

Tribunal rejects lifting of corporate veil and affirms taxpayer is not the beneficial owner of foreign assets owned by a BVI company

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In a recent ruling, the Delhi bench of the Income Tax Appellate Tribunal (Tribunal) held that Indian resident shareholders (Taxpayers) of a British Virgin Islands (BVI) company cannot be treated as the beneficial owner of the foreign assets owned by such company, in the absence of any investment from undisclosed sources.

Background

- The Taxpayers (being family members) were residents of India for Indian tax purposes who held shares in Carmichael Capital Limited (CCL) a company incorporated in BVI. These shares were acquired by remitting the funds in compliance with the Liberalised Remittance Scheme (LRS) of the Reserve Bank of India and were appropriately disclosed in the Indian tax filings.
- With the funds received from the Taxpayers and the bank loan, CCL and its wholly owned subsidiary, Eaton Estates Limited (EEL), incorporated in the United Kingdom (UK) purchased certain real estate assets in UK.
- These assets generated rental income in the hands of CCL. However, CCL and EEL sold the real estate assets in the year 2014 and 2016 and realized certain capital gain thereon. Additionally, CCL also earned interest income on bank deposits placed outside India. As the income accrued to CCL / EEL, the non-resident companies outside India, none of the aforesaid income was subject to tax in India.
- In the Financial Year (FY) 2016-17, the tax authorities conducted a search at the premises of the Taxpayers and thereafter, initiated tax proceedings for the period of FY 2010-11 to FY 2016-17. Based on the information gathered during search proceedings and certain information received from BVI and Singapore, the tax authorities alleged that:
 - (a) CCL was incorporated solely to acquire and hold properties in the UK and avoid taxes in India; and
 - (b) The Taxpayers were the beneficial owners of CCLs bank accounts.
- Accordingly, the tax authorities lifted the corporate veil and taxed the income earned by CCL / EEL from the real estate assets and the bank deposits in the hands of the Taxpayers. Similar actions were invoked under the provisions of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (Black Money Law).
- The actions of the tax authorities were affirmed by the Commissioner of Income-Tax (Appeals). Aggrieved, the Taxpayers preferred an appeal before the Tribunal.

Tax authority's arguments

- The sole purpose of incorporating the BVI Company was to hold real estate assets in the UK and avoid disclosure of such assets and payment of income-tax in India.

- From the calendar entries in the mobile phone of one of the Taxpayers, the tax authorities claimed that such Taxpayer was involved in maintaining the properties and was also using one of the properties for residential purposes (along with his daughter).
- The Taxpayers had appointed nominee directors on the board of directors of CCL and EEL, who did not have control over the estate of these companies.
- CCL had a bank account with Barclays Bank, Singapore. Based on the information received from the competent authority of Singapore, the Taxpayers were reported as ultimate beneficial owner (UBO) for this bank account.
- The Taxpayer had created this structure to obtain tax benefit, and which is not ordinarily employed for bonafide purposes. Accordingly, the corporate veil of CCL and its subsidiary was lifted, and the Taxpayers were alleged to be the beneficial owner of the assets and income arising thereon.

Tribunal Ruling

Noting that the remittance for subscription to shares in CCL was in accordance with the Indian exchange control regulations, out of tax paid money and there was no tainted money involved, the Tribunal ruled in favour of the Taxpayers. Key observations of the Tribunal are as set out below:

