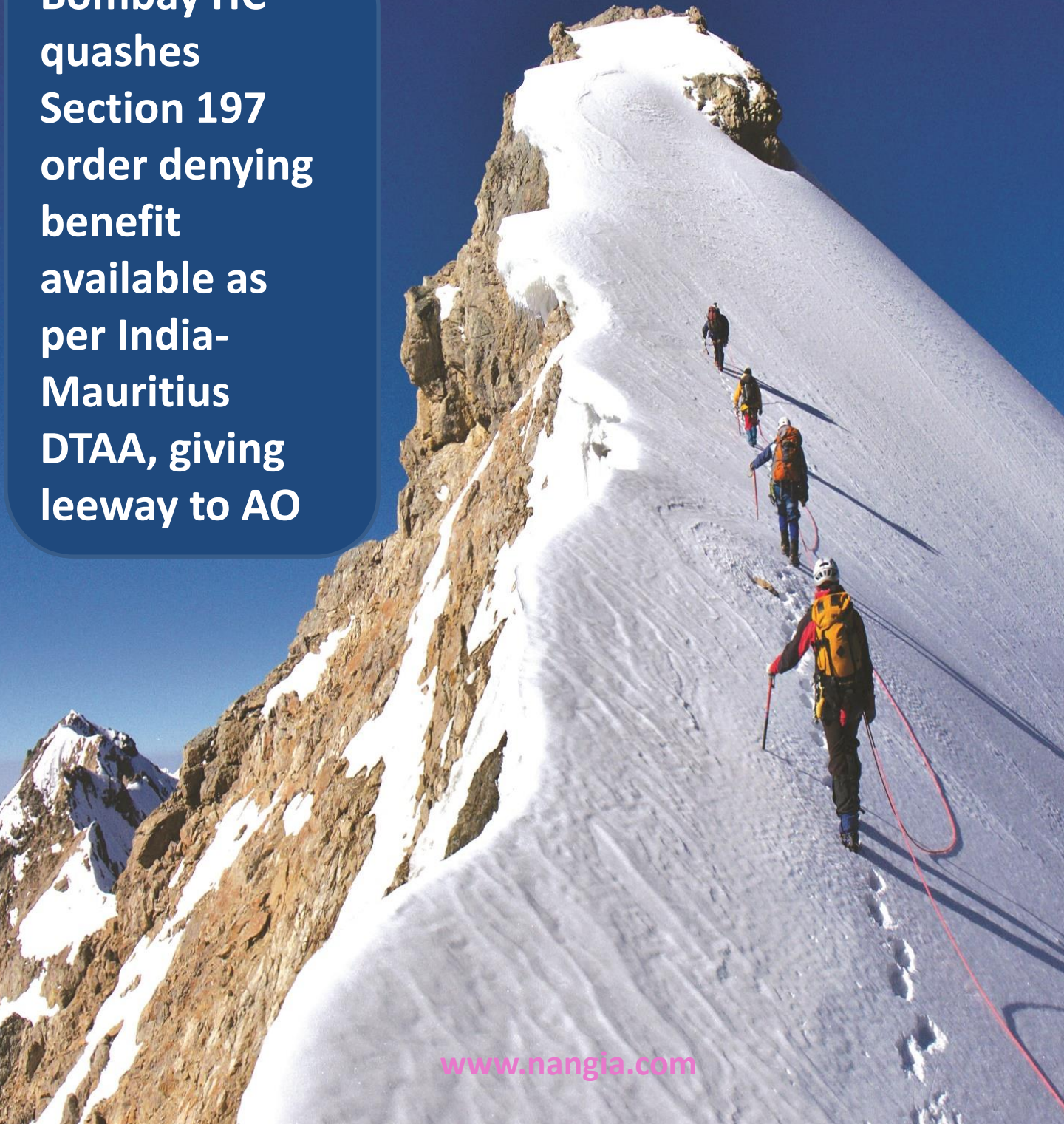


NEWSFLASH

May, 2019 – Volume 117

**Bombay HC
quashes
Section 197
order denying
benefit
available as
per India-
Mauritius
DTAA, giving
leeway to AO**



Bombay HC quashes Section 197 order denying benefit available as per India-Mauritius DTAA, giving leeway to AO

