

**IN THE HIGH COURT OF PUNJAB & HARYANA AT
CHANDIGARH**

**Civil Writ Petition No. 11037 of 2014 (O&M)
Date of Decision: 26th August, 2015**

Serco BPO Private Limited, Gurgaon, Haryana.

..Petitioner

versus

Authority for Advance Rulings, Satya Marg, Chanakyapuri, New Delhi and
others.

..Respondents

**CORAM: HON'BLE MR. JUSTICE S.J.VAZIFDAR, ACTING CHIEF JUSTICE.
HON'BLE MR. JUSTICE G.S.SANDHAWALIA.**

1. Whether Reporters of local papers may be allowed to see the judgment?
2. Whether to be referred to the Reporters or not ?
3. Whether the judgment should be reported in the Digest?

Present : Mr. Porus Kaka, Senior Advocate with
Mr. J.S.Dhaliwal, Advocate,
Mr. Manish Kanth, Advocate,
Mr. Rajesh Sunhan, Advocate,
Mr. Prateek Banjara, Advocate, for the petitioner.

Mr. Tejinder Joshi, Advocate,
for the respondents.

S.J.VAZIFDAR, ACTING CHIEF JUSTICE

The petitioner has challenged an order dated 02.05.2014 issued by respondent No.1-Authority for Advance Rulings under Section 245-R of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') and for consequential reliefs restraining respondent No.2-Assistant Commissioner of Income Tax from initiating proceedings or taking any coercive action in relation to the matter to be considered by respondent No.1 under section 245-R(4) of the Act. The petitioner has also sought an order declaring that the

transaction in question is not designed for avoidance of tax and directing that the consideration paid by the petitioner and received by its seller is not taxable and therefore, the petitioner was not required to withhold the tax in respect of such consideration. Lastly, the petitioner has sought an order remanding the matter to respondent No.1 for consideration of its application on merits. The application for remand was, however, not pressed and we were invited to decide the matter ourselves in view of the considerable delay that has occurred despite the mandate of the Act.

2. On 31.05.2011, the petitioner made an application to the first respondent-Authority for Advance Ruling. The first respondent by the impugned order dated 02.05.2014 declined to give a ruling on the application on the basis of a prima-facie finding that the factual scenario projected by the Revenue establishes that the transaction in question was designed for avoidance of income tax. It was held that for dealing with a situation under Section 245-R(2)(iii) detailed and in-depth analysis to arrive at a definite conclusion about the nature of the transaction is impermissible.

3. We have accepted the request made by Mr. Kaka, the learned Senior counsel appearing on behalf of the petitioner to decide the matter on-merits instead of remanding it due to a combination of reasons. The Act mandates an application for advance ruling under Section 245R(6) to be decided within six months. It is now over four years since the application was made on 03.05.2011. The matter had been heard several times before respondent No.1. It had at one stage been reserved for orders but then released on the respondents' application for further material. It had to be argued afresh as the constitution of respondent No.1 had changed. The matter was argued before respondent No.1 on several occasions over a period of

almost three years. On the application of the respondents, the petitioner produced from time to time voluminous records before respondent No.1. Mr. Joshi, the learned counsel appearing on behalf of the Department admitted that the record is complete in all respects. We are informed that the petition had been heard fully and was reserved for judgment but had to be released as one of the learned Judges ceased to be a Judge of this Court. It would in these circumstances be unfair to remand the matter for yet another hearing effectively the fourth before the first respondent.

FACTS

4. The petitioner was incorporated on 20.01.2002. Barclays (H&B) Mauritius Limited., (hereinafter referred to as 'Barclays') was incorporated on 02.08.2004 in Mauritius. Blackstone GPV Capital Partners (Mauritius) V-B Ltd. (hereafter referred to as 'Blackstone Mauritius') was incorporated on 10.05.2006 in Mauritius. On 01.06.2007, SKR BPO Services Pvt. Ltd. was incorporated in India.