- Purpose of CCL: The allegation that CCL was incorporated solely for the purpose of acquiring the UK properties cannot be sustained as CCL was incorporated on 9th March 2005 whereas the first property was purchased on 14th February 2008.
- Beneficial ownership: Referring to the definition of 'beneficial owner' under the Indian tax provisions (Section 139), the Tribunal noted that 'beneficial owner' in respect of an asset is the one who provides consideration for the asset, directly or indirectly, for the immediate or future benefit, of himself or any other person. In the instant case, the Taxpayers have remitted money to subscribe to the shares in CCL and not for the assets owned by CCL and EEL. Post subscription to the shares, the Taxpayers right in CCL was limited to the dividend or any other pay-outs due to the shareholders but the Taxpayers do not have any right in the income or assets of CCL / EEL. While the Taxpayers own the shares in CCL, the assets were owned by CCL / EEL. The Taxpayers neither holds the right to claim the proceeds from the sale of such assets nor had the right to seek alienation of assets from the Company to the Taxpayers.
- UBO: The Tribunal clarified that the concept of UBO (invoked basis the information reported with Barclays Bank, Singapore for CCLs bank account) was not comparable to the beneficial ownership construct under the Indian tax law. While the shareholders of a company are its UBO, it does not imply that such shareholders are the beneficial owners of the assets owned by the company.
- Lifting of corporate veil: The Tribunal heavily relied on the decision of Gujarat High Court in the case of Ajay Surendra Patel, which suggests that corporate veil could be lifted only in the following scenarios: (a) if the statute so permits, or (b) the facts demonstrate that a complex web is created to defraud the tax department, or (c) the company has been set up for fraudulent purpose, or (d) the company acts an agent of the shareholder, or (e) the company is engaged in undertaking business activity which is beyond the object stated in its Memorandum of Association. The Tribunal noted that none of these elements were present in this case of the Taxpayers. There was no involvement of any tainted money or undisclosed income in the entire structure and hence, the claim that CCL was incorporated to avoid taxes in India is incorrect. CCL / EEL being a closely held company, in itself, cannot be a reason to claim that such companies were bogus entities or shell entities. Further, payment by the Taxpayers (as shareholders) for the incorporation cost of CCL and maintaining the property records in the mobile phone of the shareholder who was 70 years old cannot be the grounds to pierce the corporate veil.
- Payment of taxes in UK: The fact that CCL / EEL was liable to pay Annual Tax on Enveloped Dwellings in UK, which is applicable on residential properties held by non-natural person, establishes that holding of real estate by a UK company is a legal and tax compliant way of holding such assets. As CCL was liable to and actually paid ATED on the real estate properties under UK laws, there was no basis for the tax authorities to treat the Taxpayers as the beneficiaries or holding the beneficial interest in such properties.
- Pre-decided conclusion: The statement by the tax officer in the assessment order that *"to pierce the corporate veil, the seized data has been analysed and the following events / materials are crucial for*

lifting of corporate veil which range from incorporation of the company to day-to-day affairs of the assets of the company” demonstrates that the tax officer had reached a conclusion to levy tax on Taxpayers by lifting the corporate veil and the information / documents were then assessed to support the said conclusion.

Based on the aforesaid principles and observations, the Tribunal also allowed the appeal under Black Money Law in favour of the Taxpayers.

Comments

At the outset, this ruling re-affirms the legal position that a corporate entity is a separate legal entity distinct from its shareholders. The principle of corporate veil as laid down in the landmark ruling of *Salomon v Salomon* is a foundational principle of corporate law, and the same should not be disregarded without adequate cause. The use of a special purpose vehicle (SPV) is a globally recognized mechanism for making and holding investments, which has also received acceptance from the Supreme Court in the case of *Vodafone International Holdings B.V. v Union of India*. The apex court in *Vodafone* (supra) goes on to recognize the fact that parent and subsidiary are distinct taxpayers, and the mere fact that the shareholders exercise influence over the subsidiary should not be a ground to disregard the corporate veil.

This ruling is a shot in the arm for holding company structures, with the Tribunal holding that tax authorities cannot lift the corporate veil in case of a company operating within the scope of its object stated in the Memorandum of Association unless the company has been set up to defraud the tax department or for any fraudulent purpose or acts as an agent for any person.

The concept of ‘beneficial ownership’ is often debated in the context of foreign entities claiming tax treaty benefits. Under the tax treaty provisions, the recipient of income is generally treated as the beneficial owner, if such a recipient has unconstrained right to use and enjoy the income and does not have any obligation (contractual or otherwise) to pass on such income to any person. Tax authorities tend to challenge the beneficial ownership in SPV structures especially where the holding company is based in a third jurisdiction. However, in this case, the Tribunal has succinctly distinguished the concept of beneficial ownership qua the shares held in the company vis-à-vis the assets owned by such company. In the same breath, the clarification that shareholder being the UBO of a company does not necessarily mean that such a shareholder is the beneficial owner of the assets held, or entitled to the income earned by the company, is well timed and should certainly assist in the ongoing tax litigation on beneficial ownership.

For the Black Money Law to apply, the alleged undisclosed foreign asset should satisfy the definition prescribed under the law. In a nutshell, a foreign asset should not be regarded as an undisclosed foreign asset if the taxpayer offers proper explanation about the source of their investment. In this case, the investment in CCL was made by the taxpayer from tax paid capital, which was remitted under the LRS in compliance with Indian foreign exchange regulations. Therefore, it appears to be a bona-fide corporate structure.

Lastly, the ruling underscores the importance of need to demonstrate the bonafide and genuineness in the holding company and investment structures. Factors such as source of funds, compliance with the applicable laws, adequate disclosure of information to the tax and regulatory authorities and maintenance of relevant documents are the basic tenets to substantiate bonafide and genuineness of any particular structure.

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