Brief Facts:

- ❑ Indostar Capital (“Company or Assessee”) is a private limited company incorporated under the laws of Mauritius.
- ❑ The Company holds a Category 1 Global Business License (“GBC1 License”) issued by the Financial Services Commission (“FSC”) of Mauritius with the principal activity of investment holding.
- ❑ The Company held 97.30% of share capital in Indostar Capital Finance Limited (“ICFL”), a company incorporated in India under the provisions of the Companies Act, 1956 acquired in different tranches during the year of 2011 to 2015.
- ❑ The Company proposes to partially offload the shares held in ICFL through IPO.
- ❑ In this regard, the Company filed an application for obtaining “NIL” withholding tax certificate in terms of Section 197 of the Act based on the premise that the Long Term Capital Gain arising on the proposed sale of shares would not be liable to tax in India in terms Article 13 of the India-Mauritius Double Taxation Avoidance Agreement (“DTAA”) read with Section 90(2) of the Income Tax Act, 1961 (“the Act”) and accordingly the liability to deduct tax would not arise.
- ❑ While doing so, the Company also furnished Tax Residency Certificate (“TRC”) issued by Mauritius Revenue Authority (“MRA”) along with the other relevant documents.

- ❑ However, the Assessing officer (“AO”) rejected the application considering the entire transaction was not genuine and passed the order directing the payer to withhold tax @ 7.73% on the entire amount.
- ❑ The Company thereafter filed the petition before the Hon’ble High Court of Bombay challenging the aforesaid order passed by the AO.

Assessee’s Contentions:

- ❑ The Company contended that any capital gains arising to an entity incorporated in Mauritius from the transfer of shares of an Indian company acquired on or before March 31, 2017 would not taxable in India in terms of Article 13 of India-Mauritius Treaty. Accordingly, withholding of taxes would not permissible.
- ❑ The Income Tax Authorities cannot go beyond the TRC and deny residential status contrary to the CBDT circular¹ which are binding on the Income Tax Authorities.
- ❑ The AO cannot conduct a full-fledged investigation while issuing certificate under Section 197 of the Act.
- ❑ No material/evidence placed by the AO which could establish that the said transaction was considered as sham or bogus.

¹Circular No. 789, dated April 13, 2000

AO's Contentions:

- ❑ The Company neither made any business transaction nor engaged in other commercial activities apart from making investment and advancing loan.
- ❑ Further, the Company neither maintained any establishment nor incurred any administrative expenses at Mauritius.
- ❑ Also, the Company failed to produce TRC of eight equity fund companies holding its shares as well as the details of ultimate beneficiaries of the shares being transferred.
- ❑ The AO opined that the aforesaid transaction was not genuine and entire tax structure was created to avoid legitimate tax liability.

High Court's judgement:

- ❑ The Hon'ble High court ("HC") affirmed that the capital gain arising to the Company from proposed sale of shares acquired on or before March 31, 2017 would not be taxed in India in terms of Article 13 of India-Mauritius DTAA.
- ❑ The fact that the Company has not transacted in any other business by itself would not be conclusive evidence to consider the said transaction as sham and bogus.
- ❑ Further, the factum that the company's inability to produce TRC of the companies holding its shares, the extent of administrative expenditure and employment structure would not be sufficient to establish the transaction as sham and existence of the Company as fraudulent. The same can be further examined in detail at the time of assessment proceedings.

- ❑ HC quashed the order passed under Section 197 of the Act and directed the AO to release the tax already withheld along with the interest payable as per the law.
- ❑ However, in order to adequately protect the interest of revenue, directed the company to maintain certain minimum shareholding in ICFL till the time limit prescribed for regular assessment under the Act and to furnish security to the satisfaction of AO in the event, the said conditions are not fulfilled.

