(a) and Rule 10U(2), and "investment" in Rule 10U(1)(d), cannot be ignored. The differentiation is purposeful. Rule 10U(1)(a) excludes small-value arrangements falling below the monetary threshold, even if they are otherwise impermissible avoidance arrangements. In contrast, Rule 10U(1)(d) concerns genuine investments, while Rule 10U(2) targets abusive arrangements irrespective of their historical origin. Any interpretation collapsing these distinct concepts would render portions of the Rule otiose and defeat legislative intent.

7.21. As regards the Shome Committee Report and the CBDT Circular dated 27.01.2017, the learned Additional Solicitor General submitted that they are confined to the treatment of "investments" and do not extend to complex "arrangements" lacking commercial substance. The Finance Minister's Budget Speech of 2012, it was argued, primarily addressed the retrospective amendments to Section 9(1) introduced in response to *Vodafone*. These amendments, later made prospective, had no bearing on the operation of GAAR. The speech thus clarified that GAAR would apply prospectively, which implementation was ultimately deferred to 01.04.2017. Accordingly, GAAR became applicable from AY 2018–19, and the transaction in the present case, pertaining to AY 2019–20, squarely falls within its ambit.

7.22. Regarding *Azadi Bachao Andolan*, the learned Additional Solicitor General submitted that the said decision concerned the legality of investments made by FIIs and mutual funds and did not involve cross-border transactions relating to the direct or indirect transfer of shares constituting business investments. Moreover, the decision was rendered in the context of the Mauritius Offshore Business Activities Act, 1992, and not the later Financial Services Act regime. The factual and statutory context of the present case was thus asserted to be materially distinct.

7.23. The learned Additional Solicitor General referred to the issuance of show cause notices to FIIs in the year 2000, the resulting market volatility, and the subsequent Press Note dated 04.04.2000 and Circular No. 789, which were issued to restore investor confidence and reaffirm treaty commitments. It was emphasised that these measures were directed exclusively at portfolio investments by SEBI-registered FIIs and mutual funds operating in Indian capital markets. At the time, large-scale indirect transfers of shares constituting business reorganisations were neither prevalent nor contemplated. Consequently, Circular No. 789 cannot be extended by implication to such transactions.

7.24. Turning to *Vodafone*, it was submitted by the learned Additional Solicitor General that while the case involved an indirect transfer of shares constituting a business investment, it neither concerned the DTAA nor Circular No. 789.

Nevertheless, the judgment affirmed that doctrines such as substance over form, piercing the corporate veil, lack of commercial substance, and the concept of sham or conduit entities are part of Indian tax jurisprudence and capable of legislative codification as GAAR. Emphasis was placed on the recognition that a TRC is not conclusive and that the tax authorities may examine the real nature of the transaction notwithstanding formal documentation.

7.25. It was further submitted by the learned Additional Solicitor General that paragraph 311 of *Vodafone* forms part of a concurring opinion and must be read harmoniously with the majority judgment. The observations therein, particularly in relation to Circular No. 789 and the control and management test, were characterised as *obiter dicta* and not the *ratio decidendi.* Treating them as overriding the conclusions of the majority would, it was urged, be legally impermissible.

7.26. The learned Additional Solicitor General also emphasised that Circular No. 789 applies to "residents" of Mauritius under Article 4 of the DTAA and that the categorisation of an entity as an FII or investment fund is a creation of Indian law, without relevance under Mauritian law. Further, the Circular predates the introduction of GBLs, which were brought in only under the Financial Services Act, 2001. By the time, the 2007 Act came into force, all entities were required to obtain GBLs, a development not contemplated by the Circular.

7.27. It was contended by the learned Additional Solicitor General that even where an entity holds a TRC and is incorporated in Mauritius, the Indian tax authorities retain the power to examine the substance of the transaction for treaty abuse, including issues of control and management and financial substance. This position, it was submitted, is consistent with international tax principles and OECD guidance recognising the right of the source State to deny treaty benefits in cases of abuse.

7.28. Finally, the learned Additional Solicitor General submitted that while Mauritius authorities may regulate licensees, the power to deny treaty benefit rests with India where treaty abuse is established.

7.29. On the aforesaid grounds, the learned Additional Solicitor General prayed that the appeals be allowed and the impugned judgment of the High Court be set aside.

(B) <u>ON BEHALF OF THE RESPONDENTS</u>

8. *Per contra*, Mr. Harish Salve, learned Senior Counsel for the respondents – assessees submitted that Article 4 of the DTAA begins with the words *"For the purposes of this Convention, the term 'resident of a Contracting State' means…"*, thereby establishing that the Article prescribes a mandatory and exclusive rule for determining residence. The succeeding phrase *"any person who, under the laws of that State, is liable to taxation therein"* makes it explicit that the Treaty permits each Contracting State to apply its own domestic tests of

residency, and that such State alone is competent to determine whether a person is "liable to tax" within its jurisdiction. The term "person" must therefore be understood as referring to an entity treated as a taxable unit under the domestic law of the Contracting State.

8.1. It was submitted by the learned Senior Counsel that the DTAA further recognises the right of a Contracting State to impose tax liability "*by reason of his domicile, residence, place of management or any other criterion of similar nature"*. Accordingly, a State may adopt one or more criteria for creating tax liability. By way of illustration, it was submitted that a company incorporated in India – even if wholly owned by foreign shareholders and managed and controlled outside India – is nonetheless "liable to tax" in India in respect of its global income by virtue of Section 6 of the Act. Likewise, India cannot refuse to treat as a resident of Mauritius a company which is "liable to taxation" in Mauritius under Mauritian law. The only situation in which residence determination by both States arises is where a person is simultaneously a resident of both Contracting States.

8.2. The learned Senior Counsel further submitted that the enquiry initiated by the Indian Tax Department into the "head and brain" of the respondent companies was not on the footing that their corporate existence should be disregarded or that they should be treated as mere conduits – an argument that could arise only if the Department had sought to tax the Cayman holding companies instead of the respondents. The respondents' corporate structures are

wholly consistent with those typically adopted by FIIs and investment funds. The enquiry into "head and brain" was directed solely at challenging the validity of the TRC and proceeded on the flawed premise that Indian authorities are entitled to interpret the Financial Services Act, 2007 of Mauritius and other Mauritian laws to determine whether the respondents are "liable to tax" in Mauritius. Such an approach, it was submitted, is contrary to the express language of Article 4 of the DTAA.

8.3. Reliance was placed on Section 90(4) of the Act, which makes it clear that the question whether a person is a resident of a foreign State must be determined by that State alone. The provision requires the assessee to obtain a certificate from the Government of the foreign State, and such certificate constitutes evidence of residence. Section 90(5) further stipulates that the assessee must provide any additional prescribed documents. Thus, the documentation required to claim DTAA benefits is exhaustively enumerated.

8.4. Learned Senior Counsel referred to Circular No.789, which remains in force and explicitly states 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."* Paragraph 3 of the Circular clarifies that this applies to capital gains arising from the sale of shares.

8.5. According to the learned Senior Counsel, the Revenue's arguments are an attempt to circumvent the plain terms of Circular No. 789. The Circular was expressly upheld by this Court in *Azadi Bachao Andolan*, where it was observed that had the Contracting States intended to restrict treaty benefits for nationals of third countries, a suitable limitation clause would have been inserted. In the absence of such a clause, no disabling condition can be judicially introduced.

8.6. It was submitted by the learned Senior Counsel that domestic law doctrines such as "lifting the corporate veil" or "substance over form" cannot be invoked to deny treaty benefits in the absence of express treaty language to that effect. Treaty provisions operate as a self-contained code; unilateral domestic doctrines cannot override them.

8.7. The learned Senior Counsel submitted that treaty abuse concerns were comprehensively addressed through the 2016 Protocol to the DTAA, which came into effect from 01.04.2017. The amended provisions operate prospectively and do not affect gains arising from investments made prior thereto. This demonstrates that exclusive taxing rights over capital gains vested in Mauritius prior to 01.04.2017.

8.8. It was argued by the learned Senior Counsel that the Treaty constitutes a complete code, and unless the Treaty expressly incorporates domestic law, changes in domestic law cannot alter Treaty interpretation. Accordingly, the principles governing residence and allocation of taxing rights must be ascertained strictly within the Treaty framework. On this basis, learned Senior

Counsel outlined the following sequence for determining tax residence under the DTAA:

- First, for the purposes of assessment under Indian law, the Department must examine whether the entity is a resident of India under Section 6 of the Act;
- If the entity is not a resident under Indian law, it is to be assessed as a non-resident;
- Where a non-resident claims the benefit of a DTAA, the Department must examine whether the entity possesses a valid TRC issued by the other Contracting State, in this case, Mauritius. Under a Treaty such as the DTAA, the determination of whether a person is a resident of Mauritius must be made by the Mauritian authorities in accordance with their domestic law;
- Only in cases of dual residency – i.e., where the person is found to be a resident of both India and Mauritius – does the question of applying the tiebreaker clause arise;
- In such a case, it is for Indian tax law to define the standard by which a person is considered a tax resident of India, and for the Indian tax authorities to decide whether such a person has its "place of effective management" situated in India. These are questions of Indian law and administration of Indian laws. If, in this enquiry, the Indian tax authority

holds that under Indian law the place of effective management is situated in India, it could not apply the DTAA; and

- Moreover, the tiebreaker clause is not concerned with whether the person is (or is not) a resident of a particular State under its laws; the enquiry is whether, under Indian law, the person is a resident of India because its place of effective management is situated in India – the test for determining place of effective management in India being those established by Indian law. It is an enquiry under domestic law by a domestic forum, and such an enquiry is expressly provided for by the DTAA.

8.9. It was submitted by the learned Senior Counsel that the respondents form part of an alternative investment fund structure established at the time of initial investment. They were incorporated in Mauritius, obtained GBLs, complied with Mauritian law, and were issued TRCs after examination of control and management.

8.10. According to the learned Senior Counsel, the respondents are the legal owners of the income. Having furnished valid TRCs, Circular No. 789 and the Press Release dated 01.03.2013 preclude the Department from going behind the TRC. The proposal to treat TRC as "necessary but not sufficient" was consciously abandoned.

8.11. On the appellants' submission that observations in *Azadi Bachao Andolan* and *Vodafone* were *obiter*, it was argued by the learned Senior Counsel that this is untenable. In *Vodafone*, the principal contention of the Revenue was that the offshore structure was created solely to avoid capital gains tax on the sale of shares of the Indian operating companies. The assessees countered that the structure afforded treaty protection under the DTAA; thus, the correctness of *Azadi Bachao Andolan* directly arose. The Court reaffirmed *Azadi Bachao Andolan* and clarified the limited scope of ***McDowell & Company Ltd v. Commercial Tax Officer***[18], holding that corporate structures may be disregarded only when used as artificial or colourable devices. No such allegation exists in the present case. *Vodafone* also reaffirmed the "look at" principle, requiring the Court to view the transaction holistically rather than through a dissecting lens. The respondents' investment structure was long-standing, commercially rational, and had generated taxable revenues; thus, characterising it as a preordained tax avoidance scheme contradicts *Vodafone.*

8.12. It was argued by the learned Senior Counsel that applying JAAR- or GARR-inspired principles to determine Mauritian residence is impermissible. Under the Treaty, residence must be determined exclusively under Mauritian law by Mauritian authorities. Treaty shopping and sham transactions are distinct concepts; the Department has conflated them. If Treaty abuse existed, it was for the Contracting States to amend the Treaty, which they have done prospectively.

[18] (1985) 3 SCC 230

8.13. It was also submitted by the learned Senior Counsel that the Government of India has notified the Mauritius Treaty under Section 90 of the Act, and under Section 90(2), the Treaty prevails to the extent more beneficial to the assessee. Therefore, the charge of tax under the Income Tax Act will be overridden by a more beneficial provision under a tax treaty and vice versa. Domestic doctrines like JAAR, which are not more beneficial, cannot be superimposed onto treaty interpretation. Section 90(2A), which provides GAAR override, cannot be judicially extended to JAAR.

8.14. The learned Senior Counsel submitted that without prejudice to the applicability of Explanation 7 to Section 9(l)(i) in relation to the transfer, gains arising to the assessees from the transfer may not be deemed to accrue / arise in India in light of Section 9 of the ITA. According to the learned Senior Counsel, a plain reading of Section 90 establishes that the only requirement that needs to be satisfied in respect of treaty eligibility under Section 90(2) is the satisfaction of the criteria laid out under Section 90(4) and Section 90(5). It meets the said criteria in light of the TRC issued by the MRA and Form 10F issued by it. Thus, as long as the assessees qualify as a person to whom the Treaty applies under the provisions of the DTAA, the provisions of the ITA and more specifically, Section 5 read with Section 45 read with Section 9 will have no application if the Treaty is more beneficial to the assessees. This, according to the learned

Senior Counsel, is a well-established proposition in law and has been upheld by this Court in several decisions, including *Vodafone* and *Azadi Bachao Andolan*.

8.15. On grandfathering under GAAR, it was submitted by the learned Senior Counsel that only income from transfer of pre-2017 investments is protected. Rule 10U(2) does not dilute Rule 10U(1)(d). The appellants' interpretation would render Rule 10U(1)(d) redundant – an interpretation contrary to settled principles.

8.16. Reliance was placed on the Shome Committee Report, the Finance Minister's 2015 Budget Speech, the 2016 Protocol, CBDT Circulars, and FAQs to emphasise that GAAR applies only prospectively to investments made on or after 01.04.2017. Pre-2017 investments are fully grandfathered.

8.17. The learned Senior Counsel submitted that the appellant's contention that Circular No. 789 applies only to FIIs or NRIs and not to GBL holders is liable to be rejected as being contrary to the language of the Circular, which extends to "other investment funds, etc." Paragraph 2 refers broadly to "investors from Mauritius", and no artificial distinction between classes of Mauritian residents can be introduced.

8.18. It was further pointed out by the learned Senior Counsel that the judgment in *Azadi Bachao Andolan* dealt with "Overseas Business Corporations", and the Court rejected the argument that such entities were not residents of Mauritius merely because they lacked business operations there. GBLs have existed since 2001, and the Indian legislature has never drawn any

distinction between GBL holders and other Mauritian investment vehicles. In fact, the regulatory framework under the Financial Services Act, 2007 is more stringent than the earlier regime.

8.19. It was submitted by the learned Senior Counsel that the Ministry of Finance Press Release dated 01.03.2013 reaffirmed that Circular No. 789 "continues to be in force" without carving out any exception for GBL holders.

8.20. On GAAR applicability, it was clarified by the learned Senior Counsel that Rule 10U(1)(b) exempts only those FIIs who (a) are assesses under the Act, (b) do not avail DTAA benefits, and (c) invest under SEBI approval. FIIs claiming treaty benefits remain subject to GAAR; therefore, the supposed distinction between FIIs and GBL entities is illusory.

8.21. Accordingly, the learned Senior Counsel submitted that Indian authorities are precluded from going behind the TRC issued to GBL holders except in cases where dual residence triggers Article 4(3).

8.22. Ultimately, the learned Senior Counsel contended that the CIT failed to establish *prima facie* tax avoidance; reference made by the CIT to the case of Tiger Global International III Holdings was misplaced; the statutory bar under Section 245R(2)(iii) requires clear evidence of a premeditated tax avoidance design, which is absent; the transaction was commercially driven and lawful; and exemption was claimed solely on treaty allocation of taxing rights, which does not attract Section 245R(2)(iii).

8.23. Thus, learned Senior Counsel for the respondents submitted that the impugned judgment of the High Court warrants no interference and prayed for dismissal of the present appeals.

V. ANALYSIS

9. We have considered the submissions made by the learned senior counsel on either side and analysed the materials available on record carefully and meticulously.

10. On 24.01.2025, when the matter was taken up for consideration, this Court stayed the impugned judgment and order from its operation, implementation and execution. Subsequently, this Court also stayed the assessment proceedings initiated against the respondents / assessees, by order dated 04.02.2025, which is reproduced below for ease of reference:

> *"1. This matter was notified for admission on 24.01.2025 on that day this Court issued notice and stayed the operation of the impugned order passed by the High Court of Delhi.*
>
> *2. Today Mr. Harish Salve, the learned senior counsel mentioned the matter, pointing out that no sooner this Court stayed the operation of the judgment of the High Court the assessment proceedings have started.*
>
> *3. He would submit that they have succeeded before the High Court and having succeeded before the High Court till the final disposal of the main matter they should not be subjected the further assessment proceedings.*
>
> *4. On the other hand Mr. N Venkataraman, the learned ASG submitted that if the operation of the impugned judgment is not stayed then most of the notices may get time barred.*
>
> *5. With a view to balance the situation, we direct let the main matter come up for final hearing on 18.03.2025.*

6. With a view to protect the interest of the revenue and obviate the difficulty of the notices getting time barred the further proceedings of the assessment shall remain stayed till 18.03.2025."

Thereafter, the appeals were taken up and proceeded with for final hearing.

(A) ISSUES FOR CONSIDERATION

11. Evidently, in the present case, the AAR had *prima facie* found the claim to be an arrangement to avoid tax and hence, the applications fell under the proviso to Section 245R(2) of the Act and were not maintainable. However, the High Court has set aside the order of the AAR and rendered its findings on the merits of the case, by judgment dated 28.08.2024, the correctness of which is challenged before us.

11.1. Though the learned Additional Solicitor General appearing for the appellants – Revenue made elaborate contentions touching all the findings of the High Court, we are inclined to deal with the core issue alone that revolves around the present case, *viz.*,

"*Whether the AAR was right in rejecting the applications for Advance Ruling on the ground of maintainability, by treating the capital gains arising out of a transaction of sale of shares of a Singapore Co., which holds the shares of an Indian company, by a Mauritian company controlled by an American company, to be prima facie an arrangement for tax avoidance, and hence, whether it can be enquired into to ascertain whether the capital gains would be taxable in*

India under the Income Tax Act read with the relevant provisions of the Mauritius Treaty or not?"

(B) LEGAL BACKGROUND

12. At the outset, we deem it apt to deal extensively with the relevant background and provisions pertaining thereto, to shed light on the issue at hand.

DTAA

12.1. The fulcrum of the DTAA with respect to capital gains taxation lies in Article 13, which initially contained five paragraphs. Paragraphs 1, 2, and 3 allocated taxation rights to the source State on gains arising from the alienation of immovable property, movable property forming part of a permanent establishment/fixed base, and ships and aircraft operating in international traffic, respectively. Paragraph 4, which is of primary importance, was drafted as a residuary provision. Unlike the preceding paragraphs, it did not consider situs as a factor and instead allocated taxation rights over gains derived by a resident from the alienation of any remaining properties (other than those covered under Paragraphs 1, 2, and 3) to the resident jurisdiction. Paragraph 5 defined the concept of alienation. Further, under Article 4, the term 'residence' has been defined as any person who, under the laws of that State, is liable to taxation by reason of his domicile, residence, place of management, or any other criterion of

a similar nature. The clauses as they stood originally are reproduced as hereunder:

> *"**ARTICLE 4 - Residents** - 1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of similar nature. The terms "resident of India" and "resident of Mauritius" shall be construed accordingly.*
> *2. Where by reason of the provisions of paragraph (1), an individual is a resident of both Contracting States, then his residential status for the purposes of the Convention shall be determined in accordance with the following rules:*
> *(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (hereinafter referred to as his "centre of vital interests");*
> *(b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;*
> *(c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;*
> *(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.*
> *3. Where by reason of the provisions of paragraph (1), a person other than an individual is a resident of both the Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated."*

> *"**ARTICLE 13 - Capital gains** - 1. Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.*
>
> *2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or*

together with the whole enterprise) or of such a fixed base, may be taxed in that other State.

3. Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this article shall be taxable only in that State.

5. For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States."

12.2. Thus, pursuant to Article 13(4), capital gains from the alienation of shares were taxable only in the resident jurisdiction, if the case did not fall under any of the preceding clauses. In the context of Mauritius-based investments in India, the capital gains were treated as taxable only in Mauritius. However, as Mauritius' domestic tax law exempted capital gains from share transfers, such gains were effectively not taxed in either India or Mauritius. This created a significant tax arbitrage opportunity.

12.3. Notably, it was only from 1992 onwards that a substantial increase in foreign investment through Mauritius was observed, leading to the emergence of the Mauritius Route as the dominant investment structure for foreign capital inflows into India. This shift was primarily driven by the Mauritius Offshore Business Activities Act, 1992, which established the Mauritius Offshore

Business Authority (MOBA) in 1993, thereby creating a favourable regulatory framework for offshore investments. This development coincided with India's economic liberalization policy of 1991-1992, further accelerating foreign capital inflows through Mauritius.

CBDT Circular No. 682 dated 30.02.1994

12.4. Upon becoming aware that the Treaty was being misused, as the ultimate beneficiaries of the investments were often residents of third countries, discussions emerged regarding the potential taxation of such gains in India. This led to uncertainty in investor sentiment and raised diplomatic considerations. In response, the CBDT issued Circular No. 682, clarifying that under Article 13(4) of the DTAA, capital gains derived by Mauritius residents would be taxable only in Mauritius, thereby reaffirming India's commitment to the Treaty and solidifying the Mauritius Route as a preferred investment structure.

12.5. Paragraph 4 of *CBDT Circular No.682: Clarification Regarding Agreement for Avoidance of Double Taxation with Mauritius dated 30.03.1994* deals with taxation of capital gains arising from the alienation of any property other than those mentioned in the preceding paragraphs and grants the right of taxation of capital gains only to that State of which the person deriving the capital gains is a resident. In terms of paragraph 4, capital gains derived by a resident of Mauritius from the alienation of shares of companies shall be taxable only in Mauritius according to Mauritius tax law. Therefore, any resident of

Mauritius deriving income from the alienation of shares of Indian companies will be liable to capital gains tax only in Mauritius, as per Mauritius tax law, and will not have any capital gains tax liability in India.

CBDT Circular No. 789 dated 13.04.2000

12.6. Pursuant to further discussions between India and Mauritius, a Joint Working Group was constituted in 1995 to renegotiate the DTAA in light of growing concerns regarding tax avoidance and potential misuse of the Treaty, including money laundering. The Indian delegation proposed the insertion of a limitation clause to address treaty abuse, suggesting that if India's right to tax income was restricted under the Treaty, but such income was exempt in Mauritius as foreign-sourced income, then India should have the right to tax it as if the DTAA did not exist. However, this proposal was rejected by Mauritius (*Thirteenth Lok Sabha, Joint Committee on Stock Market Scam and Matters Relating Thereto, 2002 – Pg. 182-186, Pg. 297-308*).

12.7. In the year 2000, Indian tax authorities denied the benefit of Article 13(4) of the DTAA to certain Foreign Institutional Investors (FIIs) on the ground that their beneficial ownership was outside both India and Mauritius. This resulted in capital outflows from India, diplomatic friction with Mauritius, and concerns over the stability of foreign investments. Mauritius argued that these entities were legitimately incorporated under its offshore regulatory regime and, therefore, qualified as residents of Mauritius for tax purposes.

12.8. To clarify India's position, the Indian Finance Minister issued a press note on 04.03.2000, stating that the actions of certain tax officers were case-specific assessments and did not reflect the Government's policy regarding the taxation of FIIs. Subsequently, the CBDT issued Circular No. 789 reaffirming that FIIs and investment funds operating from Mauritius were liable to tax in Mauritius. It further clarified that once such entities obtained a TRC from the Mauritian authorities, this would constitute sufficient proof of: (i) beneficial ownership and residence for claiming the concessional rate on dividend income under Article 10; and (ii) residence for capital gains taxation under Article 13(4). The relevant portion reads as under:

> *"CBDT Circular No. 789, Clarification Regarding Taxation of Income from Dividends and Capital Gains Under the Indo-Mauritius Double Tax Avoidance Convention (DTAC) dated 13.04.2000:*
>
> *1. The provisions of the Indo-Mauritius DTAC of 1983 apply to 'residents' of both India and Mauritius. Article 4 of the DTAC defines a resident of one State to mean "any person who, under the laws of that State is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature." Foreign Institutional Investors and other investment funds, etc., which are operating from Mauritius are invariably incorporated in that country. These entities are 'liable to tax' under the Mauritius Tax law and are, therefore, to be considered as residents of Mauritius in accordance with the DTAC.*
>
> *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.*
>
> *3. The test of residence mentioned above would also apply in respect of income from capital gains on sale of shares. Accordingly, FIIs, etc., which are resident in Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares as per paragraph 4 of article 13."*

CBDT Circular No. 1/2003 dated 10.02.2003

12.9. Thereafter, another Clarification in CBDT Circular No. 1/2003 dated 10.02.2003 was issued upon certain doubts being raised regarding the effect of Circular No. 789, particularly as to whether the said Circular would also apply to entities which are residents of both India and Mauritius. It was clarified that where an assessee is a resident of both the Contracting States in accordance with paragraph 1 of Article 4 of the Indo-Mauritius DTAC, then his residence is to be determined in accordance with paragraph 3 of the said Article. The relevant portion is reproduced hereinbelow:

> *"CBDT Circular No. 1/2003: Clarification regarding residential status under Indo-Mauritius Double Taxation Avoidance Convention (DTAC) dated 10.02.2003*
>
> *…….Certain doubts have been raised regarding the effect of the aforesaid circular, particularly whether the said circular would also apply to entities which are resident of both India and Mauritius. In order to remove all doubts on the subject, it is hereby clarified that where an assessee is a resident of both the contracting States, in accordance with para 1 of article 4 of Indo-Mauritius DTAC, then, his residence is to be determined in accordance with para 3 of the said article, which reads as under :—*
>
> > *"3. Where, by reason of the provisions of paragraph 1, a person other than an individual is resident of both the Contracting States, then it shall be deemed to be a resident of the Contracting State in which the place of effective management is situated."*
>
> *In view of the above, where an Assessing Officer finds and is satisfied that a company or an entity is resident of both India and Mauritius, he would be free to proceed to determine the residential status under para 3 of article 4 of DTAC. Where it is found as a fact that the company has its place of effective management in India, then notwithstanding its being incorporated in Mauritius, it would be taxed under the DTAC in India."*

Union of India v. Azadi Bachao Andolan

12.10. While so, Circular No. 789 was challenged by way of a Public Interest Litigation in *Azadi Bachao Andolan.* This Court upheld the legal validity of the Circular and ruled that Article 13(4) of the DTAA did not require the control or beneficial ownership of shares to be within India or Mauritius. It was further held that the Union Government is empowered to issue Circulars for Treaty implementation, and such Circulars would prevail over domestic law in case of inconsistency. This Court acknowledged concerns over Treaty shopping and possible abuse but remarked that such practices "may have been intended". This Court also noted that if India intended to deny benefits to nationals of third States, a LOB clause should have been included in the DTAA. Further, this Court observed that tax treaties are negotiated with multiple considerations in mind and that developing countries often allow Treaty shopping to attract scarce foreign capital and technology.

Vodafone International Holdings BV v. Union of India

12.11. Later, the judgment of this Court in *Vodafone,* prompted significant changes in India's tax regime, including retrospective amendments. Though it did not deal with the DTAA, it nevertheless had a ripple effect on it. Vodafone International Holdings B.V., a Dutch firm, bought shares of a Cayman Islands-based business that Hutchison controlled, thereby acquiring a 67% holding in Hutchison Essar Limited (HEL), an Indian Corporation. The deal, which was

executed outside India, was worth about USD 11.2 billion. The Indian tax authorities issued a show cause notice demanding tax and penalties, claiming that Vodafone was required to pay capital gains tax under Indian law because the transaction's underlying assets were situated in India. The main legal question was whether the Indian Income Tax Act, 1961 could be used to tax the transfer of shares of a foreign corporation that indirectly possessed assets in India. This Court interpreted Section 9(1)(i), which deals with income deemed to accrue or arise in India, and held that indirect share transfers, such as the Vodafone–HTIL transaction, are not covered under Section 9(1)(i) of the Income Tax Act. The Bombay High Court's "rights and entitlements" theory was rejected, clarifying that control is merely incidental to share ownership and not an independent capital asset. Emphasizing a "look at" test over a "look through" approach, this Court observed that for taxability under Section 9(1)(i), the capital asset must be situated in India. It also distinguished legitimate tax planning from tax evasion, aligned with *Azadi Bachao Andolan*, and upheld Vodafone's transaction. This Court reiterated that TRCs cannot be pierced except in cases involving fraud, sham transactions, *etc.*, and reaffirmed the validity of the Mauritius Route and its inextricable link with foreign investment. The relevant paragraphs of the judgment are extracted below, for ease of reference:

"***Our analysis***

61. *Before coming to Indo-Mauritius Double Taxation Avoidance Agreement (DTAA), we need to clear the doubts raised on behalf of the Revenue regarding the correctness of Azadi Bachao [(2004) 10 SCC 1] for the simple reason that certain tests laid down in the judgments of the English Courts subsequent to IRC v. Duke of Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] and Ramsay (W.T.) Ltd. v. IRC [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] help us to understand the scope of Indo-Mauritius DTAA.*

62. *It needs to be clarified that McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] dealt with two aspects. First, regarding validity of the circular(s) issued by CBDT concerning Indo-Mauritius DTAA. Second, on the concept of tax avoidance/evasion. Before us, arguments were advanced on behalf of the Revenue only regarding the second aspect.*

63. *The Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] principle states that: (Ramsay case [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] , AC p. 323 G)*

"Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance."

The said principle has been reiterated in subsequent English Courts judgments as "the cardinal principle".

64. *Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] was a case of sale-lease back transaction in which gain was sought to be counteracted, so as to avoid tax, by establishing an allowable loss. The method chosen was to buy from a company a readymade scheme, whose object was to create a neutral situation. The decreasing asset was to be sold so as to create an artificial loss and the increasing asset was to yield a gain which would be exempt from tax. The Crown challenged the whole scheme saying that it was an artificial scheme and, therefore, fiscally ineffective. It was held that Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] did not compel the court to look at a document or a transaction, isolated from the context to which it properly belonged. It is the task of the Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. In the present case, the Revenue has adopted a dissecting approach at the Department level.*

65. *Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] did not discard Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] but read it in the proper context by which a "device" which was colourable in nature had to be ignored as fiscal nullity. Thus, Ramsay [1982 AC*

300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] lays down the principle of statutory interpretation rather than an over-arching anti-avoidance doctrine imposed upon tax laws.

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68. *The majority judgment in McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] held that: (SCC p. 254, para 45)*

"45. Tax planning may be legitimate provided it is within the framework of law." In the latter part of para 45, it held that: (SCC pp. 254-55)

"45. ... Colourable devices cannot be [a] part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods."

It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with para 46 where the majority holds: (McDowell case [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] , SCC p. 255)

"46. On this aspect one of us, Chinnappa Reddy, J., has proposed a separate ... opinion with which we agree."

The words "this aspect" express the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colourable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible. Moreover, Reddy, J. himself says that he agrees with the majority.

69. *In the judgment of Reddy, J. in McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] there are repeated references to schemes and devices in contradistinction to "legitimate avoidance of tax liability" (paras 7-10, 17 & 18). In our view, although Chinnappa Reddy, J. makes a number of observations regarding the need to depart from Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] and tax avoidance—these are clearly only in the context of artificial and colourable devices.*

70. *Reading McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391], in the manner indicated hereinabove, in cases of treaty shopping and/or tax avoidance, there is no conflict between McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] and Azadi Bachao [(2004) 10 SCC 1] or between McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] and Mathuram Agrawal [(1999) 8 SCC 667] .*

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72. *The approach of both the corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on the abovementioned separate entity principle i.e. treat a company as a separate person. The Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies and other entities subject to income tax. Companies*

and other entities are viewed as economic entities with legal independence vis-à-vis their shareholders/participants. It is fairly well accepted that a subsidiary and its parent are totally distinct taxpayers. Consequently, the entities subject to income tax are taxed on profits derived by them on stand-alone basis, irrespective of their actual degree of economic independence and regardless of whether profits are reserved or distributed to the shareholders/participants. Furthermore, shareholders/ participants that are subject to (personal or corporate) income tax, are generally taxed on profits derived in consideration of their shareholding/participations, such as capital gains. Nowadays, it is fairly well settled that for tax treaty purposes a subsidiary and its parent are also totally separate and distinct taxpayers.

73. *It is generally accepted that the group parent company is involved in giving principal guidance to group companies by providing general policy guidelines to group subsidiaries. However, the fact that a parent company exercises shareholder's influence on its subsidiaries does not generally imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. Further, if a company is a parent company, that company's executive director(s) should lead the group and the company's shareholder's influence will generally be employed to that end. This obviously implies a restriction on the autonomy of the subsidiary's executive Directors. Such a restriction, which is the inevitable consequence of any group structure, is generally accepted, both in corporate and tax laws.*

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76. *It is a common practice in international law, which is the basis of international taxation, for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as a Cayman Islands or Mauritius-based company for both tax and business purposes. In doing so, foreign investors are able to avoid the lengthy approval and registration processes required for a direct transfer (i.e. without a foreign holding or operating company) of an equity interest in a foreign invested Indian company. However, taxation of such holding structures very often gives rise to issues such as double taxation, tax deferrals and tax avoidance.*

77. In this case, we are concerned with the concept of General Anti-Avoidance Rule (GAAR). In this case, we are not concerned with treaty shopping but with the anti-avoidance rules. The concept of GAAR is not new to India since India already has a judicial anti-avoidance rule, like some other jurisdictions. Lack of clarity and absence of appropriate provisions in the statute and/or in the treaty regarding the circumstances in which judicial anti-avoidance rules would apply has generated litigation in India.

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79. When it comes to taxation of a holding structure, at the threshold, the burden is on the Revenue to allege and establish abuse, in the sense of tax avoidance in the creation and/or use of such structure(s). In the application of a judicial anti-avoidance rule, the Revenue may invoke the "substance over form" principle or "piercing the corporate veil" test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant. To give an example, if a structure is used for circular trading or round tripping or to pay bribes then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity. Similarly, in a case where the Revenue finds that in a holding structure an entity which has no commercial/business substance has been interposed only to avoid tax then in such cases applying the test of fiscal nullity it would be open to the Revenue to discard such interpositioning of that entity. However, this has to be done at the threshold.

80. In this connection, we may reiterate the "look at" principle enunciated in Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] in which it was held that the Revenue or the Court must look at a document or a transaction in a context to which it properly belongs to. It is the task of the Revenue/Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. The Revenue cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but that it should apply the "look at" test to ascertain its true legal nature [see Craven v. White (Stephen) [1989 AC 398 : (1988) 3 WLR 423 : (1988) 3 All ER 495 (HL)] which further observed that genuine strategic tax planning has not been abandoned by any decision of the English Courts till date].

81. Applying the above tests, we are of the view that every strategic foreign direct investment coming to India, as an investment destination, should be seen in a holistic manner. While doing so, the Revenue/courts should keep in mind the following factors: the concept of participation in investment, the duration of time during which the holding structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on such exit.

82. In short, the onus will be on the Revenue to identify the scheme and its dominant purpose. The corporate business purpose of a transaction is evidence of the fact that the impugned transaction is not undertaken as a colourable or artificial device. The stronger the evidence of a device, the stronger the corporate business purpose must exist to overcome the evidence of a device.

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96. *At the outset, we need to reiterate that in this case we are concerned with the sale of shares and not with the sale of assets, itemwise. The facts of this case show sale of the entire investment made by HTIL, through a top company viz. CGP, in the Hutchison structure. In this case we need to apply the "look at" test. In the impugned judgment, the High Court has rightly observed that the arguments advanced on behalf of the Department vacillated. The reason for such vacillation was adoption of "dissecting approach" by the Department in the course of its arguments. Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] enunciated the look at test. According to that test, the task of the Revenue is to ascertain the legal nature of the transaction and, while doing so, it has to look at the entire transaction holistically and not to adopt a dissecting approach.*

97. One more aspect needs to be reiterated. There is a conceptual difference between a preordained transaction which is created for tax avoidance purposes, on the one hand, and a transaction which evidences investment to participate in India. In order to find out whether a given transaction evidences a preordained transaction in the sense indicated above or investment to participate, one has to take into account the factors enumerated hereinabove, namely, duration of time during which the holding structure existed, the period of business operations in India, generation of taxable revenue in India during the period of business operations in India, the timing of the exit, the continuity of business on such exit, etc.

98. *Applying these tests to the facts of the present case, we find that the Hutchison structure has been in place since 1994. It operated during the period 1994 to 11-2-2007. It has paid income tax ranging from Rs 3 crores to Rs 250 crores per annum during the period 2002-2003 to 2006-2007. Even after 11-2-2007, taxes are being paid by VIH ranging from Rs 394 crores to Rs 962 crores per annum during the period 2007-2008 to 2010-2011 (these figures are apart from indirect taxes which also run in crores). Moreover, the SPA indicates "continuity" of the telecom business on the exit of its predecessor, namely, HTIL. Thus, it cannot be said that the structure was created or used as a sham or tax avoidant. It cannot be said that HTIL or VIH was a "fly by night" operator/short-time investor.*

99. *If one applies the look at test discussed hereinabove, without invoking the dissecting approach, then, in our view, extinguishment took place because of the transfer of the CGP share and not by virtue of various clauses of SPA. In a case like the present one, where the structure has existed for a considerable length of time generating taxable revenues right from 1994 and where the court is satisfied that the transaction satisfies all the parameters of "participation in*

investment" then in such a case the court need not go into the questions such as de facto control versus legal control, legal rights versus practical rights, etc.