5. On 27.06.2007, an application was made by Blackstone Mauritius to the Foreign Investment Promotion Board (FIPB) for subscribing upto 80% of the equity share capital of SKR BPO Services Private Limited. The application disclosed in detail the corporate structure of Blackstone Mauritius and its holding, ultimate holding and downstream companies. The inter connection of the group was also mentioned as was the purpose of the proposed acquisition of shares and the resultant holding structure of the entities involved.

Along with the application several documents were annexed including Board resolutions authorizing the above investments, Certificates of Incorporation and public announcements.

Accordingly, the following approvals were requested:-

“6. Request for Approval

In the light of the aforesaid, Blackstone Mauritius requests the Foreign Investment Promotion Board to kindly permit:

- (i) Blackstone Mauritius, directly and/or through any of its subsidiaries and affiliates, to subscribe to and hold 54,720 equity shares of face value Rs.10 each, constituting up to 80% of the post issue total paid up equity share capital of SKR BPO Services Private Limited, a company incorporated under the Companies Act, 1956, for a sum of upto Rs.447,20,00,000/-.
- (ii) Pursuant to the subscription of equity shares of SKR by Blackstone Mauritius, downstream investment by SKR by way of acquisition of 68,398,726 shares constituting 100% of the equity share capital of Intelenet Global Services Private Limited, a company incorporated under the Companies Act, 1956 and having its registered office at Ramon House, H.T. Parekh Mark, 169, Backbay Reclamation, Mumbai 400020, and engaged in the business of providing process outsourcing services in the ITES sector.
- (iii) Pursuant to the subscription of equity shares of SKR by Blackstone Mauritius, downstream investment by SKR by way of acquisition of upto 3,229,500 shares constituting 20% of the equity share capital of Sparsh BPO Services Limited, a company incorporated under the Companies Act, 1956 and having its registered office at Intelenet Towers, Plot CSA No.1406-A/28, Mindspace, Malad (W), Mumbai- 400064, and engaged in the business of providing process outsourcing services in the ITES sector.
- (iv) For SKR to make further investments from time to time in companies engaged in IT and IT enabled services.”

The application ended by stating that any further or additional information as required would be furnished.

6. The FIPB granted the approval on 27.08.2007 subject to the terms and conditions mentioned therein. Blackstone Mauritius was named therein as the foreign collaborator. By an amendment dated 31.08.2010, Barclay (H&B) Mauritius Limited was also included. As is usual, with FIPB approvals, the letter was to be made a part of the foreign collaboration agreement to be executed between the investee company and the foreign collaborator and it was provided that only those provisions of the agreement which are covered by the letter or which are not at variance with the provisions of the letter would be binding on the Government of India or the Reserve Bank of India. By Clause-13, the applicant was permitted to proceed to finalize the agreement and to file the same with the RBI. The agreement was subject to Indian laws.

7. Pursuant to the above, on 17.09.2007, Blackstone Mauritius subscribed to 54,720 equity shares of SKR BPO which constituted 80% of the share value of SKR BPO for an aggregate consideration of Rs.447.20 crores. On 26.02.2008, Blackstone Mauritius subscribed to preferential shares of SKR BPO for a consideration of about Rs.31.25 crores so as to retain its 80% holding of the equity shares of SKR BPO. On 07.07.2008, Blackstone Mauritius subscribed to shares of SKR BPO at an aggregate consideration of Rs.64.25 crores. As a result of a buy-back of shares by SK Infra, the holding of the Blackstone Mauritius was reduced to 79.04% of the equity shares of SKR BPO. The approval of FIPB in respect of these investments had been obtained.

8. On 01.10.2010, Barclay (H&B) Mauritius Limited purchased 12.75% of the shares of SKR BPO from Blackstone for a consideration of Rs.29.25 cores which reduced the shareholding of Blackstone Mauritius to 66.29%.

9. This brings us to the agreement in question. A share purchase agreement dated 31.05.2011 was entered into between Blackstone Mauritius, Barclay (H&B) Mauritius Limited, Housing Development Finance Corporation (HDFC), SKM Technology Ventures Private Limited and persons named in Schedule-II as individual sellers on the one hand (referred to in the agreement as Seller 1, Seller 2, Seller 3, Trust Seller and individual sellers, respectively) and the petitioner (therein called the purchaser) on the other. Serco Group plc and Barclay Banks plc are referred to in the agreement as the purchaser parent guarantor and Barclay, respectively.