Indostar Capital Vs. Asst. Commissioner of Income Tax (International Taxation) 2(2)(1) & Ors²

NANGIA'S TAKE:

This is a significant judgement given by Bombay High Court holding that merely not undertaking any other business transactions and incurring administrative expenses cannot be a sufficient and conclusive evidence for considering any transactions as sham, bogus while evaluating any transaction for issuance of certificate under Section 197 of the Act. Though, it is still open for detailed investigation at the time of the assessment. However, in order to protect the interest of revenue, the Tax Authorities would appropriately scrutinize the documents before issuing the certificate under Section 197 of the Act. Thus, the key takeaway which emerges out of this ruling is that while applying for certificate under Section 197 of the Act, now the Applicant Companies are required to be more cautious and maintain robust and appropriate documentation in respect of the transaction in order to establish its genuineness before the Tax Authorities, despite the fact that the same would be further investigated in detail at the time of assessment.

²Writ Petition No. 3296 of 2018, Bombay High Court

ABOUT US

Nangia Advisors LLP is a premier professional services organization offering a diverse range of Taxation, Transaction Advisory and Business Consulting services. Nangia Advisors LLP has presence currently in Noida, Delhi, Gurugram, Mumbai, Dehradun, Bengaluru and Pune. Nangia Advisors LLP has been in existence for more than 38 years and has been consistently rated as one of the best advisory firms in India for entry strategy, taxation, accounting & compliances over the past many years. Nangia Advisors LLP had announced a strategic collaboration agreement with Andersen Global last year in May. Andersen Global is an international association of legally separate, independent member firms comprised of tax and legal professionals around the world. Established in 2013 by US member firm Andersen Tax LLC, Andersen Global now has over 4,000 professionals worldwide and a presence in over 129 locations through its member and collaborating firms.

Quality of our people is the cornerstone of our ability to serve our clients. For this reason, we invest tremendous resources in identifying exceptional people, developing their skills, and creating an environment that fosters their growth as leaders. From our newest staff members through senior partners, exceptional client service represents a dedication to going above and beyond expectations in every working relationship.

We strive to develop a detailed understanding of our clients' business and industry sector to offer insights on market developments and assist our clients develop effective strategies and business models. We have the resources and experience necessary to anticipate and competently serve our clients on issues pertaining to all facets of Tax and Transaction Advisory. We take pride in our ability to provide definite advice to our clients with the shortest turnaround time. The business and tax landscapes have changed dramatically, and the pace and complexity of change continues to increase. We can assist you navigate this shifting landscape.

OUR OFFICES

NOIDA

A-109, Sector-136,
Noida (Delhi- NCR)
201304,
INDIA

DELHI

B-27, Soami Nagar,
New Delhi – 110017,
INDIA

GURUGRAM

812-814, Tower B,
Emaar Digital Greens
Sector 61,
Gurugram,
Haryana- 122102

MUMBAI

11th Floor, B Wing, Peninsula
Business Park, Ganpatrao
Kadam Marg, Lower Parel,
Mumbai – 400 013. INDIA

DEHRADUN

First Floor, "IDA"
46 E. C. Road,
Dehradun – 248001,
Uttarakhand.
INDIA

BENGALURU

150/1 Infantry Road,
Bengaluru – 560001
Karnataka
INDIA

PUNE

Office number 3, 1st
floor, Aditya,
Centeegra, Fergusson
College
Road, Next to Mantri
House,
Pune - 411004

GET IN TOUCH WITH US: contact@nangia.com, 0120-2598000, www.nangia.com

Copyright © 2019, Nangia Advisors LLP All rights reserved. The information provided in this document is provided for information purpose only, and should not be construed as legal advice on any subject matter. No recipients of content from this document, client or otherwise, should act or refrain from acting on the basis of any content included in the document without seeking the appropriate legal or professional advice on the particular facts and circumstances at issue. The Firm expressly disclaims all liability in respect to actions taken or not taken based on any or all the contents of this document.