100. *Be that as it may, did HTIL possess a legal right to appoint Directors onto the board of HEL and as such had some "property right" in HEL? If not, the question of such a right getting "extinguished" will not arise. A legal right is an enforceable right. Enforceable by a legal process. The question is what is the nature of the "control" that a parent company has over its subsidiary. It is not suggested that a parent company never has control over the subsidiary. For example, in a proper case of "lifting of corporate veil", it would be proper to say that the parent company and the subsidiary form one entity. But barring such cases, the legal position of any company incorporated abroad is that its powers, functions and responsibilities are governed by the law of its incorporation. No multinational company can operate in a foreign jurisdiction save by operating independently as a "good local citizen".*

101. *A company is a separate legal persona and the fact that all its shares are owned by one person or by the parent company has nothing to do with its separate legal existence. If the owned company is wound up, the liquidator, and not its parent company, would get hold of the assets of the subsidiary. In none of the authorities have the assets of the subsidiary been held to be those of the parent unless it is acting as an agent. Thus, even though a subsidiary may normally comply with the request of a parent company it is not just a puppet of the parent company. The difference is between having power or having a persuasive position. Though it may be advantageous for parent and subsidiary companies to work as a group, each subsidiary will look to see whether there are separate commercial interests which should be guarded.*

102. *When there is a parent company with subsidiaries, is it or is it not the law that the parent company has the "power" over the subsidiary. It depends on the facts of each case. For instance, take the case of a one-man company, where only one man is the shareholder perhaps holding 99% of the shares, his wife holding 1%. In those circumstances, his control over the company may be so complete that it is his alter ego. But, in case of multinationals it is important to realise that their subsidiaries have a great deal of autonomy in the country concerned except where subsidiaries are created or used as a sham. Of course, in many cases the courts do lift up a corner of the veil but that does not mean that they alter the legal position between the companies.*

103. *The Directors of the subsidiary under their articles are the managers of the companies. If new Directors are appointed even at the request of the parent company and even if such Directors were removable by the parent company, such Directors of the subsidiary will owe their duty to their companies (subsidiaries). They are not to be dictated by the parent company if it is not in*

the interests of those companies (subsidiaries). The fact that the parent company exercises shareholders' influence on its subsidiaries cannot obliterate the decision-making power or authority of its (subsidiary's) Directors. They cannot be reduced to be puppets. The decisive criterion is whether the parent company's management has such steering interference with the subsidiary's core activities that the subsidiary can no longer be regarded to perform those activities on the authority of its own executive Directors.

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130. *Subsidiaries are often created for tax or regulatory reasons. They at times come into existence from mergers and acquisitions. As group members, subsidiaries work together to make the same or complementary goods and services and hence they are subject to the same market supply and demand conditions. They are financially interlinked. One such linkage is the intra-group loans and guarantees. Parent entities own equity stakes in their subsidiaries. Consequently, on many occasions, the parent suffers a loss whenever the rest of the group experiences a downturn. Such grouping is based on the principle of internal correlation. The courts have evolved doctrines like piercing the corporate veil, substance over form, etc. enabling taxation of underlying assets in cases of fraud, sham, tax avoidance, etc. However, genuine strategic tax planning is not ruled out.*

131. *CGP was incorporated in 1998 in the Cayman Islands. It was in the Hutchison structure from 1998. The transaction in the present case was of divestment and, therefore, the transaction of sale was structured at an appropriate tier, so that the buyer really acquired the same degree of control as was hitherto exercised by HTIL. VIH agreed to acquire companies and the companies it acquired controlled 67% interest in HEL. CGP was an investment vehicle. As stated above, it is through the acquisition of CGP that VIH proposed to indirectly acquire the rights and obligations of GSPL in the Centrino and NDC framework agreements.*

132. *The report of Ernst & Young dated 11-2-2007 inter alia states that when they were asked to conduct due diligence by VIH, it was in relation to Array and its subsidiaries. The said report evidences that at the negotiation stage, parties had in mind the transfer of an upstream company rather than the transfer of HEL directly. The transfer of Array had the advantage of transferring control over the entire shareholding held by downstream Mauritius companies (Tier I companies), other than GSPL. On the other hand, the advantage of transferring the CGP share enabled VIH to indirectly acquire the rights and obligations of GSPL (Indian company) in the Centrino and NDC framework agreements. This was the reason for VIH to go by the CGP route.*

133. *One of the arguments of the Revenue before us was that the Mauritius route was not available to HTIL for the reason indicated above. In this connection, it was urged that the legal owner of HEL (Indian company) was not HTIL. Under the transaction, HTIL alone was the seller of the shares. VIH wanted to enter into an agreement only with HTIL so that if something goes wrong, VIH could look solely to HTIL being the group holding company (parent company). Further, funds were pumped into HEL by HTIL. These funds were to be received back in the shape of a capital gain which could then be used to declare a special dividend to the shareholders of HTIL. We find no merit in this argument.*

134. Firstly, the Tier I (Mauritius companies) were the indirect subsidiaries of HTIL who could have influenced the former to sell the shares of Indian companies in which event the gains would have arisen to the Mauritius companies, who are not liable to pay capital gains tax under the Indo-Mauritius DTAA. That, nothing prevented the Mauritius companies from declaring dividend on gains made on the sale of shares. There is no tax on dividends in Mauritius. Thus, the Mauritius route was available but it was not opted for because that route would not have brought in the control over GSPL.

135. Secondly, if the Mauritius companies had sold the shares of HEL, then the Mauritius companies would have continued to be the subsidiaries of HTIL, their accounts would have been consolidated in the hands of HTIL and HTIL would have accounted for the gains in exactly the same way as it has accounted for the gains in the hands of HTIHL (CI) which was the nominated payee. Thus, in our view, two routes were available, namely, the CGP route and the Mauritius route. It was open to the parties to opt for any one of the two routes.

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Summary of findings

179. Applying the look at test in order to ascertain the true nature and character of the transaction, we hold, that the offshore transaction herein is a bona fide structured FDI investment into India which fell outside India's territorial tax jurisdiction, hence not taxable. The said offshore transaction evidences participative investment and not a sham or tax avoidant preordained transaction. The said offshore transaction was between HTIL (a Cayman Islands company) and VIH (a company incorporated in the Netherlands). The subject-matter of the transaction was the transfer of CGP (a company incorporated in the Cayman Islands). Consequently, the Indian Tax Authority had no territorial tax jurisdiction to tax the said offshore transaction.

Conclusion

180. *FDI flows towards locations with a strong governance infrastructure which includes enactment of laws and how well the legal system works. Certainty is*

integral to the rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner. Legal doctrines like "limitation of benefits" and "look through" are matters of policy. It is for the Government of the day to have them incorporated in the treaties and in the laws so as to avoid conflicting views. Investors should know where they stand. It also helps the tax administration in enforcing the provisions of the taxing laws. As stated above, the Hutchison structure has existed since 1994. According to the details submitted on behalf of the appellant, we find that from 2002-2003 to 2010-2011 the Group has contributed an amount of Rs 20,242 crores towards direct and indirect taxes on its business operations in India.

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Need for legislation

252. *Tax avoidance is a problem faced by almost all countries following civil and common law systems and all share the common broad aim, that is to combat it. Many countries are taking various legislative measures to increase the scrutiny of transactions conducted by non-resident enterprises. Australia has both general and specific anti-avoidance rule (GAAR) in its income tax legislations. In Australia, GAAR is in Part IV-A of the Income Tax Assessment Act, 1936, which is intended to provide an effective measure against tax avoidance arrangements. South Africa has also taken an initiative in combating impermissible tax avoidance or tax shelters. Countries like China, Japan, etc. have also taken remedial measures.*

253. *The Direct Taxes Code Bill (DTC), 2010, proposed in India, envisages creation of an economically efficient, effective direct tax system, proposing GAAR. GAAR intends to prevent tax avoidance, what is inequitable and undesirable. Clause 5(4)(g) provides that the income from transfer outside India of a share in a foreign company shall be deemed to arise in if the FMV of assets India owned by the foreign company is at least 50% of its total assets. Necessity to take effective legislative measures has been felt in this country, but we always lag behind because our priorities are different. Lack of proper regulatory laws leads to uncertainty and passing inconsistent orders by courts, tribunals and other forums, putting the Revenue and taxpayers at bay.*

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A. Lifting the veil — Tax laws

277. Lifting the corporate veil doctrine is readily applied in the cases coming within the company law, law of contract, law of taxation. Once the transaction is shown to be fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also for tax evasion, the court can always lift the corporate veil and examine the substance of the transaction.

278. *This Court in CIT v. Sri Meenakshi Mills Ltd. [AIR 1967 SC 819] held that the court is entitled to lift the veil of the corporate entity and pay regard to the economic realities behind the legal facade meaning that the court has the power to disregard the corporate entity if it is used for tax evasion. In LIC v. Escorts Ltd. [(1986) 1 SCC 264] this Court held that: (SCC p. 336, para 90)*

90. ... the corporate veil may be lifted where a statute itself contemplates lifting [of] the veil, or fraud or improper conduct is intended to be prevented, or a taxing statute or a [beneficial] statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern.

279. *Lifting the corporate veil doctrine was also applied in Juggilal Kamlapat v. CIT [AIR 1969 SC 932 : (1969) 1 SCR 988] , wherein this Court noticed that the assessee firm sought to avoid tax on the amount of compensation received for the loss of office by claiming that it was capital gain and it was found that the termination of the contract of managing agency was a collusive transaction. The Court held that it was a collusive device, practised by the managed company and the assessee firm for the purpose of evading income tax, both at the hands of the payer and the payee.*

280. Lifting the corporate veil doctrine can, therefore, be applied in tax matters even in the absence of any statutory authorisation to that effect. The principle is also being applied in cases of holding company-subsidiary relationship, where in spite of being separate legal personalities, if the facts reveal that they indulge in dubious methods for tax evasion.

B. Tax avoidance and tax evasion

281. *"Tax avoidance" and "tax evasion" are two expressions which find no definition either in the Companies Act, 1956 or the Income Tax Act, 1961. But the expressions are being used in different contexts by our courts as well as the courts in England and various other countries, when a subject is sought to be taxed.*

282. *One of the earliest decisions which came up before the House of Lords in England demanding tax on a transaction by the Crown is Duke of Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] . In that case, the Duke of Westminster had made an arrangement that he would pay his gardener an annuity, in which case, a tax deduction could be claimed. Wages of household services were not deductible expenses in computing the taxable income, therefore, the Duke of Westminster was advised by the tax experts that if such an agreement was employed, the Duke would get tax exemption. Under the tax legislation then in force, if it was shown as gardener's wages, then the wages paid would not be deductible. The Inland Revenue contended that the form of the*

transaction was not acceptable to it and the Duke was taxed on the substance of the transaction, which was that payment of annuity was treated as a payment of salary or wages. The Crown's claim of substance doctrine was, however, rejected by the House of Lords.

283. *Lord Tomlin's celebrated words are quoted below: (Duke of Westminster case [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] , AC pp. 19-20)*

"... Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."

Lord Atkin, however, dissented and stated that: (Duke of Westminster case [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] , AC p. 15)

"... the substance of the transaction was that what was being paid was remuneration."

284. *The principles which have emerged from that judgment are as follows:*

(1) A legislation is to receive a strict or literal interpretation;

(2) An arrangement is to be looked at not in by its economic or commercial substance but by its legal form; and

(3) An arrangement is effective for tax purposes even if it has no business purpose and has been entered into to avoid tax.

285. *The House of Lords, during the 1980s, it seems, began to attach a "purposive interpretation approach" and gradually began to give emphasis on "economic substance doctrine" as a question of statutory interpretation. In a most celebrated case in Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)], the House of Lords considered this question again. That was a case whereby the taxpayer entered into a circular series of transactions designed to produce a loss for tax purposes, but which together produced no commercial result. Viewed that transaction as a whole, the series of transactions was self-cancelling, the taxpayer was in precisely the same commercial position at the end as at the beginning of the series of transactions. The House of Lords ruled that, notwithstanding the rule in Duke of Westminster case [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)], the series of transactions should be disregarded for tax purposes and the manufactured loss, therefore, was not available to the taxpayer.*

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303. *The above discussion would indicate that a clear-cut distinction between tax avoidance and tax evasion is still to emerge in England and in the absence of any legislative guidelines, there is bound to be uncertainty, but to say that the principle of Duke of Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] has been exorcised in England is too tall a statement and not seen accepted even in England. The House of Lords in McGuckian [(1997) 1 WLR 991 : (1997) 3 All ER 817 : 1997 BTC 346 (HL)] and MacNiven [(2003) 1 AC 311 : (2001) 2 WLR 377 : (2001) 1 All ER 865 (HL)] , it may be noted, has emphasised that the Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] approach is a principle of statutory interpretation rather than an overarching anti-avoidance doctrine imposed upon tax laws. The Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] approach is ultimately concerned with the statutory interpretation of a tax avoidance scheme and the principles laid down in Duke of Westminster [IRC v. Duke of Westminster, 1936 AC 1 : 1935 All ER Rep 259 (HL)] , it cannot be said, have been given a complete go-by in Ramsay [1982 AC 300 : (1981) 2 WLR 449 : (1981) 1 All ER 865 (HL)] , Dawson [1984 AC 474 : (1984) 2 WLR 226 : (1984) 1 All ER 530 (HL)] or other judgments of the House of Lords.*

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Limitation of benefit clause (LOB)

309. *The Indo-Mauritius Treaty does not contain any limitation of benefit (LOB) clause, similar to the Indo-US Treaty, wherein Article 24 stipulates that benefits will be available if 50% of the shares of a company are owned directly or indirectly by one or more individual residents of a controlling State. The LOB clause also finds a place in India-Singapore DTA. The Indo-Mauritius Treaty does not restrict the benefit to companies whose shareholders are non-citizens/residents of Mauritius, or where the beneficial interest is owned by non-citizens/residents of Mauritius, in the event where there is no justification in prohibiting the residents of a third nation from incorporating companies in Mauritius and deriving benefit under the treaty. No presumption can be drawn that the Union of India or the Tax Department is unaware that the quantum of both FDI and FII do not originate from Mauritius but from other global investors situate outside Mauritius. Mauritius, it is well known is incapable of bringing FDI worth millions of dollars into India. If the Union of India and the Tax Department insist that the investment would directly come from Mauritius and Mauritius alone then the Indo-Mauritius Treaty would be dead letter.*

310. *Mr Aspi Chinoy, learned Senior Counsel's contention that in the absence of an LOB clause in the Indo-Mauritius Treaty, the scope of the Treaty would be positive from Mauritius Special Purpose Vehicles (SPVs) created specifically to route investments into India, meets with our approval. We acknowledge that on a subsequent sale/transfer/disinvestment of shares by the Mauritian company,*

after a reasonable time, the sale proceeds would be received by the Mauritius company as the registered holder/owner of such shares, such benefits could be sent back to the foreign principal/100% shareholder of Mauritius company either by way of a declaration of special dividend by the Mauritius company and/or by way of repayment of loans received by the Mauritius company from the foreign principal/shareholder for the purpose of making the investment. Mr Chinoy is right in his contention that apart from DTAA, which provides for tax exemption in the case of capital gains received by a Mauritius company/shareholder at the time of disinvestment/exit and the fact that Mauritius does not levy tax on dividends declared and paid by a Mauritius company/subsidiary to its foreign shareholders/principal, there is no other reason for this quantum of funds to be invested from/through Mauritius.

311. We are, therefore, of the view that in the absence of an LOB clause and the presence of Circular No. 789 of 2000 and the TRC certificate, on the residence and beneficial interest/ownership, the Tax Department cannot at the time of sale/disinvestment/exit from such FDI, deny benefits to such Mauritius companies of the Treaty by stating that FDI was only routed through a Mauritius company, by a company/principal resident in a third country; or the Mauritius company had received all its funds from a foreign principal/company; or the Mauritius subsidiary is controlled/managed by the foreign principal; or the Mauritius company had no assets or business other than holding the investment/shares in the Indian company; or the foreign principal/100% shareholder of Mauritius company had played a dominant role in deciding the time and price of the disinvestment/sale/transfer; or the sale proceeds received by the Mauritius company had ultimately been paid over by it to the foreign principal/its 100% shareholder either by way of special dividend or by way of repayment of loans received; or the real owner/beneficial owner of the shares was the foreign principal company. Setting up of a WOS Mauritius subsidiary/SPV by principals/genuine substantial long-term FDI in India from/through Mauritius, pursuant to the DTAA and Circular No. 789 can never be considered to be set up for tax evasion.

TRC whether conclusive

312. LOB and look through provisions cannot be read into a tax treaty but the question may arise as to whether the TRC is so conclusive that the Tax Department cannot pierce the veil and look at the substance of the transaction.

313. DTAA and Circular No. 789 dated 13-4-2000, in our view, would not preclude the Income Tax Department from denying the tax treaty benefits, if it is established, on facts, that the Mauritius company has been interposed as the owner of the shares in India, at the time of disposal of the shares to a third

party, solely with a view to avoid tax without any commercial substance. The Tax Department, in such a situation, notwithstanding the fact that the Mauritian company is required to be treated as the beneficial owner of the shares under Circular No. 789 and the Treaty is entitled to look at the entire transaction of sale as a whole and if it is established that the Mauritian company has been interposed as a device, it is open to the Tax Department to discard the device and take into consideration the real transaction between the parties, and the transaction may be subjected to tax. In other words, TRC does not prevent enquiry into a tax fraud; for example, where an OCB is used by an Indian resident for round-tripping or any other illegal activities, nothing prevents the Revenue from looking into special agreements, contracts or arrangements made or effected by Indian resident or the role of OCB in the entire transaction.

314. No court will recognise a sham transaction or a colourable device or adoption of a dubious method to evade tax, but to say that the Indo-Mauritian Treaty will recognise FDI and FII only if it originates from Mauritius, not the investors from third countries, incorporating company in Mauritius, is pitching it too high, especially when statistics reveal that for the last decade FDI in India was US $178 billion and, of this, 42% i.e. US $74.56 billion was through the Mauritian route. Presently, it is known, FII in India is Rs 4,50,000 crores, out of which Rs 70,000 crores is from Mauritius. The facts, therefore, clearly show that almost the entire FDI and FII made in India from Mauritius under DTAA does not originate from that country, but has been made by Mauritius companies/SPV, which are owned by companies/individuals of third countries providing funds for making FDI by such companies/individuals not from Mauritius, but from third countries.

315. *Mauritius, and India, it is known, have also signed a memorandum of understanding (MoU) laying down the rules for information exchange between the two countries which provides for the two signatory authorities to assist each other in the detection of fraudulent market practices, including insider dealing and market manipulation in the areas of securities transactions and derivative dealings. The object and purpose of the MoU is to track down transactions tainted by fraud and financial crime, not to target the bona fide legitimate transactions. Mauritius has also enacted stringent "Know Your Clients" (KYC) regulations and anti-money laundering laws which seek to avoid abusive use of treaty.*

316. *Viewed in the above perspective, we also find no reason to import the "abuse of rights doctrine" (abus de droit) to India. The above doctrine was seen applied by the Swiss court in A Holdings ApS [A Holdings ApS v. Federal Tax Administration, (2005) 8 ITLR 536] , unlike courts following common law. That was a case where a Danish company was interposed to hold all the shares in a*

Swiss company and there was a clear finding of fact that it was interposed for the sole purpose of benefiting from the Swiss-Denmark DTA which had the effect of reducing a normal 35% withholding tax on dividend out of Switzerland down to 0%. The court in that case held that the only reason for the existence of the Danish company was to benefit from the zero withholding tax under the tax treaty. On facts also, the above case will not apply to the case in hand.

317 [Ed.: Para 317 corrected vide Official Corrigendum No. F.3/Ed.B.J./18/2012 dated 3-3-2012.]. *The Cayman Islands, it was contended, was a tax haven and CGP was a shell company, hence, they have to be looked at with suspicion. We may, therefore, briefly examine what those expressions mean and how they are understood in the corporate world.*

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334. The Revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every taxpayer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury. The Revenue's stand that the ratio laid down in McDowell [(1985) 3 SCC 230 : 1985 SCC (Tax) 391] is contrary to what has been laid down in Azadi Bachao Andolan [(2004) 10 SCC 1], in our view, is unsustainable and, therefore, calls for no reconsideration by a larger Bench.

