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Supreme Court denies India-Mauritius tax treaty benefit for Tiger Global, rejects grandfathering protection under GAAR

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In a landmark ruling, the Supreme Court of India (SC) has denied capital gains tax exemption claimed by Tiger Global International II Holdings, Tiger Global International III Holdings and Tiger Global International IV Holdings (Tiger Global) under the double taxation avoidance agreement between India and Mauritius (India-Mauritius Tax Treaty) on sale of shares of Flipkart Private Limited, a Singapore entity (Flipkart Singapore) to Fit Holdings S.A.R.L. an third-party buyer based out of Luxembourg (Buyer), as a part of a broader transaction of Walmart Inc acquiring majority stake in Flipkart (please refer to our earlier ERGO on the HC ruling).

Overturning the decision of the High Court at Delhi and affirming the conclusions of the Authority of Advance Rulings (AAR), the SC ruled that the arrangement herein was *prima facie* an impermissible tax avoidance structure making it ineligible to claim the India-Mauritius Tax Treaty benefit.

Notably, the SC also revoked the shield under the 'General Anti-Avoidance Rules' (GAAR) for investments undertaken prior to 1 April 2017 and treated the transaction as an impermissible avoidance arrangement.

Background

Tiger Global was incorporated in Mauritius holding Category-1 Global Business License (GBL) issued by the Mauritius Government. The investments by Tiger Global were managed by its investment manager, Tiger Global Management LLC (TGM LLC), a US company. Between October 2011 to April 2015, the Tiger Global invested in the shares of Flipkart Singapore, which in turn held shares in certain Indian companies.

Tiger Global proposed to transfer the shares of Flipkart as a part of a broader transaction of Walmart Inc acquiring majority stake in Flipkart. As Flipkart Singapore derived substantial value from India, capital gains on sale of such shares was liable to tax in India under the provisions of Indian domestic tax law. However, Tiger Global intended to claim the capital gain tax exemption under the India-Mauritius Tax Treaty as it held a valid 'tax residency certificate' (TRC) issued by the Mauritian authorities.

Accordingly, Tiger Global approached the Indian tax authorities to issue a nil withholding tax certificate. This request was denied on the premise that the Tiger Global did not exercise independence in their decision making and control and management and hence, it was not eligible to claim the India-Mauritius Tax Treaty benefit.

AAR Ruling

Subsequently, Tiger Global filed an application before the AAR. However, the AAR observed that control and management of Tiger Global was not in Mauritius but in the United States of America (US) with Mr. Charles P. Coleman (a US resident and sole director of ultimate parent entity in US), who was signatory to Tiger Global's bank account and was also disclosed as the beneficial owner in the GBL application form filed with Mauritius Financial Services Authority. Accordingly, the AAR took a view that the transaction of sale of shares of Flipkart constituted *prima facie* a tax avoidance arrangement.

High Court decision

The HC reversed the judgement of the AAR and granted the capital gains tax exemption claimed under India-Mauritius Tax Treaty on the following grounds: (a) TRC is sacrosanct in claiming the tax treaty benefits (b) beneficial ownership test is relevant only if a taxpayer holds shares as an assignee or has a contractual obligation to pass on the income to any other person (c) mere authorization rights with some US directors does not mean that taxpayer is controlled from US as the authorization was provided by the board directors of Tiger Global, and a parent is expected to have certain level of influence over the subsidiaries (d) investment from a low tax jurisdiction by itself does not imply that such investment is not *bonafide* and (e) GAAR provisions are not applicable as the investments were undertaken prior to 1 April 2017.

The tax department challenged the aforesaid decision before the Supreme Court of India, primarily relying on the judgement of the AAR.

Supreme Court Ruling

Pursuant to detailed arguments, the SC held that instant transaction was designed *prima facie* for tax avoidance and accordingly, denied the capital gains tax exemption claimed by Tiger Global under India-Mauritius Tax Treaty. Key observations by the SC are as follows:

- **Taxation in residence state is a pre-requisite:** The object of a tax treaty is to prevent double taxation and not to facilitate tax avoidance. Therefore, applicability of tax treaty is subject to the relevant transaction being taxable in the resident state.

- **TRC is not a sufficient condition:** Pursuant to certain legislative amendments (including to India-Mauritius Tax Treaty in the year 2016 and introduction of GAAR under Indian tax law), holding a TRC *ipso facto* is not sufficient to claim the benefits under India-Mauritius Tax Treaty, thereby setting aside the principle laid down in Circular No. 789 of 2000 and the decision of the SC in *the case of Azadi Bachao Andolan*. Further, TRC is not binding unless a statutory authority or court undertakes an independent verification.

- **Applicability of GAAR:** Grandfathering protection under GAAR with respect to 'investments' undertaken prior to 1 April 2017 cannot be applied to an '***arrangement***', in respect of which, a tax benefit has been obtained on or after 1 April 2017.

- **Judicial Anti-Avoidance Rules (JAAR):** Even if GAAR is not applicable, the tax treaty benefit could be denied based on JAAR enabling the authorities / courts to evaluate such benefit based on 'substance over form' approach.

- **Sovereign right to taxation:** Levying tax on income arising out of its own country is an inherent sovereign right of that country and hence, fraudulent or fictitious transactions cannot be granted any tax exemption. To this extent, the SC has also suggested certain safeguards that should be built in while executing tax treaties, including (a) denying tax treaty benefit to shell entities (b) GAAR to override tax treaty benefit in artificial transactions (c) levy tax on digital platforms operating without physical presence in India (d) retain right to taxation on income arising from India.

Comments

At the outset, the denial of capital gains tax exemption on sale of shares of Flipkart Singapore is primarily on the basis of transaction being an impermissible avoidance arrangement and hence, implying that indirect transfer is otherwise covered by India-Mauritius Tax Treaty.

The SC judgment deviates from the well-established legal and judicial position in the context of granting tax treaty benefits based on TRC issued by the resident country. The assertion that TRC is ambiguous, non-decisive and lacks the quality of a binding order may have to be considered from the perspective of it being issued by a sovereign country.

Denying grandfathering protection under GAAR to pre-April 2017 investments may open a plethora of questions on the relevance of grandfathering protection and hence, requires a clarification given the wide ramifications that may arise from this position.

In nutshell, the SC has emphasized that eligibility to claim tax treaty benefit will necessarily have to be evaluated by applying ‘substance over form’ approach.

As a result, it is critical for the India focused funds as well as investors to undertake a threadbare analysis with respect to the cross-border investment structures, particularly on aspects around ‘control and management’, ‘decision-making’ individuals and ‘commercial substance’ in the relevant jurisdiction.

- *Sanjay Sanghvi (Partner), Rahul Jain (Partner) and Avin Jain (Principal Associate)*

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