Recital 'C' sets out the business of the petitioner i.e. the purchaser. It is the same as that of the target company SKR BPO. Each of the sellers i.e. shareholders agreed to sell their shares and the purchaser i.e. the petitioner agreed to purchase the same on the terms and conditions stipulated therein. Blackstone sold its 66.29% equity shares and Barclay sold its 12.75% equity shares in SKR BPO for a consideration of about Rs.1,400 crores and Rs.269.40 crores respectively. The question is whether the petitioner was bound to deduct the tax at source and to pay over the same to the Government.

10. Under cover of its letter dated 31.05.2011, the petitioner forwarded an application to respondent No.1 seeking an advance ruling under Section 245Q(1) of the Income Tax Act, 1961, on the following questions:-

- “1. Whether, on the facts and in the circumstances of the case, the capital gains arising in the hands of Blackstone GPV Capital Partners Mauritius V-B Ltd. (‘Blackstone Mauritius’) and Barclays (H&B) Mauritius Limited (‘Barclays Mauritius’) (Collectively referred to as the ‘Sellers’) on account of the sale of shares of SKR BPO Services Private Limited is not chargeable to tax having regard Article 13(4) of the Agreement for the Double Taxation and Prevention of Fiscal Evasion with Mauritius (‘India Mauritius DTAA’) read with Section 90(2) of the Income Tax Act, 1961 (the ‘Act’)?”
2. Whether, on the facts and in the circumstances of the case, and on the basis that capital gains earned by the Sellers is not chargeable to tax in India having regard to Article 13(4) of India Mauritius DTAA read with section 90(2) of the Act, the Appellant is not required to withhold tax under Section 195 of the Act while making payment of sale consideration to Sellers?”

The dates of closing of the sale by Blackstone Mauritius and Barclay were 08.07.2011 and 19.10.2011.

11. It would be convenient at this stage to set out the relevant provisions of the Act from Chapter XIX-B relating to advance rulings:-

“245-N. Definitions.—In this Chapter, unless the context otherwise requires,—

a) “advance ruling” means—

(i)

(ii) a determination by the Authority in relation to *the tax liability of a non-resident arising out of* a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with *such* non-resident, and such determination shall include the determination of any question of law or of fact specified in the application;

..... .

245-Q. Application for advance ruling.—(1) An applicant desirous of obtaining an advance ruling under this Chapter may make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought.

..... .

245-R. Procedure on receipt of application.—(1) On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Commissioner and, if necessary, call upon him to furnish the relevant records:

Provided that where any records have been called for by the Authority in any case, such records shall, as soon as possible, be returned to the Commissioner.

(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 pending before any income tax authority or Appellate Tribunal [except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of Section 245-N] or any court;
- (ii) involves determination of fair market value of any property;
- (iii) relates to a transaction or issue which is designed prima facie for the avoidance of income tax [except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of Section 245-N or in the case of an applicant falling in sub-clause (iii-a) of clause (b) of Section 245-N]

Provided further that no application shall be rejected under this sub-section unless an opportunity has been given to the applicant of being heard:

Provided also that where the application is rejected, reasons for such rejection shall be given in the order.

(3) A copy of every order made under sub-section (2) shall be sent to the applicant and to the Commissioner.

(4) Where an application is allowed under sub-section (2), the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.

(5) On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.

Explanation.—For the purposes of this sub-section, “authorised representative” shall have the meaning assigned to it in sub-section (2) of Section 288, as if the applicant were an assessee.

(6) The Authority shall pronounce its advance ruling in writing within six months of the receipt of application.....”

12. It is not disputed that the sale of shares by Blackstone Mauritius and Barclays to the petitioner would attract capital gain tax and accordingly the petitioner would have been liable to deduct tax at source under section 195. The petitioner, however, contends that its sellers are not liable to capital gains tax on account of the agreement for avoidance of double taxation between Mauritius and India and consequently there was no question of its being required to deduct tax at source.