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355. *Share of CGP situates in the Cayman Islands and that of Array in Mauritius. Mauritian entities which hold 42% shares in HEL became the direct and indirect subsidiaries of Array, on Vodafone purchasing the CGP share. Voting rights, controlling rights, right to manage, etc., of Mauritian companies vested in those companies. HTIL has never sold nor has Vodafone purchased any shares of either Array or the Mauritian subsidiaries, but only CGP, the share of which situates in the Cayman Islands. By purchasing the CGP share its situs will not shift either to Mauritius or to India, a legal issue, already explained by us. Array being a WOS of CGP, CGP may appoint or remove any of its Directors, if it wishes by a resolution in the general body of the subsidiary, but CGP, Array and all Mauritian entities are separate legal entities and have decentralised management and each of the Mauritian subsidiaries has its own management personnel.*

356. *Vodafone on purchase of the CGP share got controlling interest in the Mauritian companies and the incident of transfer of the CGP share cannot be considered to be two distinct and separate transactions, one shifting of the share and another shifting of the controlling interest. Transfer of the CGP share automatically results in host of consequences including transfer of controlling interest and that controlling interest as such cannot be dissected from the CGP*

share without legislative intervention. Controlling interest of CGP over Array is an incident of holding majority shares and the control of company vests in the voting power of its shareholders.

357. *Mauritian entities being a WOS of Array, Array as a holding company can influence the shareholders of various Mauritian companies. Holding companies like CGP, Array, may exercise control over the subsidiaries, whether a WOS or otherwise by influencing the voting rights, nomination of members of the Board of Directors and so on. On transfer of shares of the holding company, the controlling interest may also pass on to the purchaser along with the shares. Controlling interest might have percolated down the line to the operating companies but that controlling interest is inherently contractual and not a property right unless otherwise provided for in the statute. Acquisition of shares, may carry the acquisition of controlling interest which is purely a commercial concept and the tax can be levied only on the transaction and not on its effect. Consequently, on transfer of the CGP share to Vodafone, Vodafone got control over eight Mauritian companies which owned shares in VEL totalling to 42% and that does not mean that the situs of the CGP share has shifted to India for the purpose of charging capital gains tax.*

358. *Vodafone could exercise only indirect voting rights in VEL through its indirect subsidiary CGP(M) which held equity interests in TII, an Indian company, which held equity interests in VEL. Similarly, Vodafone could exercise only indirect voting rights through HTI(M) which held equity interests in Omega, an Indian company which in turn held equity interests in HEL. On transfer of the CGP share, Vodafone gets controlling interest in its indirect subsidiaries which are situated in Mauritius which have equity interests in TII and Omega, Indian companies which are independent legal entities. Controlling interest, which stood transferred to Vodafone from HTIL accompanies the CGP share and cannot be dissected so as to be treated as transfer of controlling interest of Mauritian entities and then that of Indian entities and ultimately that of HEL. Situs of the CGP share, therefore, determines the transferability of the share and/or interest which flows out of that share including controlling interest. Ownership of shares, as already explained by us, carries other valuable rights like, right to receive dividend, right to transmit the shares, right to vote, right to act as per one's wish, or to vote in a particular manner, etc; and on transfer of shares those rights also sail along with them.*

359. *Vodafone, on purchase of the CGP share got all those rights, and the price paid by Vodafone is for all those rights, in other words, control premium paid, not over and above the CGP share, but is the integral part of the price of the share. On transfer of the CGP share situated in the Cayman Islands, the entire rights, which accompany stood transferred not in India, but offshore and the facts reveal that the offshore holdings and arrangements made by HTIL and*

Vodafone were for sound commercial and legitimate tax planning, not with the motive of evading tax.

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408. *Section 9 has no "look through provision" and such a provision cannot be brought in through construction or interpretation of a word "through" in Section 9. In any view, "look through provision" will not shift the situs of an asset from one country to another. Shifting of situs can be done only by express legislation. Federal Commr. of Taxation v. Lamesa Holdings BV [(1998) 157 ALR 290 (Aust)] gives an insight as to how "look through" provisions are enacted. Section 9, in our view, has no inbuilt "look through mechanism". Capital gains are chargeable under Section 45 and their computation is to be in accordance with the provisions that follow Section 45 and there is no notion of indirect transfer in Section 45. Section 9(1)(i), therefore, in our considered opinion, will not apply to the transaction in question or on the rights and entitlements, stated to have been transferred, as a fallout of the sale of the CGP share, since the Revenue has failed to establish both the tests, resident test as well as the source test.*"

Finance Bill 2012 and Finance Act, 2012

12.12. After the fallout of the *Vodafone* case, the Indian Government introduced the Finance Bill, 2012, bringing three significant amendments aimed at overriding the implications of the judgment by removing its basis and addressing tax avoidance concerns, *viz*., (i) amendment to Section 9 – indirect transfer provisions; (ii) introduction of the General Anti-Avoidance Rule (GAAR) provisions; and (iii) amendment to Section 90 – Treaty override and TRC requirements.

(i) Amendment to Section 9 – Indirect Transfer Provisions

12.13. The definition of "income deemed to accrue or arise in India" under Section 9(1)(i), which sets out circumstances in which income accruing or

arising, directly or indirectly, is taxable in India, was retrospectively amended with effect from 01.04.1962. One of the limbs of clause (i) pertains to income accruing or arising directly or indirectly through the transfer of a capital asset situated in India. The amendment clarified that gains from the transfer of shares or interests in a foreign entity deriving substantial value from assets located in India would be taxable in India. They are extracted as follows:

> *"…….Certain judicial pronouncements have created doubts about the scope and purpose of sections 9 and 195. Further, there are certain issues in respect of income deemed to accrue or arise where there are conflicting decisions of various judicial authorities.*
>
> *It is, therefore, proposed to amend the Income Tax Act in the following manner:-*
> *(i) Amend section 9(1)(i) to clarify that the expression 'through' shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*
>
> *(ii) Amend section 9(1)(i) to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.*
> *…….*
> *(v) Amend section 195(1) to clarify that obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident has:-*
> *(a) a residence or place of business or business connection in India; or*
> *(b) any other presence in any manner whatsoever in India."*

12.14. Pursuant to the above, Explanations 4 and 5 were inserted in Section 9(1)(i) as under:

> *"**Explanation 4.**—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*

> ***Explanation 5.***—*For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India."*

12.15. Through this amendment, the scope and application of Section 9 were expanded, codifying the principle of source-based taxation, wherein the State where the actual economic nexus of income exists has the right to tax such income, irrespective of the place of residence of the entity deriving it. Further, Section 195, which mandates the deduction of tax at source before making payments to a non-resident, was also amended. The amendment explicitly provided that a non-resident person was also required to deduct tax at source before making payments to another non-resident, if the payment represented income chargeable to tax in India in the hands of the payee non-resident.

(ii) <u>GAAR</u>

12.16. Keeping in view the increasing prevalence of aggressive tax planning through complex structures, it was considered necessary to codify the doctrine of "substance over form", ensuring that the real intention of the parties, the actual effect of transactions, and the purpose of an arrangement were taken into account for determining tax consequences. Accordingly, the Finance Act, 2012, introduced statutory GAAR to address such aggressive tax planning strategies.

12.17. Under Section 96 of the Act, an 'impermissible avoidance arrangement' was defined as an arrangement where the main purpose, or one of the main

purposes, was to obtain a tax benefit, and which satisfied at least one of the prescribed conditions. Likewise, Section 98 prescribed the consequences of such arrangements. Moreover, Section 100 specifically excluded FIIs from the applicability of GAAR, provided they had not claimed benefits under a DTAA. Further, Section 101 empowered the CBDT to issue guidelines for the implementation of GAAR. The relevant provisions are reproduced hereunder:

> *"**Chapter XA – General Anti Avoidance Rule***
> ***Section 95.** Applicability of General Anti-Avoidance Rule. - Notwithstanding anything contained in the Act, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.*
> *Explanation. - For the removal of doubts, it is hereby declared that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.*
>
> ***Section 96.** Impermissible avoidance arrangement. - (1) An impermissible avoidance arrangement means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and it -*
> *(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;*
> *(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;*
> *(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or*
> *(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.*
> *(2) An arrangement shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.*
>
> ***Section 97.** Arrangement to lack commercial substance. - (1) An arrangement shall be deemed to lack commercial substance if -*
> *(a)the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or*
> *(b)it involves or includes –*

(i)round trip financing;
(ii)an accommodating party;
(iii)elements that have effect of offsetting or cancelling each other; or
(iv)a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or
(c)it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party.
(2)For the purposes of sub-section (1), round trip financing includes any arrangement in which, through a series of transactions –
(a) funds are transferred among the parties to the arrangement; and
(b)such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter), without having any regard to –
(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;
(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or
(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.
(3)For the purposes of this Chapter, a party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.
(4)The following shall not be taken into account while determining whether an arrangement lacks commercial substance or not, namely: -
(i) the period or time for which the arrangement (including operations therein) exists;
(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;
(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Section 98. *Consequence of impermissible arrangement. - (1) If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined, in such manner as is deemed appropriate, in the circumstances of the case, including by way of but not limited to the following, namely: -*

(a)disregarding, combining or recharacterising any. step in, or a part or whole of, the impermissible avoidance arrangement;
(b)treating the impermissible avoidance arrangement as if it had not been entered into or carried out;
(c)disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;
(d)deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;
(e) reallocating amongst the parties to the arrangement –
(i) any accrual, or receipt, of a capital or revenue nature; or
(ii) any expenditure, deduction, relief or rebate;
(f) treating –
(i) the place of residence of any party to the arrangement; or
(ii) the situs of an asset or of a transaction, at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or
(g) considering or looking through any arrangement by disregarding any corporate structure.
(2) For the purposes of sub-section (1), -
(i) any equity may be treated as debt or vice versa;
(ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or
(iii)any expenditure, deduction, relief or rebate may be recharacterised.

Section 99. *Treatment of connected person and accommodating party. - For the purposes of this Chapter, in determining whether a tax benefit exists -*
(i) the parties who are connected persons in relation to each other may be treated as one and the same person;
(ii) any accommodating party may be disregarded;
(iii)such accommodating party and any other party may be treated as one and the same person;
(iv)the arrangement may be considered or looked through by disregarding any corporate structure.

Section 100. Application of Chapter. - *The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.*

Section 101. *Framing of Guidelines. - The provisions of this Chapter shall be applied in accordance with such guidelines and subject to such conditions and the manner as may be prescribed.*

Section 102. Definitions. - *In this Chapter, unless the context otherwise requires, -*

(1)"arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

(2)"asset" includes property, or right, of any kind;

(3)"associated person", in relation to a person, means –

(a) any relative of the person, if the person is an individual;

(b) any director of the company or any relative of such director, if the person is a company;

(c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member if the person is a firm or association of persons or body of individuals;

(d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;

(e) any individual who has a substantial interest in the business of the person or any relative of such individual;

(f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of die person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;

(g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member have a substantial interest in the business of the person, or family or any relative of such director, partner or member;

(h) any other person who carries on a business, if –

(i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or

(ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

(4)"benefit" includes a payment of any kind whether in tangible or intangible form;

(5)"connected person" means any person who is connected directly or indirectly to another person and includes associated person;

(6)"fund" includes –

(a)any cash;

(b)cash equivalents; and

(c)any right, or obligation, to receive, or pay, the cash or cash equivalent;

(7)"party" means any person including a permanent establishment which participates or takes part in an arrangement;
(8)"relative" shall have the meaning assigned to it in the Explanation to clause (vi) of sub-section (2) of section 56;
(9) a person shall be deemed to have a substantial interest in the business, if –
(a)in a case where the business is carried on by a company, such person is, at any time during the financial year, the beneficial owner of equity shares carrying twenty per cent, or more, of the voting power; or
(b)in any other case, such person is, at any time during the financial year, beneficially entitled to twenty per cent, or more, of the profits of such business;
(10) "step" includes a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement;
(11)"tax benefit" means –
(a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or
(b) an increase in a refund of tax or other amount under this Act; or
(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or
(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or
(e) a reduction in total income including increase in loss, in the relevant previous year or any other previous year;
(12)"tax treaty" means an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A."

12.18. The above provisions sought to introduce a comprehensive mechanism to deter tax evasion under the guise of FII investments by companies misusing the DTAA with the Mauritius Government. However, given the wide discretion and authority conferred upon the tax administration, concerns were raised regarding the potential for uncertainty and misuse. Consequently, it was deemed necessary to constitute an expert committee (*the Shome Committee)* to review and analyse the provisions before their implementation. This resulted in the postponement of the GAAR provisions to the assessment year 2013-14, which was again deferred to 2015 and eventually, implemented from 01.04.2017.

12.19. In this regard, the relevant portions of the Finance Minister's speech during the discussion on the Finance Bill 2012 are extracted below:

> *"....In addition, certain provisions relating to General Anti-Avoidance Rules (GAAR) have also been proposed in the Finance Bill, 2012. After examining the recommendations of the Standing Committee on GAAR provisions in the DTC Bill, 2010, I propose to amend the GAAR provisions as follows:*
>
> *(i) Remove the onus of proof entirely from the taxpayer to the Revenue Department before any action can be initiated under GAAR.*
> *(ii) Introduce an independent member in the GAAR approving panel to ensure objectivity and transparency. One member of the panel now would be an officer of the level of Joint Secretary or above from the Ministry of Law.*
> *(iii)Provide that any taxpayer (resident or non-resident) can approach the Authority for Advance Ruling (AAR) for a ruling as to whether an arrangement to be undertaken by is permissible or not under the GAAR provisions.*
>
> *To provide greater clarity and certainty in the matters relating to GAAR, a Committee has been constituted under the Chairmanship of the Director General of Income Tax (International Taxation) to give recommendations for formulating the rules and guidelines for implementation of the GAAR provisions and to suggest safeguards so that these provisions are not applied indiscriminately. The Committee has already held several rounds of discussion with various stakeholders including the Foreign Institutional Investors. The Committee will submit its recommendations by 31st May, 2012.*
>
> *To provide more time to both taxpayers and the tax administration to address all related issues, I propose to defer the applicability of the GAAR provisions by one year. The GAAR provisions will now apply to income of Financial Year 2013-14 and subsequent years."*

In the same discussion, the Finance Minister also stated that the clarificatory amendments pertaining to Section 9(1)(i) would not override the provisions of the DTAA and would impact only those countries where transactions were routed through low-tax or no-tax jurisdictions with whom India did not have a DTAA and it is as under:

"Hon. Members are aware that a provision in the Finance Bill which seeks to retrospectively clarify the provisions of the Income Tax Act relating to capital gains on sale of assets located in India through indirect transfers abroad, has been intensely debated in the country and outside. I would like to confirm that clarificatory amendments do not override the provisions of Double Taxation Avoidance Agreement (DTAA) which India has with 82 countries. It would impact those cases where the transaction has been routed through low tax or no tax countries with whom India does not have a Double Taxation Avoidance Agreement.

The retrospective clarificatory amendments which are now under consideration of Parliament will not be used to reopen any cases where assessment orders have already been finalized. I have asked the Central Board of Direct Taxes to issue a policy circular to clearly state this position after the passage of the Finance Bill.

Currently, long term capital gain arising from sale of unlisted securities in the case of Foreign Institutional Investors is taxed at the rate of 10 per cent while other non-resident investors, including Private Equity Investors are taxed at the rate of 20 per cent. In order to provide parity to such investors, I propose to reduce the rate in their case from 20 per cent to 10 per cent on the same lines as applicable to Foreign Institutional Investors....."

(iii) <u>Amendment to Section 90 – GAAR override and TRC requirements</u>

12.20. Section 90 of the Income Tax Act empowers the Central Government to enter into agreements with foreign countries or specified territories for the purpose of granting relief, particularly in respect of double taxation and tax avoidance. The Finance Act, 2012 and the Finance Act, 2013 introduced amendments to Section 90, primarily in light of the introduction of GAAR and to clarify the requirements concerning TRC.

12.21. It is also pertinent to note that Section 90(4) was amended, and the words "a certificate containing such particulars as may be prescribed, of his being a resident" were substituted as follows:

> *"(4) An assessee, not being a resident, to whom an agreement referred to in sub-section (1) applies, shall not be entitled to claim any relief under such agreement unless [a certificate of his being a resident] in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory."*

Further, Section 90(5) was inserted, empowering the Central Government to prescribe additional conditions for treaty benefits. The amendment was made retrospectively applicable from 01.04.2013, thereby applying from the assessment year 2013-14 onwards. For better appreciation, the said provision reads as follows:

> *"(5) The provisions of this section shall not be applicable to the assessee unless he provides such other documents and information, as may be prescribed."*

12.22. As already observed, the Memorandum explaining the provisions of the Finance Bill, 2012, in the context of the insertion of Section 90(4), had stated that while a TRC containing prescribed particulars was a necessary condition for claiming benefits under a DTAA, it was not a sufficient condition. This was sought to be codified through the insertion of Section 90(5) via the Finance Bill, 2013 and the same is reproduced hereunder:

> *"The certificate of being a resident in a country outside India or specified territory outside India, as the case may be, referred to in sub-section (4), shall be necessary but not a sufficient condition for claiming any relief under the agreement referred to therein."*

12.23. However, an uproar from the market led the then Finance Minister to issue a clarification that the proposed amendment would not affect the Mauritius Route. Further, Section 90(5) stated that the relevant documents and information

that would have to be provided by an assessee would be prescribed; the documents and information contemplated therein would have to read as such documents that establish that the transaction of the assessee is not precluded under Chapter XA or Rule 10U. Moreover, Section 90(2A) was amended, with its applicability deferred to 01.04.2016. This amendment aligned the implementation timeline of Section 90(2A) with the broader framework governing treaty benefits and GAAR. The Finance Minister clarified in the Budget Speech that GAAR would apply prospectively to investments made on or after 01.04.2017. The term "investment" was mentioned and not "arrangement". The relevant portion reads as follows:

> *"109. Implementation of the General Anti Avoidance Rule (GAAR) has been a matter of public debate. The investment sentiment in the country has now turned positive and we need to accelerate this momentum. There are also certain contentious issues relating to GAAR which need to be resolved. It has therefore been decided to defer the applicability of GAAR by two years. Further, it has also been decided that when implemented, GAAR would apply prospectively to investments made on or after 01.04.2017."*

Moreover, GAAR was deferred for another two years. The relevant portion of the Finance Bill, 2015 reads as under:

> *"As provided in the Act, GAAR provisions are to come into effect from 1.04.2016. These provisions, therefore, shall be applicable to the income of the financial year 2015-16 (Assessment Year 2016-17) and subsequent years.*
>
> *The implementation of GAAR provisions has been reviewed. Concerns have been expressed regarding certain aspects of GAAR. Further, it has been noted that the Base Erosion and Profit Shifting (BEPS) project under Organisation of Economic Cooperation and Development (OECD) is continuing and India is an active participant in the project. The report on various aspects of BEPS and recommendations regarding the measures to counter it are awaited. It would,*

therefore, be proper that GAAR provisions are implemented as part of a comprehensive regime to deal with BEPS and aggressive tax avoidance.

Accordingly, it is proposed that implementation of GAAR be deferred by two years and GAAR provisions be made applicable to the income of the financial year 2017-18 (Assessment Year 2018-19) and subsequent years by amendment of the Act. Further, investments made up to 31.03.2017 are proposed to be protected from the applicability of GAAR by amendment in the relevant rules in this regard.
This amendment will take effect from 1st April, 2015."

12.24. Prior to the Finance Act, 2012, Section 90(2) provided that where a DTAA exists between India and another country, the provisions of the Act or the DTAA, whichever is more beneficial to the taxpayer, shall apply. Thus, if the provisions of the Income Tax Act impose a higher tax burden, the DTAA provisions will prevail, ensuring a Treaty override in favour of the taxpayer. However, the Finance Act, 2012, in line with the GAAR provisions, inserted Section 90(2A), which created an exception to the Treaty override principle enshrined in Section 90(2). The new provision clarified that GAAR provisions would apply even if they result in tax consequences that take away any benefit despite an existing DTAA. By introducing Section 90(2A), the Legislature curtailed the absolute benefit of Treaty override under Section 90(2) by making it subject to GAAR provisions, thereby preventing Treaty abuse through aggressive tax planning structures. In other words, it now ensured that taxpayer-friendly DTAA provisions would not be available if GAAR is invoked. Further, Section 90(4) was introduced, making the submission of a TRC necessary. These amendments took effect from 01.04.2013, applying to Assessment Year

2013-14 onwards. Section 90(5) mandated that the assessee shall also provide such other documents and information, implying that the existence of a TRC alone need not be treated as sufficient to avoid taxation under the domestic law. This led to ambiguity among investors as to whether a TRC alone was sufficient to establish tax residency. Further, Section 90(3) also empowered the Central Government to assign a meaning, by notification, to any term used in a DTAA that was not defined in either the Act or the Treaty. The Finance Act, 2012 amendment also clarified, by inserting Explanation 3 to Section 90, that such a notification would have retrospective effect from the date the agreement came into force. It took effect retrospectively from 01.10.2009.

Shome Committee Report dated 30.09.2012

12.25. The Expert Committee's recommendations included suggestions for legislative amendments, formulation of rules, and prescribing guidelines for the implementation of GAAR. It also gave observations and recommendations regarding grandfathering of investments and arrangements. The relevant passage is extracted hereunder:

> *"Grandfathering an existing arrangement (instead of existing investments) may inadvertently keep many future advance tax avoidance schemes out of examination under GAAR since a tax avoidance structure itself would receive indefinite protection, and diminish the effectiveness of GAAR. In other words, it would allow an impermissible arrangement to exist in perpetuity if created before commencement of GAAR and grandfathered under GAAR provisions. For instance, if a conduit company (says a letter box company) is incorporated in a favourable jurisdiction in 2008 and this arrangement is grandfathered, then, all future investments made by it would also enjoy tax exemption for the indefinite*

future. Once this was explained, stakeholders agreed that the intention should be to grandfather investments rather than arrangements.

It was also suggested to grandfather only those investments which have remained invested in India for a number of years (say five years or so), this would be unfair to those who invested within the last five years, considering the existing law at that point of time. Thus it is important to grandfather all investments.

In view of the above, the Committee recommends that all investments (though not arrangements) made by a resident or non-resident and existing as on the date of commencement of the GAAR provisions should be grandfathered so that on exit (sale of such investments) on or after this date, GAAR provisions are not invoked for examination or denial of tax benefit."

(emphasis supplied)

Moreover, it also recommended that GAAR will not apply wherever Circular No. 789 is applicable, and the same reads as follows:

"Stakeholders also raised an issue regarding the status of Circular No 789 of 2000 issued by the Govt. The Circular provided that a Certificate of Residence (TRC) issued by the Govt. of Mauritius would constitute sufficient evidence for accepting the status of residence of a person as well as beneficial ownership for applying the tax treaty. Currently, the Revenue cannot look into the genuineness of residence of a company incorporated in Mauritius based on commercial substance, or other criteria, once a TRC is issued by the Mauritius authorities. Thus, the Circular would be in direct conflict with GAAR provisions. Hence, clarity was sought by stakeholders whether the Circular would be withdrawn after commencement of GAAR or, if not withdrawn, whether it would still be applicable to avail treaty benefit.

In view of the above, the Committee recommends that, where Circular No. 789 of 2000 with respect to Mauritius is applicable, GAAR provisions shall not apply to examine the genuineness of the residency of an entity set up in Mauritius.

As needed, the Mauritius treaty itself should be revisited if policy so dictates, rather than challenged indirectly through the use of the GAAR instrument."

(emphasis supplied)

However, it is pertinent to point out that no guidance was issued to this effect thereafter, and the amendments that took away the supremacy of the DTAA were brought into effect.

Clarification issued by the Finance Ministry on TRC dated 01.03.2013

12.26. As already mentioned, upon concerns being raised regarding Section 90(4), which mandated the production of a TRC as a prerequisite for availing benefits under a DTAA, the contents of Section 90(5) and the corresponding Explanatory Memorandum, which stated that while a TRC containing prescribed particulars was a necessary condition, it was not a sufficient condition for claiming DTAA benefits, the Finance Ministry issued a clarification on 01.03.2013, affirming that a TRC issued by the tax authorities of a contracting State would be accepted as conclusive evidence of the assessee's residency in that State. It was explicitly stated that Indian tax authorities would not look beyond the TRC or challenge the residential status of an individual or entity in possession of a valid TRC. The relevant portion reads thus:

> *".....In the explanatory memorandum to the Finance Act, 2012, it was stated that the Tax Residency Certificate containing prescribed particulars is a necessary but not sufficient condition for availing benefits of the DTAA. The same words are proposed to be introduced in the Income-tax Act as sub-section (5) of section 90. Hence, it will be clear that nothing new has been done this year which was not there already last year.*
> *However, it has been pointed out that the language of the proposed sub-section (5) of section 90 could mean that the Tax Residency Certificate produced by a resident of a contracting state could be questioned by the Income Tax Authorities in India. The government wishes to make it clear that that is not the intention of the proposed subsection (5) of section 90.* ***The Tax Residency Certificate produced by a resident of a contracting state will be accepted as evidence that***

he is a resident of that contracting state and the Income Tax Authorities in India will not go behind the TRC and question his resident status.

In the case of Mauritius, circular no. 789, dated 13-4-2000 continues to be in force, pending ongoing discussions between India and Mauritius.
However, since a concern has been expressed about the language of sub-section (5) of section 90, this concern will be addressed suitably when the Finance Bill is taken up for consideration."

(emphasis supplied)

Finance Bill 2013 and Finance Act, 2013

12.27. Accepting the majority of the Shome Committee recommendations, with certain modifications, the Government introduced amendments to Chapter XA and Section 144BA through the Finance Act, 2013. Pursuant to these amendments, the applicability of GAAR was deferred, with its provisions coming into force with effect from 01.04.2016, instead of the earlier date of 01.04.2014, thereby making them applicable from the assessment year 2016-17 onwards. Further, Section 96 was amended to provide that an arrangement would be considered an impermissible avoidance arrangement if the main purpose of such arrangement was to obtain a tax benefit, thereby removing the earlier criterion that included arrangements where obtaining a tax benefit was merely one of the main purposes. Section 96 (2) also laid down that even if the main purpose of the arrangement was not to obtain a tax benefit, it would be presumed to be so if the main purpose of any step in, or part thereof, is to obtain a tax benefit, implying that a tax benefit cannot, either by direct arrangement or indirect arrangement or implication, be the object or purpose of the whole

arrangement, part of the arrangement, or a benefit of any action carried out in furtherance of such arrangement. Section 97 was inserted to determine the arrangements which lack commercial substance. The provisions stated the transactions which would be deemed to lack commercial substance, including transactions involving or including round-trip financing, an accommodating party, offsetting or cancelling transactions, transactions conducted through one or more persons and disguising the value, location, source, ownership or control of funds, transactions that involve the location of an asset or of a transaction or of the place of residence without any substantial commercial purpose other than obtaining a tax benefit, and for that purpose treated certain factors, such as, the duration of an arrangement, tax payments made by the assessee, and the presence of an exit route, as inapplicable in determining whether an arrangement lacked commercial substance. Furthermore, the definition of lack of commercial substance was expanded to include arrangements that do not have a significant effect on the business risks or net cash flows of any party, apart from any effect attributable to the tax benefit. Section 97 (3) made it clear that if the purpose of participation of any party, directly or indirectly in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit for the assessee, irrespective of him being a third party, such party shall be treated as an accommodating party. The provisions literally contemplated stricter scrutiny and took away the unlimited right to avoid tax under the

domestic law by production of a TRC. Chapter XA was to be applicable from assessment year 2018-19 onwards.

12.28. With regard to the applicability of GAAR, guidelines were notified *vide* CBDT Notification dated 23.09.2013, through the insertion of Rules 10U to 10UC in the Income-tax Rules, 1962, along with the prescription of Forms bearing Nos. 3CEG, 3CEH, and 3CEI. These were also to come into force from April 1, 2016. Among these Rules, Rule 10U is paramount as it delineates the scope of applicability and exclusions under GAAR, including the grandfathering provisions. Rule 10(U) reads as follows:

> *"DD. Application of General Anti Avoidance Rule*
> ***Chapter X-A not to apply in certain cases***
>
> *10U. (1) The provisions of Chapter X-A shall not apply to –*
> *(a)an arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of rupees three crore;*
> *(b)Foreign Institutional Investor, –*
> *(i)who is an assessee under the Act;*
> *(ii) who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and*
> *(iii)who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments;*
> *(c)a person, being a non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor;*
> ***(d)any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before the 1st day of April 2017 by such person.***
>
> ***(2) Without prejudice to the provisions of clause (d) of sub-rule (1), the provisions of Chapter X-A shall apply to any arrangement, irrespective of the***

date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after the 1st day of April, 2017.

(3) For the purposes of this rule, -
(i) "Foreign Institutional Investor" shall have the same meaning as assigned to it in the Explanation to section 115AD;
(ii) "off shore derivative instrument" shall have the same meaning as assigned to it in the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 issued under Securities and Exchange Board of India Act, 1992 (15 of 1992);
(iii) "Securities and Exchange Board of India" shall have the same meaning as assigned to it in clause (a) of sub-section (1) of section 2 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);
(iv) "tax benefit" as defined in clause (10) of section 102 and computed in accordance with Chapter X-A shall be with reference to-
(a) sub-clauses (a) to (e) of the said clause, the amount of tax; and
(b) sub-clause (f) of the said clause, the tax that would have been chargeable had the increase in loss referred to therein been the total income."

12.29. GAAR was expressly excluded from applying to income arising from investments made before 30.08.2010, initially. It is necessary to mention that the Rules dealt with two aspects: one is the period of investment and another is the income arising from the transfer of the investment. When the investment is made after the cut-off date, the exemption from the applicability of GAAR is not available. As Chapter XA itself was introduced much later, the Rules were notified with effect from 01.04.2017, and the cut-off date was accordingly amended.

12.30. Further, Rule 10U(2) introduced a crucial distinction wherein an arrangement was not automatically grandfathered in its entirety. In other words, irrespective of the date on which the arrangement was entered into, the provisions of GAAR were to apply if the tax benefit from such an arrangement

was obtained on or after 01.04.2015, initially, and later substituted to be effective from 01.04.2017. This ensured that while pre-existing investments were safeguarded, arrangements that continued to yield tax benefits beyond the specified date remained within the ambit of GAAR, preventing abuse of the grandfathering provisions. Therefore, any benefit arising out of any arrangement that has yielded a benefit of more than Rupees Three Crores after 01.04.2017, when the amount of tax benefit arising in aggregate to all the parties is above Rs. Three Crores, can be subject to scrutiny under GAAR, and an assessee simply cannot walk away by citing that the investments were made prior to 01.04.2017. The use of the word "any arrangement" is exhaustive enough to include any benefit arising out of the sale of shares.

DTAA Amendment

12.31. To address long-pending issues of Treaty abuse and round-tripping of funds associated with the DTAA, and to curb revenue loss, prevent double non-taxation, streamline investment flows, and enhance the exchange of information between the countries, the DTAA was amended through a Protocol signed on 10.05.2016. The amendments, which came into effect from 01.04.2017, introduced significant changes to Article 13. More particularly, two new paragraphs were inserted, effectively vesting the right to tax capital gains arising from "transfer of investments" acquired on or after 01.04.2017, with the source jurisdiction. Needless to mention that the sale of shares is a transfer of

investment. Further, capital gains on such shares, if derived between 01.04.2017 and 31.03.2019, would be eligible for a concessional tax rate, 50% of the prevailing rate in the source State, subject to the fulfilment of conditions specified in the LOB clause under the newly introduced Article 27A. At the same time, it was clarified that existing investments, i.e., those made before 01.04.2017, would be grandfathered and would not be subject to capital gains taxation in India.

12.32. Further, Press Release dated 10.05.2016 stated that the Protocol for amendment of the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on income and capital gains between India and Mauritius was signed by both countries on 10.05.2016 at Port Louis, Mauritius. The key features of the Protocol are as under:

> *"**(i) Source-based taxation of capital gains on shares:** With this Protocol, India gets taxation rights on capital gains arising from alienation of shares acquired on or after 1st April, 2017 in a company resident in India with effect from financial year 2017-18, while simultaneously protection to investments in shares acquired before 1st April, 2017 has also been provided. Further, in respect of such capital gains arising during the transition period from 1st April, 2017 to 31st March, 2019, the tax rate will be limited to 50% of the domestic tax rate of India, subject to the fulfillment of the conditions in the Limitation of Benefits Article. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.*
>
> ***(ii) Limitation of Benefits (LOB):** The benefit of 50% reduction in tax rate during the transition period Mauritius from 1st April, 2017 to 31st March, 2019 shall be subject to LOB Article, whereby a resident of (including a shell/ conduit company) will not be entitled to benefits of 509% reduction in tax rate, if it fails the main purpose test and bonafide business test. A resident is deemed to be a shell/ conduit company, if its total expenditure on operations in Mauritius is less*

than Rs. 2,700,000 (Mauritian Rupees 1,500,000) in the immediately preceding 12 months.

(iii) Source-based taxation of interest income of banks: *Interest arising in India to Mauritian resident loans made after subject 31st to March, withholding tax in India at the rate of 7.5% in respect of debt claims or of debt-claims 2017. However, interest income of Mauritian resident banks in respect existing on or before 31st March 2017 shall be exempt from tax in India.*

(iv) The Protocol provision also provides for updation of Exchange of Information Article as per international for assistance in collection of taxes, source-based taxation of other income. amongst other changes.

Major impact: *The Protocol will tackle the long pending issues of treaty abuse and round tripping of funds investment and India-Mauritius treaty, curb revenue loss, prevent double non-taxation, streamline the flow of stimulate the flow of exchange of information between India and Mauritius, It will improve transparency investments, i.e. in tax matters and will help curb tax evasion and tax avoidance. At the same time, existing investments, i.e. investments made before 1.4.2017 have been grand-fathered and will not be subject to capital gains taxation in India."*

12.33. It is also to be pointed out that the following provisions were inserted in Article 13 and they are:

*"**3A.** Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.*

***3B.** However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated;"*

Further, Article 13(4) was amended. However, it still left the taxing rights of any property, other than that mentioned in paragraphs 1, 2, 3, and 3A, with the residence State. After Amendment, Article 13(4) reads as under:

> *"**4.** Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident."*

12.34. The LOB under Article 27A was restricted solely to capital gains and was only to be in force for two years. It was a transitional provision. The conditions contained in the LOB stated that the entity should not be (a) arranged with the primary purpose of taking advantage of the particular provision, or (b)a shell/conduit company. An entity fulfilling the former criterion appears to also satisfy the *bona fide* business activities test. A shell/conduit company is defined as an entity "with negligible or nil business operations or with no real and continuous business activities carried out in the Contracting State." An entity is deemed to be not a "shell/conduit company" if (a) in the immediately preceding twelve-month period its expenditure on operations is equal to or more than INR 2.7 million, or (b) the entity is listed on a recognised stock exchange in one of the Contracting States. It will be useful to refer to Article 27A, which reads as follows:

> *"**Article 27A**: Limitation of Benefits*
> *1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.*
>
> *2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.*

3. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian Rs.1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

4. A resident of a Contracting State is deemed not to be a shell/conduit company if:
(a) it is listed on a recognized stock exchange of the Contracting State; or
(b) its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs.1,500,000 or Indian Rs.2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.
Explanation: The cases of legal entities not having bona fide business activities shall be covered by Article 27A(1) of the Convention."

Clarification dated 27.01.2017 on implementation of GAAR provisions

12.35. Finally, GAAR was to be implemented from AY 2018-19 onwards. The Ministry of Finance issued a Clarification dated 27.01.2017 regarding "arrangement" and the "grandfathering" provisions. The relevant portions are extracted as under:

"……Stakeholders and industry associations had requested for clarifications on implementation of GAAR provisions and a Working Group was constituted by CBDT to examine the issues raised. Accordingly, CBDT has issued the clarifications on implementation of GAAR provisions on 27th January, 2017.

Amongst others, it has been clarified that if the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply. GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction. Further, grandfathering as per IT Rules will be available to compulsorily convertible instruments, bonus issuances or split / consolidation of holdings in respect of investments made prior to 1st April 2017 in the hands of same investor. It has also been clarified that adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. However, if a case of avoidance is sufficiently addressed by

Limitation of Benefits (LoB) provisions in the tax treaty, there shall not be an occasion to invoke GAAR.

It has been clarified that if at the time of sanctioning an arrangement, the Court has explicitly and adequately considered the tax implications, GAAR will not apply to such an arrangement. It has also been clarified that GAAR will not apply if an arrangement is held as permissible by the Authority for Advance Rulings. Further, it has been clarified that if an arrangement has been held to be permissible in one year by the PCIT/CIT/Approving Panel and the facts and circumstances remain the same, GAAR will not be invoked for that arrangement in a subsequent year.

The proposal to apply GAAR will be vetted first by the Principal Commissioner of Income Tax /Commissioner of Income Tax and at the second stage by an Approving Panel headed by a judge of High Court. The stakeholders have been assured that adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner……"

CBDT press release dated 27.01.2017

12.36. The CBDT issued a Press Release dated 27.01.2017 clarifying the applicability of GAAR. The relevant portions are as under:

"The provisions of General Anti Avoidance Rule (GAAR) are contained in Chapter X-A of the Income Tax Act, 1961. The GAAR provisions shall be effective from assessment year 2018-19 onwards, i.e. financial year 2017-18 onwards. The necessary procedures for application of GAAR and conditions under which it shall not apply, have been enumerated in Rules 10U to 10UC of the Income-tax Rules, 1962.

***Question no. 1**: Will GAAR be invoked if SAAR applies?*
***Answer:** It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.*

***Question 2:** Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?*
***Answer:** Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled*

through domestic anti-avoidance rules, If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.

Question 5: *Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?*
Answer: *Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 10U(1)(d) of the Income Tax Rules.*

Question 6: *The expression "investments" can cover investment in all forms of instrument - whether in an Indian Company or in a foreign company so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, aircraft leases) and loan arrangements, etc.*
Answer: *Grandfathering is available in respect of income from transfer of investments made before 1st April 2017. As per Accounting Standards "investments" are assets held by an enterprise for earning income by way of dividends, interest, rentals `and for capital appreciation Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.*

Question 7: *Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling?*
Answer: *No. The AAR ruling is binding on the PCIT / CIT and the Income Tax Authorities subordinate to him in respect of the applicant.*

Question 8: *Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?*
Answer: *Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement."*

(C) DISCUSSION AND FINDINGS

13. Let us first consider and discuss the relevant provisions of the DTAA and their application to the instant case. Article 1(e) defines the term "person" to include an individual, a company, and any other entity, corporate or non-corporate, which is treated as a taxable unit under the taxation laws in force in the respective Contracting States. Further, the Ministry of Finance (Department of Revenue) of the Central Government, in the case of India, and the Commissioner of Income Tax, in the case of Mauritius, are designated as the "competent authority". As already stated, the applicability of the DTAA is determined by Article 4, which at the cost of repetition, is extracted below:

> *"**Article 4 - Residents**:*
> *1. For the purposes of the Convention, the term "resident of a Contracting State" means any person who under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place or management or any other criterion of similar nature. The terms "resident of India" and "resident of Mauritius" shall be construed accordingly.*
>
> *2. Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his residential status for the purposes of this Convention shall be determined in accordance with the following rules:*
> *(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (hereinafter referred to as his "centre of vital interests");*
> *(b) if the Contracting State in which he has his centre of vital interest cannot be determined, or if he does not have a permanent home available to him in either Contracting State he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;*
> *(c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;*

(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provision of paragraph 1, a person other than an individual is a resident of both the Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated."

14. The Agreement allocates taxing jurisdiction between the Contracting States with respect to different heads of income. Detailed rules govern the taxation of dividends (Article 10), interest (Article 11), royalties (Article 12), capital gains (Article 13), income from independent personal services (Article 14), income from dependent personal services (Article 15), directors' fees (Article 16), income of artists and athletes (Article 17), governmental functions (Article 18), income of students and apprentices (Article 20), income of professors, teachers and research scholars (Article 21), and other income (Article 22).

15. At the outset, it is necessary to examine the scope of Article 13 of the DTAA, which governs the taxation of capital gains. It provides that gains from the alienation of immovable property may be taxed in the Contracting State in which such property is situated. Gains derived by a resident of a Contracting State from the alienation of movable property forming part of the business property of a permanent establishment, or pertaining to a fixed base for performing independent personal services, may be taxed in the State in which

such permanent establishment or fixed base is situated. Gains from the alienation of ships and aircraft operated in international traffic, and movable property pertaining thereto, are taxable only in the Contracting State in which the place of effective management is situated. With respect to capital gains derived by a resident of a Contracting State from the alienation of any other property, taxation is confined to the State in which such person is a resident.

16. Notably, a careful reading of Article 13(2) illustrates that it covers cases where the gain arises from the sale of movable property forming part of a permanent establishment or fixed base of a Mauritian-resident company in the other Contracting State. The expression used is "in the other Contracting State" and not "owned by an establishment in another State", thereby implying that it applies only where the sale relates to movable property of a permanent establishment directly owned by the Mauritian company in the other State. Transactions such as the present one would not fall within its sweep.

17. Further, Article 13 (3A), which was inserted in 2016, applies to cases involving the sale of shares of a company in a Contracting State acquired on or after 01.04.2017, and provides for taxation in the source State. This again depends upon the situs of the company whose shares are directly held and sold by the Mauritian entity. Under Article 13(4), all transactions not covered under Paragraphs 1, 2, 3 and 3A are taxable in the State of residence.

18. Thus, on a combined reading, it seems clear that for the benefit under Article 13(4), the person claiming treaty protection must not only qualify as a "resident" of the other State i.e., Mauritius, but also establish that the movable property or shares forming the subject matter of the transaction are directly held by such resident entity. In all other cases, the transaction is taxable in India, where the capital gains arise out of the disposition of movable property, including movable property forming part of the business property held by a permanent establishment in India. Thus, an indirect sale of shares would not, at the threshold, fall within the treaty protection contemplated under Article 13.

19. It is now necessary to consider the conditions under which a DTAA may be invoked, and the extent to which such treaties operate within the framework of domestic tax law. Pertinently, the cut-off date on the sale of shares contemplated under the Agreement in Article 13 is restricted only to cases falling under Paragraph 3A, and transactions falling outside its purview are governed by Article 13(4), subject to the alienator being a resident. The object of the DTAA is to prevent double taxation and not to facilitate avoidance or evasion of tax. Therefore, for the treaty to be applicable, the assessee must prove that the transaction is taxable in its State of residence. The amendments to the Agreement as discussed above, were introduced precisely to prevent revenue loss to the State where the gains actually arise, by abuse of the Treaty. The

assessee, hence, has to establish that it is a resident of the Contracting State covered by the DTAA by producing all relevant documents.

20. Article 25 lays down the Mutual Agreement Procedure. It provides that where a resident of a Contracting State considers that the actions of one or both Contracting States result, or will result, in taxation not in accordance with the Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident. The complaint must be lodged within three years of receipt of the notice giving rise to such taxation. If the objection appears to be justified, the competent authority shall endeavour to resolve the matter by mutual agreement with the competent authority of the other Contracting State so as to avoid taxation inconsistent with the Convention. Article 25 also provides for continuous communication between the competent authorities to resolve doubts regarding interpretation or application of the Convention.

21. At this stage, it is relevant to recall the purpose of a Double Taxation Treaty or Convention and importantly, to note that such treaties are entered into pursuant to the enabling provisions of Chapter IX of the Income Tax Act and must be read harmoniously with other provisions of the Act. Section 4 provides for the charge of income-tax. Section 5 stipulates the scope of total income. The total income of a resident includes income received or accrued in India or

outside India. In the case of a non-resident, the total income includes all income received or deemed to be received in India, or accruing or deemed to accrue in India. A resident is taxable on global income, subject to the exception of persons "not ordinarily resident" as defined in Section 6. The residence of a company is determined by the situs of control and management.

22. Indisputably, every country seeks to tax income generated within its territory on the basis of one or more connecting factors such as the situs of the transaction, source of income, residence of the taxable entity, maintenance of a permanent establishment, and so on. The sovereign right to tax, as settled in law, is in the larger public interest and for the development of the country. A country might choose to emphasise one or the other of the aforesaid factors for exercising fiscal jurisdiction to tax an entity. Depending on which factor is considered the connecting factor in different countries, the same income of the same entity may become taxable in multiple jurisdictions, resulting in hardship and impeding economic activity. To avoid such anomalies, States enter into bilateral treaties for granting relief against double taxation. These are known as DTAAs.

23. The power to enter into treaties is an incident of the sovereign authority of the State. Under Article 73 of the Constitution, the executive power of the Union extends to matters on which Parliament may legislate. However, the executive power of the Union shall not extend to matters over which the State

has authority to legislate, unless expressly provided under the Constitution. The Executive, *qua* the State, is competent to represent the State in all international matters relating to subjects over which it can legislate and may, by agreement, convention or treaty, incur obligations which, in international law, are binding upon the State. However, the obligations arising under the agreements or treaties cannot *ipso facto* affect the rights of the citizens of the country. The power to legislate in respect of treaties lies with Parliament under Entries 10 and 14 of List I of the Seventh Schedule. An enactment in the form of a law under that authority is necessary when the treaty or agreement operates to restrict the rights of citizens or others, or modifies the law of the State. If the rights of citizens or others which are justiciable are not affected, no legislative measure is needed to give effect to the agreement or treaty, because of the power of judicial review vested in constitutional courts to protect the fundamental and constitutional rights guaranteed under the Constitution.

24. In cases of fiscal treaties dealing with double taxation avoidance, different countries have varying procedures. In the United States, such a treaty becomes a part of municipal law upon ratification by the Senate. In the United Kingdom, such a treaty would have to be endorsed by an order made by the Queen in Council. In India, since such a treaty has to be approved by an Act of Parliament, a special procedure was evolved by enacting Section 90 of the Act. The purpose of Section 90 becomes clear by reference to its legislative history.

Section 49A of the Income-tax Act, 1922 enabled the Central Government to enter into an agreement with the Government of any country outside India for the granting of relief in respect of income on which both income-tax (including super-tax) under the Act and income-tax in that country, under the corresponding law in force therein, had been paid. The Central Government could make such provisions as necessary for implementing the agreement by notification in the Official Gazette. When the Income-tax Act, 1961 was introduced, Section 90 contained therein was initially a reproduction of Section 49A of the 1922 Act. The Finance Act, 1972 (Act 16 of 1972) modified Section 90 and brought it into force with effect from 01.04.1972. The object and scope of the substitution were explained by CBDT Circular No. 108 dated 20.03.1973. The said circular clarified that the purpose was to empower the Central Government to enter into agreements with foreign countries not only for the avoidance of double taxation of income but also for enabling tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income, for investigation of cases involving tax evasion or avoidance, or for recovery of taxes in foreign countries on a reciprocal basis. In 1991, the existing Section 90 was renumbered as sub-section (1), and sub-section (2) was inserted by the Finance Act, 1991 with retrospective effect from 01.04.1972. CBDT Circular No. 621 dated 19.12.1991 reads as follows:

> *"Taxation of foreign companies and other non- resident taxpayers-*
> *43. Tax treaties generally contain a provision to the effect that the laws of the two contracting States will govern the taxation of income in the respective State*

except when express provision to the contrary is made in the treaty. It may so happen that the tax treaty with a foreign country may contain a provision giving concessional treatment to any income as compared to the position under the Indian law existing at that point of time. However, the Indian law may subsequently be amended, reducing the incidence of tax to a level lower than what has been provided in the tax treaty.

43.1. Since the tax treaties are intended to grant tax relief and not put residents of a contracting country at a disadvantage vis-à-vis other taxpayers, section 90 of the Income-tax Act has been amended to clarify that any beneficial provision in the law will not be denied to a resident of a contracting country merely because the corresponding provision in the tax treaty is less beneficial."

25. In ***K.P. Varghese v. Income-Tax Officer, Ernakulam***[19]**,** this Court held that not only are the circulars and instructions issued by the CBDT in exercise of the power under Section 119 binding on the authorities administering the tax department, but they are also clearly in the nature of *contemporanea exposition,* furnishing legitimate aid to the construction of the Act. The rule of *contemporanea expositio* is that administrative construction i.e., contemporaneous construction placed by administrative or executive officers, should generally not be overturned unless it is clearly wrong; such a construction, though non-controlling, is nevertheless entitled to considerable weight and is highly persuasive. It was further held that the circulars issued by the CBDT in exercise of its power under Section 119 are legally binding on the Revenue. Such binding force attaches to these circulars even where they are found not to be in strict accordance with the correct interpretation of sub-section (2) or where they depart from the proper statutory construction.

[19] AIR 1981 SC 1922

26. In ***Commissioner of Income-Tax v. Anjum M.H. Ghaswala and Others***[20], it was pointed out that the circulars issued by the CBDT under Section 119 of the Act have statutory force and are binding on every income-tax authority, although such may not be the case with regard to press releases issued by the CBDT for the information of the public.

27. No doubt, the provisions of Sections 4 and 5 of the Act are expressly made subject to the provisions of the Act, which would include Section 90. The judicial consensus in India has been that Section 90 is specifically intended to enable and empower the Central Government to issue a notification for the implementation of the terms of a DTAA. However, the amendments subsequent to the *Vodafone* to Chapter IX, the insertion of Chapter XA, the amendments to Rule 10U, and the DTAA have completely changed the scenario. Circulars issued earlier, though binding on the Revenue at the time of their issuance, operate only within the legal regime in which they were issued and cannot override subsequent statutory amendments. It is equally settled law that Parliament is well within its right to bring in a law, either by amendment, substitution, or introduction so as to remove the basis of a judicial decision. It will be useful to refer to the judgment of this Court in ***Hindustan Construction Company Limited and others v. Union of India and others***[21], on this aspect:

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[20] 2001 INSC 519
[21] MANU/SC/1638/2019: 2020 (17) SCC 324

"41. Dr. Singhvi has argued, based on a number of judgments of this Court, that the question of removing the basis of a judgment cannot arise unless and until the judgment is present to the mind of the legislature. He stated that in all the major cases in which a judgment of a court is nullified by removing its basis, the judgment in question has been expressly referred to in the concerned Statement of Objects and Reasons. We are afraid that we cannot agree with this line of argument. What is important is to see whether, in substance, the basis of a particular judgment is in fact removed, whether or not that judgment is referred to in the Statement of Objects and Reasons of the amending act which seeks to remove its basis.

42. In ***Shri Prithvi Cotton Mills Ltd. and Anr. v. Broad Borough Municipality and Ors.*** *MANU/SC/0057/1969 : (1969) 2 SCC 283, this Court held:*
4.*....Granted legislative competence, it is not sufficient to declare merely that the decision of the Court shall not bind for that is tantamount to reversing the decision in exercise of judicial power which the Legislature does not possess or exercise. A court's decision must always bind unless the conditions on which it is based are so fundamentally altered that the decision could not have been given in the altered circumstances.*

43. In ***State of Tamil Nadu v. Arooran Sugars Ltd.*** *MANU/SC/0426/1997 : (1997) 1 SCC 326, this Court after setting out what was held in* ***Shri Prithvi Cotton Mills*** *(supra) stated:*
16.*..The same view was reiterated in the cases of West Ramnad Electric Distribution Co. Ltd. v. State of Madras MANU/SC/0060/1962 : [(1963) 2 SCR 747 : AIR 1962 SC 1753]; Udai Ram Sharma v. Union of India [MANU/SC/0154/1968 : (1968) 3 SCR 41 : AIR 1968 SC 1138]; Tirath Ram Rajindra Nath v. State of U.P. [MANU/SC/0555/1972 : (1973) 3 SCC 585: 1973 SCC (Tax) 300]; Krishna Chandra Gangopadhyaya v. Union of India [MANU/SC/0143/1975 : (1975) 2 SCC 302]; Hindustan Gum & Chemicals Ltd. v. State of Haryana [MANU/SC/0254/1985 : (1985) 4 SCC 124]; Utkal Contractors and Joinery (P) Ltd. v. State of Orissa [MANU/SC/0125/1987 : 1987 Supp SCC 751]; D. Cawasji & Co. v. State of Mysore [MANU/SC/0254/1984 : 1984 Supp SCC 490: 1985 SCC (Tax) 63] and Bhubaneshwar Singh v. Union of India [MANU/SC/0844/1994 : (1994) 6 SCC 77]. It is open to the legislature to remove the defect pointed out by the court or to amend the definition or any other provision of the Act in question retrospectively. In this process it cannot be said that there has been an encroachment by the legislature over the power of the judiciary. A court's directive must always bind unless the conditions on which it is based are so fundamentally altered that under altered circumstances such decisions could not have been given. This will include removal of the defect in a statute pointed out in the judgment in question, as well as alteration or substitution of provisions of the enactment on which such judgment is based, with retrospective effect.*

> *44. Likewise, in* ***Goa Foundation v. State of Goa*** *MANU/SC/0334/2016 : (2016) 6 SCC 602, this Court held:*
>
> ***24****...The power to invalidate a legislative or executive act lies with the Court. A judicial pronouncement, either declaratory or conferring rights on the citizens cannot be set at naught by a subsequent legislative act for that would amount to an encroachment on the judicial powers. However, the legislature would be competent to pass an amending or a validating act, if deemed fit, with retrospective effect removing the basis of the decision of the Court. Even in such a situation the courts may not approve a retrospective deprivation of accrued rights arising from a judgment by means of a subsequent legislation (Madan Mohan Pathak v. Union of India [Madan Mohan Pathak v. Union of India, MANU/SC/0253/1978 : (1978) 2 SCC 50 : 1978 SCC (L & S) 103]). However, where the Court's judgment is purely declaratory, the courts will lean in support of the legislative power to remove the basis of a court judgment even retrospectively, paving the way for a restoration of the status quo ante. Though the consequence may appear to be an exercise to overcome the judicial pronouncement it is so only at first blush; a closer scrutiny would confer legitimacy on such an exercise as the same is a normal adjunct of the legislative power. The whole exercise is one of viewing the different spheres of jurisdiction exercised by the two bodies i.e. the judiciary and the legislature. The balancing act, delicate as it is, to the constitutional scheme is guided by the well-defined values which have found succinct manifestation in the views of this Court in Bakhtawar Trust [Bakhtawar Trust v. M.D. Narayan, MANU/SC/0390/2003 : (2003) 5 SCC 298].”*

After the amendment has come into effect, there can be no doubt whatsoever that a TRC alone is not sufficient to avail the benefits under the DTAA, and reliance upon earlier judgments dealing with circulars issued in the pre-amendment regime cannot *ipso facto* come to the aid of the respondents. Rather, the facts will have to be independently analysed to decide on the applicability of Chapter XA.

28. Thus, the first step is to examine whether the transaction falls within the scope of Section 9(1)(i) of the Act, which deems income arising from the

transfer of a capital asset situated in India to accrue in India. Explanation 5 to the said provision extends this deeming fiction to cover shares in a foreign company if such shares derive, directly or indirectly, their value substantially from assets located in India. Once domestic taxability is established, the second limb of the analysis considers whether such taxability is curtailed or overridden by the DTAA. This enquiry centres on: (a) whether the taxpayer is a "resident" of Mauritius within the meaning of Article 4(1) of the DTAA; (b) whether the transaction falls within the scope of Article 13(3A) and 13(3B), introduced via the 2016 Protocol, or Article 13(4), a residuary rule; and (c) whether the limitation of benefits clause under Article 27A applies to deny treaty protection.

29. At this juncture, it is important to note that as the provisions have undergone a sea change by amendments to Chapter IX, Chapter XA of the Act and Rule 10U, the assessing officers under the Indian Income-tax Act, 1961 are now empowered to determine where taxable entities are really resident by investigating the centre of their management, and thereafter to apply the provisions of the Act to the global income earned by them by reason of Sections 4 and 5. The amendments to the Act, the Rules, and the terms of the agreement which have enabled strict scrutiny, cannot be ignored, and relief cannot be *ipso facto* granted. It is to be borne in mind that the income-tax authorities were seeking to examine whether the assessees were in fact residents of a third country on the basis of alleged control and management being exercised from

that country. The term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of domicile, residence, place of management, or any other criterion of a similar nature. The terms "resident of India" and "resident of Mauritius" are to be construed accordingly.

30. As already mentioned, Article 13 of the DTAA lays down detailed rules with regard to taxation of capital gains. As far as capital gains resulting from the alienation of shares are concerned, Article 13(4) provides that the gains derived by a "resident" of a Contracting State shall be taxable only in that State. Article 4 declares that the term "resident of Mauritius" means any person who, under the laws of Mauritius, is liable to taxation therein by reason, *inter alia*, of residence. Clause (2) of Article 4 enumerates detailed rules as to how the residential status of an individual resident in both Contracting States is to be determined for the purposes of the DTAA. Clause (3) of Article 4 provides that if, after application of the detailed rules provided therein, a person other than an individual is found to be a resident of both Contracting States, the benefit under the DTAA cannot be availed. The benefit of exemption available to a resident by virtue of the DTAA is not available if the transaction is taxable in the source State.

31. In ***McDowell,*** Justice Ranganath Mishra, writing for the majority, held as under:

*"**25.** We may also recall the observations of Viscount Simon in Latilla v. I.R.C. (1943) 25 T C 107:*

Of recent years much ingenuity has been expended in certain quarters in attempting to devise methods of disposition of income by which those who were prepared to adopt them might enjoy the benefits of residence in this country while receiving the equivalent of such income, without sharing in the appropriate burden of British taxation. Judicial dicta may be cited which point out that, however elaborate and artificial such methods may be, those who adopt them are "entitled" to do so. There is, of course, no doubt that they are within their legal rights, but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary one result of such methods, if they succeed, is of course to increase pro tanto the load of tax on the shoulders of the great body of good citizens who do not desire, or do not know how, to adopt these maneuvers. Another consequence is that the Legislature has made amendments to our Income Tax Code which aim at nullifying the effectiveness of such schemes."

***26.** Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges.*

***46.** On this aspect one of us, Chinnappa Reddy, J., has proposed a separate and detailed opinion with which we agree."*

In the same Judgment, O. Chinnappa Reddy, J. while concurring with the judgment of the five-Judge Bench, observed as follows:

*"**46.** We think that time has come for us to depart from the Westminster [1936 AC 1 : 1935 All ER Rep 259] principle as emphatically as the British Courts have done and to dissociate ourselves from the observations of Shah, J. and similar observations made elsewhere. The evil consequences of tax avoidance are manifold. First there is substantial loss of much needed public revenue, particularly in a Welfare State like ours. Next there is the serious disturbance caused to the economy of the country by the piling up of mountains of black-money, directly causing inflation. Then there is "the large hidden loss" to the community (as pointed out by Master Wheatcroft [18 Modern Law Review 209]) by some of the best brains in the country being involved in the perpetual war waged between the tax-avoider and his expert team of advisers, lawyers, and accountants on one side and the tax-gatherer and his perhaps not so skilful,*

advisers on the other side. Then again there is the "sense of injustice and inequality which tax avoidance arouses in the breasts of those who are unwilling or unable to profit by it". Last but not the least is the ethics (to be precise, the lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of the "artful dodgers". It may, indeed, be difficult for lesser mortals to attain the state of mind of Mr Justice Holmes, who said, "Taxes are what we pay for civilized society. I like to pay taxes. With them I buy civilization". But, surely, it is high time for the judiciary in India too to part its ways from the principle of Westminster and the alluring logic of tax avoidance. We now live in a Welfare State whose financial needs, if backed by the law, have to be respected and met. We must recognise that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less moral plane than honest payment of taxation. In our view, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax, and whether the transaction is such that the judicial process may accord its approval to it. A hint of this approach is to be found in the judgment of Desai, J. in Wood Polymer Ltd. and Bengal Hotels Limited, In re [47 Com Cas 597 (Guj HC)] where the learned Judge refused to accord sanction to the amalgamation of companies as it would lead to avoidance of tax.

***47.** It is neither fair nor desirable to expect the Legislature to intervene and take care of every device and scheme to avoid taxation. It is up to the Court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of "emerging" techniques of interpretation (sic as) was done in Ramsay [1982 AC 300 : (1981) 1 All ER 865] , Burmah Oil [1982 STC 30] and Dawson [(1984) 1 All ER 530] , to expose the devices for what they really are and to refuse to give judicial benediction.*
..."

32. Given the settled anti-avoidance principles, Parliament has statutorily empowered the AAR to reject applications at the threshold where the transaction appears *prima facie* tax-avoidant. Section 245R(2) of the Income-tax Act reads as under:

> *"2. The Authority may, after examining the application and the records called for, by order either allow or reject the application:*
> *Provided that the Authority shall not allow the application where the question raised in the application:*
> *(i) is already behind before any income-tax authority or Appellate Tribunal except in case of a resident applicant falling in sub-clause (iii) of clause (b) of Section 45N or any court;*
> *(ii) involves market value of any property;*
> *(iii) relates to a transaction or issue which is prima facie for the avoidance of income tax except in case of a resident applicant falling under sub-clause (iii) of clause (b) of Section 245N or in case of an applicant falling in sub-clause (iiia) of clause (b) of Section 245N.*

33. In the present case, the AAR invoking Section 245R(2), rejected the applications of the non-resident applicants on the ground that the transaction was *prima facie* for the avoidance of income tax. The AAR relied upon the method of operation to ascertain the effective control and management of the applicants to hold that the effective management was not in Mauritius and was, in fact, with Mr. Charles P. Coleman in the USA. Having coming to this conclusion, the emphasis then shifts to the identity of the assessees in the transaction for the purpose of exemption, and the enquiry of the AAR into whether the shares sold were those of an Indian company pale into insignificance. Once taxability has been established on the basis that the shares sold derive their value from shares or assets in India, the AAR, basing its reasoning for rejection of exemption to the assessees only on the ground that the sale of shares was not that of an Indian company, may be an enquiry in the wrong direction. The validity of such rejection must be examined in the light of the statutory threshold prescribed under Section 245R(2).

34. At the outset, it can be seen that the language employed in Section 245R(2) is clear. It uses the word "*prima facie*". The use of the term "*prima facie*" implies that it is sufficient if the AAR, on an initial examination of the documents, is satisfied that the transaction is for avoidance of income tax and can reject the application. The provision is couched in such a way that the burden lies on the person claiming a particular fact, and such *prima facie* opinion is sufficient to reject the application. The level of satisfaction required to arrive at a *prima facie* conclusion is much less when compared to a case where a fact has to be proved. This Court, in the judgment in ***Balvir Singh v. State of Uttarkhand***[22], held as under:

> ***"47.*** *The Latin expression prima facie means "at first sight", "at first view", or "based on first impression". According, to Webster's Third International Dictionary (1961 Edn.), "prima facie case" means a case established by "prima facie evidence" which in turn means "evidence sufficient in law to raise a presumption of fact or establish the fact in question unless rebutted". In both civil and criminal law, the term is used to denote that, upon initial examination, a legal claim has sufficient evidence to proceed to trial or judgment. In most legal proceedings, one party (typically, the Plaintiff or the prosecutor) has a burden of proof, which requires them to present prima facie evidence for each element of the charges against the Defendant. If they cannot present prima facie evidence, or if an opposing party introduces contradictory evidence, the initial claim may be dismissed without any need for a response by other parties.*

35. In ***Martin Burn Ltd. v. R.N. Banerjee***[23]**,** this Court, while considering whether a *prima facie* case is made out or not, held as under:

> *"A prima facie case does not mean a case proved to the hilt but a case which can be said to be established if the evidence which is led in support of the same*

[22] MANU/SC/1092/2023: AIR 2023 SC 5551
[23] MANU/SC/0081/1957: AIR 1958 SC 79,

were believed. While determining whether a prima facie case had been made out the relevant consideration is whether on the evidence led it was possible to arrive at the conclusion in question and not whether that was the only conclusion which could be arrived at on that evidence. It may be that the Tribunal considering this question may itself have arrived at a different conclusion. It has, however, not to substitute its own judgment for the judgment in question. It has only got to consider whether the view taken is a possible view on the evidence on the record.
(See Buckingham and Carnatic Co., Ltd. Case 1952 L.A.C. 490."

36. In this context, it becomes necessary to reiterate the limited evidentiary role of a TRC in proceedings under Section 245R(2), particularly in view of the statutory amendments which now govern the field, notwithstanding earlier circulars. All that is required for the AAR, in the case of an application by a non-resident, is to see whether the contents of the application and the documents disclose a transaction by which an attempt is made to avoid payment of tax, if it is otherwise taxable under law. The language of the provision has to be read in tandem with the object of the respective provisions of the Income-tax Act and the Rules as applicable to the facts of the case. The High Court, in our view, was not right in observing that since the appellants have been in existence from 2011 onwards, such a presumption cannot be made by relying upon the judgments of this Court which were rendered prior to the amendment of the provisions, wherein, by necessary amendment, the mere existence of a TRC is now held to be insufficient to establish the resident status of the applicant in the other State.

37. Section 90(4) of the Act only speaks of the TRC as an "eligibility condition". It does not state that a TRC is "sufficient" evidence of residency, which is a slightly higher threshold. The TRC is not binding on any statutory authority or Court unless the authority or Court enquires into it and comes to its own independent conclusion. The TRC relied upon by the applicant is non-decisive, ambiguous and ambulatory, merely recording futuristic assertions without any independent verification. Thus, the TRC lacks the qualities of a binding order issued by an authority.

38. 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. These twin rights are referred to as residence-based or source-based taxation. We also do not find that even in the judgments relied upon by the respondents rendered prior to the amendment, this Court had totally shut out the case of the Revenue when it comes to a fraudulent or fictitious transaction. On the facts of the present case, each case has to be evaluated on its own facts.

39. The DTAA is a treaty. As already noted, treaty provisions are expressions of sovereign policy of more than one sovereign State, negotiated and entered into at a political/diplomatic level and having several explicit and/or subliminal and unarticulated considerations as their bases. A tax treaty must be seen in the context of aiding commercial relations between treaty partners and as being

essentially a bargain between Contracting States as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions. As *Azadi Bachao Andolan* has noticed, treaty negotiations are essentially a bargaining process, with each side seeking concessions from the other. The final agreement would often represent several compromises, and it may be uncertain whether a full and sufficient *quid pro quo* is obtained by both sides. Many developed countries tolerate or encourage even treaty shopping, even if it is unintended, improper or unjustified, for other and non-tax reasons, unless it leads to a significant loss of tax revenue, and allow the use of treaty networks to attract foreign enterprises and offshore activities. Some States favour treaty shopping for outbound investment to reduce foreign taxes of their tax residents but dislike their own loss of tax revenue on inbound investment or trade of non-residents. All these are sovereign policy choices. Developing countries need foreign investments, and treaty shopping opportunities could be an additional factor in attracting them. There are many principles in a fiscal economy which, though they may facially appear inequitable, are tolerated in a developing economy in the interest of long-term development.

40. Amendments to the DTAA were made through a Protocol signed on 10.05.2016. They were made for the purpose of shutting the back door that was available to residents of the Contracting Parties to completely evade taxation, and to residents of foreign countries to have wrongful access to tax advantages under the treaty through evasive practices such as treaty shopping,

establishment of conduit structures, round-tripping, hybrid structures, shell companies, *etc*. The taxation of capital gains from the sale of shares of Indian companies by Mauritian residents has set aside the indiscriminate tax exemption granted to Mauritian residents on all incomes arising in India under Article 13 of the DTAA. This was done against the hostile backdrop of many international corporations, including Indian nationals, having routed their investment in India through Mauritius. This phenomenon, technically termed "round tripping", had become a favoured tax-dodging business tactic of Indians to exploit the twin benefit of residence-based tax exemption under the DTAA and the tax haven regime offered by Mauritius.

41. According to the above amendments, the grandfathering clause under GAAR will be applied to capital gains from transfers made on or before 01.04.2017, provided the applicant satisfies the test of "resident" as defined under its State law, particularly under Section 73 of the Mauritius Income Tax Act and the provisions of the Income-tax Act. Capital gains on acquisition of shares after 01.04.2017 and transferred before 31.03.2019 will be taxed at 50% of the domestic tax rate subject to fulfilment of the conditions of the LOB clause. Transfer of shares after 31.03.2019 will be taxable at the full domestic tax rate.

42. The LOB clause unequivocally provides that a resident (conduit/shell company) will be barred from receiving concessional tax benefits if its

arrangements were meant primarily to obtain such benefits. In this regard, the Protocol defines a shell or conduit company as an entity which has nil or negligible business operations or has no real or continuous business activities being carried out in Mauritius. It further provides that a Mauritian resident will be deemed a conduit/shell company if its total expenditure on operations in Mauritius is less than Rs. 1,500,000. Nevertheless, a company will not be deemed a conduit/shell company if its shares are registered on a recognised stock exchange in Mauritius or if the expenditure incurred on its operations in Mauritius is more than Rs. 1,500,000. The changes relating to capital gains and the insertion of the LOB clause are stated to have had ripple effects on the India – Singapore DTAA as well, since that treaty provides for tax exemption for alienation of shares of Indian companies along the lines of the India – Mauritius treaty. The treaty, complying with international standards, also provides for sharing of information under Article 26 for effective prevention of tax avoidance by promoting mutual cooperation. The treaty, as it stands after amendment, has been made comprehensive by protecting against abuse of tax advantages through inclusion of anti-avoidance provisions and by reducing opaqueness through provisions fostering certainty and transparency in treaty administration.

43. Undoubtedly, the mere holding of a TRC cannot, by itself, prevent an enquiry subsequent to the amendments brought into the statute, particularly by

the introduction of Section 90 (2A) and Chapter XA to the Act and the Rules, if it is established that the interposed entity was a device to avoid tax. We do not find the terms of the DTAA to be contrary to the provisions of the Income-tax Act and the Rules. We also do not find the terms of the DTAA, as amended, to be contrary to the provisions of the Income-tax Act and the Rules. It is reiterated that the circulars, having since been superseded by statutory amendments, will not come to the aid of the respondents.

44. The Revenue has contended that mere production of a TRC is not conclusive in establishing treaty eligibility, particularly post the enactment of Sections 90(4) and 90(5) of the Act and in light of the anti-abuse objectives underlying the LOB clause. It further submits that Circular No. 789 and the decision in *Azadi Bachao Andolan* dealt with distinct factual scenarios involving FIIs/NRIs debarred from conducting business in Mauritius and cannot be extended to Global Business Licence holders who are entitled to carry on commercial activities. The Revenue also questions the relevance of the *Vodafone* ruling in the treaty context, submitting that it involved a challenge to a domestic law assessment and not a direct ruling on the scope of Article 13 of the DTAA.

45. Notably, the LOB clause is not applicable as it can be applied only to cases falling under Clause 3B of Article 13. The application of India's anti-avoidance provisions is also relevant to test the applicability of the DTAA.

Here, the Revenue invokes both statutory and judicial anti-abuse doctrines. Under the statutory GAAR provisions, the Revenue submits that the present transaction falls within the scope of an "impermissible avoidance arrangement" lacking commercial substance. The Revenue distinguishes between mere "investments" (which are grandfathered under Rule 10U for pre-2017 investments) and "arrangements" (which are not grandfathered if the transfer occurred post 01.04.2017). It was contended that even if the investment was made prior to 2017, the subsequent indirect transfer of shares post-2017 brings the transaction within GAAR scrutiny. This position is fortified by the distinctions drawn in statutory rules, parliamentary committee reports, and the Shome Committee recommendations between passive investment activity and active arrangement-based structuring.

46. There is no dispute that GAAR is applicable to the assessment year under consideration, empowering the Revenue to declare the subject transaction to be an impermissible arrangement, which means "an arrangement, the main purpose of which is to obtain a tax benefit, and which, *inter alia*, is entered into or carried out by means or in a manner which is not ordinarily employed for *bona fide* purposes." As seen earlier, two important conditions are prescribed under Rule 10U of the Income-tax Rules, 1962, to seek exemption from the applicability of Chapter XA, in addition to the exemption applicable to an FII which does not seek any benefit under Section 90 or Section 90 A, as the case

may be. Notably, these provisions which were brought into effect after the judgment of this Court in *Vodafone*, were introduced to prevent treaty abuse and to ensure that exemptions or concessions are available only to genuine entities resident in the Contracting State with commercial interest and without tax avoidance as their main object. Rule 10U(1)(a) reads as under:

> *"An arrangement where the tax benefit in the relevant assessment year arising in aggregate, to all the parties to the arrangement, does not exceed a sum of Rs. 3 crores"*

Further, Rule 10U(1)(d) provides:

> *"Any income accruing or arising to, or deemed to accrue arise to, or received or deemed to be received by, any person from transfer of investments made before the first day of April, 2017 by such person."*

This is where Section 96 (2) and Rule 10U(2) become significant. By the use of the words "without prejudice to the provisions of clause (d) of sub-rule (1)", Chapter XA is made applicable to any arrangement, irrespective of the date on which it was entered into, in respect of a tax benefit obtained from such arrangement on or after 01.04.2017. Therefore, the prescription of the cut-off date of investment under Rule 10U(1)(d) stands diluted by Rule 10U(2), if any tax benefit is obtained based on such arrangement. The duration of the arrangement is irrelevant.

47. In the light of the aforementioned provisions and rules, in the case at hand, though it *prima facie* appears as if the assessees acquired the capital gains before the cut-off date, i.e., 01.04.2017, it is to be noted that the proposal for

transfer of investments commenced only on 09.05.2018. A Share Purchase Agreement was executed between Walmart International Holdings Inc., a Delaware Corporation described as the "purchaser"; the shareholders of Flipkart Singapore identified in Schedule I thereto and collectively described as the "sellers"; and Fortis Advisors LLC, a Delaware limited liability company described as the "sellers' representative". As per the Share Purchase Agreement, the sale of shares held by the assessees was approved by the Board in its meeting held on 04.05.2018. The subject appears to have arisen for discussion in the meeting held on 12.06.2018, when the Board took note of Walmart's offer to purchase a controlling stake in Flipkart Singapore for USD 16 billion, and the assessees considered selling 74% of their stake therein and closing the transaction, which occurred after the cut-off date prescribed under Rule 10U(1)(d).

48. In the alternative, even if GAAR is held to be inapplicable, the Revenue invoked the JAAR, grounded in the doctrine of substance over form, consistently recognised in Indian jurisprudence, including *McDowell* and *Vodafone*. It was contended that JAAR continues to operate in parallel with GAAR and empowers Indian authorities to deny treaty benefits in cases involving treaty abuse or conduit structures. The Revenue further contended that the respondents themselves acknowledged the applicability of this doctrine by safeguarding against such scrutiny in the Share Purchase Agreement and by

furnishing detailed documentation regarding control and management, thereby conceding that mere possession of a TRC is not sufficient. Thus, the Revenue's position proceeds in a logical sequence. We find force in these contentions and agree with them for the following reasons: First, taxability is established under Section 9(1)(i); second, the availability of treaty relief is contested by challenging the residency claim in view of the *prima facie* finding that effective management and control were not in Mauritius, the scope of Article 13, and the applicability of Circular No. 789 and *Azadi Bachao Andolan* in the current factual context; third, GAAR and, in the alternative, JAAR are invoked to pierce the structure and deny treaty benefits where the transaction lacks genuine commercial substance. Though several specific questions were raised by the Revenue, including interpretation of the Mauritius Financial Services Act, the nature of GBLs, and the role of the LOB clause, these issues merely reinforce the three-tier framework for determining taxability in the present case.

49. The *Vodafone* judgment provides crucial insight into this issue. It implies that business intent behind a transaction serves as strong evidence of whether the transaction is deceptive or an artificial arrangement. The commercial motive behind a transaction often reveals its true nature. In the present case, the respondents seek exemption from the Indian Income tax while, at the same time, contending that the transaction is also exempt under Mauritian law, which runs contrary to the spirit of the DTAA and presents a strong case for the Revenue to deny the benefit as such an arrangement is impermissible. Here again, it may be

stated that this stand would again strengthen the reasoning that whether the sale is of shares of an Indian company then, will not be germane for consideration because only if the assessee is liable to pay tax in Mauritius, he can derive benefit under the provision under Article 13(c) of the DTAA as amended. Section 96(2) places the onus on the taxpayer to disprove the presumption of tax avoidance. This represents a significant shift in the burden of proof. In the case at hand, there is clear and convincing *prima facie* evidence to demonstrate that the arrangement was designed with the sole intent of evading tax, and the assessees have failed to furnish sufficient material to rebut this presumption. Though it is permissible in law for an assessee to plan his transaction so as to avoid the levy of tax, the mechanism must be permissible and in conformity with the parameters contemplated under the provisions of the Act, rules, or notifications. Once the mechanism is found to be illegal or sham, it ceases to be "a permissible avoidance" and becomes "an impermissible avoidance" or "evasion". The Revenue is, therefore, entitled to enquire into the transaction to determine whether the claim of the assessees for exemption is lawful.

VI. CONCLUSION

50. In our view, once it is factually found that the unlisted equity shares, on the sale of which the assessees derived capital gains, were transferred pursuant to an arrangement impermissible under law, the assessees are not entitled to claim exemption under Article 13(4) of the DTAA. The Revenue has proved

that the transactions in the instant case are impermissible tax-avoidance arrangements, and the evidence *prima facie* establishes that they do not qualify as lawful. Consequently, Chapter X-A becomes applicable. The applications preferred by the assessees relate to a transaction designed *prima facie* for tax avoidance and were rightly rejected as being hit by the threshold jurisdictional bar to maintainability, as enshrined in proviso (iii) to Section 245R(2). Accordingly, capital gains arising from the transfers effected after the cut-off date, i.e., 01.04.2017, are taxable in India under the Income Tax Act read with the applicable provisions of the DTAA. The judgment of the High Court therefore deserves to be set aside.

VII RESULT

51. In the result, all the appeals are allowed and the impugned judgment of the High Court is set aside. There shall be no order as to costs.

52. Pending application(s), if any, shall stand disposed of.

.....J.
[J.B. PARDIWALA]

.....J.
[R. MAHADEVAN]

NEW DELHI
JANUARY 15, 2026

J.B. PARDIWALA, J.

1. My esteemed brother Justice R. Mahadevan has penned an ineffable judgment. There is nothing further that I could conceive of adding to the erudite judgment of my brother Mahadevan. However, I would like to add few words of my own, focussing on tax sovereignty as the same assumes great significance in times of global uncertainty.

2. The strength of any Nation depends on its abilities and capabilities to perform Sovereign functions and to exercise Sovereign powers, subserving the best interest of its people. This exercise in the modern world is not limited to domestic affairs or within a Nation but also extends beyond National and geographical territory, what we call cross-border affairs and transnational affairs or international affairs.

3. Exercising Sovereign functions and powers in the international space is more dependent on the geo-political climate. Sovereign incursions, threats, or attacks or even attempts to weaken it are no longer confined only to territorial sovereignty. Economic sovereignty is gaining importance and in fact occupying centre stage in geo-political affairs. The existence, creation and the influence sought to be generated by several world bodies through a combination of Nations and attempts to

dictate a global order on economic and commercial matters through such organisations and bodies is quite rampant.

4. If one looks at the last 7-8 decades, times and periods have indeed changed. The upmanship of developed Nations over the developing or underdeveloped Nations in entering into strategic dealings and negotiations is slowly changing. Smaller Nations, Nations which are heavily import dependent, needing lot of external resources often compromise or cede many of their Sovereign rights and functions just to acquire a relationship or to connect with international trade or to somehow manage to keep their respective Nations as part of the international league and draw benefits in whatever way they flow and remain unmindful even if the benefits are in trickles. The choice is between a total neglect or isolation or being the company however significant or insignificant, based on the powerplay rules exercised by Nations which wield authority, influence and impact in global affairs.

5. This led to the creation of several leagues of Nations, plural organisations and bodies to operate as think-tanks to evolve global doctrines of economic, commercial or trade orders.

6. In the case of our own Nation, each decade has shown better progressive results from the earlier decade with so much hope and promise to hold geometrical if not astronomical growth in the decades ahead of it. The respect accorded and the importance shown to our Nation is increasing by the day. We are becoming an important element in international power play, more importantly in trade and commerce. The advantage in terms of the size of the Nation, its population, and the dominating presence of youth (India has the world's largest working-age population. India will have a skilled labour surplus of 245 million workers by 2030) a conducive atmosphere for investment and growth, peace and stability are all now turning out to be the assets of the Nation allowing companies, entities and even individuals across the globe to come to India as a destination for future growth and progress thus making India the fourth of the fifth progressive economy in the world.

7. It is in this backdrop that one has to now understand and appreciate what is tax sovereignty and how important it is to our Nation in an era which is fraught with trade and tariff wars, building and shielding one's own economy from any international economic disorder or disaster and so on. The stability of a Nation is slowly getting determined and recognised based on the strength and independence of a Nation's tax sovereignty. When it comes to a domestic exercise, tax Sovereignty has

to only pass through the filters of Constitutional trust, faith, and addressing the well-intended objectives of Part III and Part IV. Sovereign exercise of taxing power within a Nation is amenable to judicial review on the grounds of being unconstitutional, illegal and arbitrary and the likes of it. Whereas, exercising tax Sovereignty in the international domain has to pass through several filters which would include geo-political strengths and equations, diplomacy, making a Nation attractive for investments and at the same time, not compromising either its sovereignty or its interest and core objectives of its people.

8. Tying up different shades, contrary themes, international compulsions, domestic priority and beyond all these, a Nation's passion and aspiration to grow and surge ahead has to be aligned and therefore tax sovereignty in this space becomes a tightrope walk. Ability to command, remaining composed and yielding to healthy compromises and still finding the space and opportunity to grow without external Nations and entities interfering with the exercise of Sovereign tax powers will be the ideal combination that every Nation like India will look forward to.

9. Unlike domestic affairs where they are aided by the executive, the legislative builds the necessary laws into motion and the role of the Judiciary is only to allow permissible judicial review. Exercise of a tax sovereignty by a Nation and as a Nation requires the roles of all the three Constitutional bodies to play to its significance and within the umbrella of doctrine of separation of powers, the reason being when a Nation front ends its tax policy in an international domain, the role of all the three Constitutional organs becomes very relevant. Convergence without dilution to the doctrine of separation of powers would add strength and vitality for any democratic Nation to exercise its choice of tax sovereignty.

10. Broadly speaking, tax extractions by Sovereign states across the globe is broadly in the nature of an income tax called as the direct tax which includes international taxation and corporate taxation and the indirect tax which is a tax on goods and services which is termed as GST in India and VAT by the European Union and a resale tax in USA.

11. The growth and progress in achieving semblance of unity or unified progress is far distinct between indirect taxes and direct taxes. The successful experiment by India in finally ushering the GST era through the Constitutional scheme in 2017 is akin to what European Nations attempted to do amongst themselves by having a unified VAT regime.

Prior to GST, indirect tax levies were so splintered amongst the several States and Union territories and each one exercising their right of Sovereign taxation over their territory resulting in plurality of rates and uncertainty and un-uniformity in the last mile taxation on goods. The era of GST has ushered in a sense of uniformity in taxation on goods and services which looked impossible and more importantly, the federal partners namely Union and States becoming co-equal partners in the share of taxation and the hallmark in allowing a simultaneous taxation powers by the union and that respective federal partner on each supply of goods or services.

12. An asymmetric taxation regime gave way to a symmetric taxation regime through a Constitutional framework. European Union had achieved a similar milestone through the introduction of a common VAT regime amongst the European union partners. What was done at the Union and the State territories level or the sub-national level under the GST regime was achieved at a National level through essentially a common VAT legislation. This reference is cited here only to highlight that a common taxation regime amongst Nations is in fact a reality when it comes to goods and services amongst the European Union. A triumph or a hallmark for a healthy or a meaningful convergence of tax

Sovereignty at an international level. This is what we call as pooled sovereignty for the mutual benefit of one and all.

13. Surprisingly and on the contrary, such an attempt had not happened or materialised in the direct tax front across the globe and these are being secured invariably through bi-lateral treaties and also by trying to create mirror image positions or provisions of law like the transfer pricing regime but not through a uniform single statutory legislation or a code and therefore divergent views and interpretations continue to baffle international trade and commerce. This stark contrast between the direct and indirect tax regime is compelling and persisting.

14. Of course, even in the indirect tax front, there is no single uniform legislation covering the entire globe or being accepted by all Nations. There are several customs protocols and bi-lateral treaties guarding various interests and priorities. There are apex bodies like the WTO regulating the affairs without interfering into the Sovereign rights of any Nation. It is impossible, and in any view, very premature to expect a uniform global protocol or order to be followed by all Nations which would actually mean convergence of Sovereign rights or pooling of Sovereign rights for the mutual betterment of one and all. Unless such a situation ripens, it will be more or less bilateral and even any multilateral agreements may not necessarily be all encompassing.

15. In light of the above, it is but necessary that the Nations assert and protect its Sovereign rights and should not be compromised.

16. Compromising or ceding sovereignty can be in many forms and ways. External pressures and compulsions which can interfere or interdict with domestic policy making. External expectations and pressures demanding a larger than required yield of Sovereign compromises. There can also be a third factor which is a fast-emerging scenario. Nations, international bodies or even multinational companies and other entities trying to influence or force impactful changes in the tax policy choice of a Nation which may subserve their interest and betterment.

17. Policy choices and exercising bargaining powers are all matters within the realm of the executive and the ruling governance of the day. But it is important to remind that the Natural power of sovereignty is independence. Economic independence is an important rule for a Nation to grow with a vision and embark on a long-term journey. Therefore, yielding or compromising Sovereignty should not become a self-defeating interruption.

18. Yet another aspect would be to assert demand and enforce the right share of profits to be taxed in one's own soil. It is natural and imperative that it is a right of a Nation whose soil or source stands used or exploited for generating or earning an income to get the right to tax it. The place, location or the source of earning should also by default become the place or jurisdiction for taxation. Any arrangement to the contrary is nothing but a compromise. Past practices and experiences need not necessarily be carried forward as a legacy if changing times and geo-economic optics favour a Nation towards a more progressive assertion in the global space.

19. Taxing an income arising out of its own country is an inherent Sovereign right to that country. Any application of filters or diffusers to this is a direct attack or threat to its sovereignty which can affect a Nation's long-term interest.

20. Besides economic independence, a neat power is better expressed if a Nation is more and more autonomous and can determine, manage, calibrate, align and work cross-border trade and business embedding its own dimensions and aspirations and therefore in the neo era of geo-economic uncertainties, it is better prudence to retain tax Sovereignty to oneself than to yield. It is true that global equations, balances/imbalance arise out of one's negotiating power and terms. Tax Sovereignty should ensure itself to match with the political Sovereignty of the Nation and

need not be either separated or leveraged any less. Push or pull should be the Sovereign's choice and should not be dictated, thrusted or compelled and this is doable only when tax sovereignty is retained and not yielded. Not yielding one's tax sovereignty is one form of retention of power. Protecting its sovereignty from external pressures is yet another form. But a meaningful exercise of choices alone reflects strength and character and in the long run, will help to reap the required dividends.

21. When world all over believed that business investments can be managed, regulated and calibrated better only through Business Investments Treaties (BIT), India understood the downsides of it and made a very strong and forceful decision of a unilateral revocation in 2016, of course leaving an extending sunset clause for existing agreements but not renegotiating or inking many fresh agreements, reflecting its Sovereign duty to protect Nation's interest.

22. The distinction between business models becoming part of economic policies or choices of a country and corridors lobbying for legislative changes and amendments to suit their business interest are totally distinct spheres and it is a Nation's duty to protect and shield itself from any such influence in the case of the latter.

23. A surging Nation like India should take proactive steps to be part of global institutional frameworks to not only pitch its views, but also take along like Nations and Nations which are dependent on someone's bargaining powers. These are all different aspect of shades in the manner of exercise, exhibiting or even executing or rolling out future vision maps and doing a positive or constructive role in taking along smaller developing Nations to pitch a collective bargaining power in the international scene. This is doable only when tax sovereignty remains intact and a Nation is also able to leverage it in the global space. Genuine exercise of discretion will indeed inspire smaller Nations to join hands and strengthen the bargaining power and tax sovereignty is such a powerful tool if not yielded, compromised or even given away as allocation through treaties.

24. It is seen historically one more angle of exercise or assertion of tax sovereignty is the power to take or make unilateral moves instead of bilateral and frame tax policies on cross border transactions which enter a country. Powerful economies in the world exercise this unilateral power to make their trading partners fall in line to their priorities. This is one more figment of exercise of tax Sovereignty in the global space. It proves two things – Tax sovereignty has no inherent limitations and has only self-imposed limitations and it is indeed doable or achievable to

make unilateral moves to protect or guard or to enhance one's own Nation's interest to bring the trading partners in line to fit or suit their interest.

25. No doubt entering into bilateral treaties has yielded its own good, consistency and stability. But with newer and newer trade complexities emerging in the global arena, Nations should rethink very long-term treaties. There is no need to carry the burden or legacy of formative years of treating making and even more when it comes to interpretation of such treaties. Interpretations which are more sound and currently relevant should yield to archaic and behind the scheduled objectives. To assume or perceive every future possible transaction stands visualised and contemplated and need to be ring fenced within a static dimension may not be an apt or a relevant approach. When current trade affairs are so dynamic, a contextual and meaningful interpretation of such instruments would not only make it currently relevant, but also vibrant matching with the progressive global business dynamics. Any attempt to widen the gap and push it backwards when trade dynamics surge ahead should be eschewed. This is yet another dimension on tax sovereignty.

26. When the canvas or bandwidth of tax Sovereignty or spectrum is so wide in its sweep, having no inherent limitations, the endeavour of a Nation is to preserve, nurture and promote its Sovereign powers in the

global order to the best extent possible and this is possible only if such a power is retained by a Nation and not compromised. Retention should be the golden rule, and yielding should be an exception which is meaningful and not disproportionate and in aby view, not at the cost of a Nation's welfare and interest.

27. A long-term compromise leads to erosion, porosity in the ingression, weakening or even destabilising a Nation's long term strategic and security interest. It should be a Nation's aspiration and desire to avoid even a medium-term compromise and should endeavour even short-term possibilities as minimal if not, at all.

28. The golden rule of international diplomacy is how best to secure Nation's interest and yet be part of the togetherness and reflect the genuine feeling of belonging. Negotiating power and capacity therefore becomes the most vital aspect. The aspect of possessing the power and its exercise of discretion are again two distinct elements. Exercise of discretion must be thoughtful, well researched, data driven projection of a Nation's strength and what would the counter party get out of it which would meet the mutual benefit of both the parties instead of the unilateral benefit at the cost of one's own Nation.

29. In a fast growing world with recurrent uncertainties, policy framework should not be for very long term and more importantly policy disputes if any should be resolved amicably amongst Nations and through their representatives rather than giving into international dispute resolution process which inevitably goes through several uncertainties, jurisdictional vagaries and more so when the contesting parties are not Nations on both sides or not Nations with equal strength.

30. Retaining tax sovereignty becomes an impeccable strength for a Nation to stand up against cross border tax evasion, money laundering, drug and human trafficking and round tripping of funds which would result in serious breach of the security and safety of the Nation. A compromised international agreement, or a tax treaty or a protocol can pose serious challenges to the safety and security of a Nation especially when the ability to dissect a good investment from a bad or an evil one is taken away or compromised. Tax evasion and tax abuse resulting in economic disorder is itself a huge sign of weakness for a Nation.

31. If tax evasion and tax abuse happen under the umbrella or shield or in the guise of money laundering or trafficking or round tripping, it not only weakens a Nation, it makes it less powerful or even powerless in given circumstances tearing apart the social fabric and texture of a

Nation and its people. Every anti abuse law must not only appear to be a deterrent but should be implemented to achieve the underlying goal of preventing an abuse by anyone against one's Nation and its people. Any lenience is yet another form of compromising tax sovereignty.

32. When agreements need to be entered into between Nations either through its legislative or executive arm, dispute resolution should also be part of the same arm or process and should not be divorced or outsourced or pushed to mandatory arbitrations.

33. Tax treaties, international agreements, protocols and safeguards should be very engaging, transparent and capable of periodical reviews with the power to renegotiate with strong exit clauses to avoid unfair outcomes safeguarding Nation's strategic and security, prevent erosion of tax base and loss or weakening of democratic control and introduce explicit carve outs safeguarding the Sovereign's right of taxation.

34. <u>What safeguards should be taken while entering into any International Treaties?</u>

When entering into international tax treaties, India must take strong safeguards to protect its tax sovereignty, ensure fairness, and prevent abuse. These safeguards should be legal, structural, and strategic in nature.

1. **Include a Limitation of Benefits (LOB) Clause**

- Purpose: Prevent treaty shopping by shell companies set up only to exploit treaty benefits.
- Example: The amended India-Mauritius treaty includes an LOB clause to deny benefits to companies without genuine economic activity.

2. **Include a General Anti-Avoidance Rule (GAAR) Override**

- Purpose: Ensure India can override treaty benefits if the primary purpose of an arrangement is tax avoidance.
- The treaty should explicitly allow application of GAAR in cases of artificial transactions.

3. **Ensure Right to Tax Digital Economy**

- Treaties must include provisions that:

o Recognize "significant economic presence" (SEP), not just physical presence.

o Allow India to impose equalisation levies or digital services taxes on foreign digital platforms.

4. **Preserve Source-Based Taxation Rights**

- India must retain the right to tax income arising in its territory, especially:

o Capital gains on shares of Indian companies

o Interest, royalties, technical fees

o Business profits from Indian operations

- Avoid residence-based taxation-only models, which favour tax havens and developed countries.

5. **Include Tax Credit, Not Exemption**

- Treaties should follow the tax credit method (foreign tax credit), not tax exemption method, to prevent double non-taxation.

6. **Include Exit or Renegotiation Clauses**

- India must retain the right to renegotiate or withdraw from a treaty if:

o It is being misused

o It no longer aligns with India's economic goals

- Example: India renegotiated its tax treaties with Mauritius, Cyprus, and Singapore when they became problematic.

7. **Avoid "Most Favoured Nation" (MFN) Clauses**

- MFN clauses can bind India to give better terms to one country if they are given to another in the future.

- This can undermine India's flexibility in future negotiations.

8. **Clearly Define "Permanent Establishment" (PE)**

- Ensure a broad and updated PE definition to prevent avoidance through techniques like:

o Commissionaire arrangements

o Fragmentation of business activities

9. **Align with India's Domestic Laws and Constitution**

- Treaty provisions should not conflict with domestic tax laws and must be in line with:

o Constitutional powers

o Parliament's authority to legislate taxation

If there's conflict, Indian courts usually uphold whichever provision is more beneficial to the taxpayer, so drafting must be precise.

10. **Conduct Cost-Benefit Analysis Before Signing**

- Evaluate:

o Will India lose revenue?

o How will it affect domestic industry?

o What is the long-term strategic impact?

Treaties should be driven by national interest, not pressure from foreign governments or corporations.

11. **Build Treaty Monitoring and Review Mechanism**

- Set up a mechanism to periodically review tax treaties for:

o Abuse

o Relevance

o Changing business and legal trends

12. **Consult Stakeholders Before Signing**

- Involve:

o Tax experts

o Legal professionals

o Industry bodies

o Parliament committees

This ensures treaties reflect broader economic and public interest, not just bureaucratic or diplomatic goals.

.....J.
[J.B. PARDIWALA]

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