13. This brings us to the “Agreement for avoidance of double taxation and a prevention of fiscal evasion with Mauritius” (hereinafter referred to as the ‘DTAC’) between India and Mauritius. The convention had come into force between India and Mauritius for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital gains and for the encouragement of mutual trade and investment. In exercise of powers conferred under section 90 of the Act and 24(A) of the Company (Profits) Surtax Act, 1964, the Central Government directed that all the provisions of the convention would be given effect to in India. Various aspects were agreed to between the Governments of the two countries. The relevant provisions of the DTAC are as under:-

“CHAPTER 1 SCOPE OF THE CONVENTION

ARTICLE 1 – Personal scope – This Convention shall apply to persons who are residents of one or both or the Contracting States.

Article 2 – Taxes covered – 1. The existing taxes to which this Convention shall apply are:

(a) in the case of India,-

- (i) the income-tax including any surcharge thereon imposed under the income-tax Act, 1961 (43 of 1961);
- (ii) the surtax imposed under the Companies (Profits) Surtax Act, 1964 (7 of 1964):

(hereinafter referred to as “Indian tax”):

.....
.....

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.

.....
.....

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.”

14. The DTAC is itself clear. We are however, saved the exercise of analyzing it in depth on its own terms in view of the circulars issued by the Central Board of Direct Taxes under Section 119 in respect of DTAC which are of crucial importance. Our task is made simpler still in view of the judgment of the Supreme Court in *Union of India v. Azadi Bachao Andolan*, (2004) 10 SCC 1. We will, therefore, refer to the circulars immediately.

15. A) Circular No.682 dated 30-3-1994, issued “Clarification regarding agreement for avoidance of double taxation with Mauritius”. Paragraph-3 of the circular reads as under:-

“1605B. Clarification regarding agreement for avoidance of double taxation with Mauritius

1. & 2.

3. Paragraph 4 deals with taxation of capital gains arising from the alienation of any property other than those mentioned in the preceding paragraphs and gives 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 by alienation of shares of companies shall be taxable only in Mauritius according to Mauritius tax law. Therefore, any resident of Mauritius deriving income from 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.”

This circular and the next were referred to by the Supreme Court in *Union of India vs. Azadi Bachao Andolan*, (2004) 10 SCC 1, which we will refer to later.

(B) Circular No.789 dated 13.04.2000 is important and reads as under:-

“Circular No.789, dated 13-4-2000

734. Clarification regarding taxation of income from dividends and capital gains under the Indo-Mauritius Double Tax Avoidance Convention (DTAC).

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. Prior to 1-6-1997, dividends distributed by domestic companies were taxable in the hands of the shareholder and tax was deductible at source under the Income-tax Act, 1961. Under the DTAC, tax was deductible at source on the gross dividend paid out at the rate of 5% or 15% depending upon the extent of shareholding of the Mauritius resident. Under the Income-tax Act, 1961, tax was deductible at source at the rates specified under section 115A, etc. Doubts have been raised regarding the taxation of dividends in the hands of investors from Mauritius. 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.” *(emphasis supplied)*

This circular was also a clarification regarding taxation of income from dividend and capital gain under the Indo-Mauritius Double Tax Avoidance Convention (DTAC).

16. The impugned order refers to some of the facts, some of the submissions on behalf of the parties and a few judgments. The observations on-merits are only in paragraph Nos. 6, 15, 16 and 17. We will let the order in this regard speak for itself:-

“6. We have heard the rival contentions of both the applicant and the Revenue and also peruse documents filed before us. It has been noted that the applicant was reluctant in submitting documents/particulars required by the Revenue for examination though the Sr. Counsel stated that all the relevant documents required by the Department were submitted. On the basis of the submissions and examination of the documents before us, we are of the view that there is prima facie case of the transaction/arrangement being designed for avoidance of income tax in India as submitted by the Revenue. In order to find out the true nature of the transactions, it will be necessary to investigate and examine number of things like fund flows, commercial purpose of the Mauritius companies, commercial expediency of the transaction etc. that cannot be done by this Authority. We consider that this is a fit case for the Revenue to investigate and examine the necessary details in order to come to a logical conclusion. Even otherwise, this is a case that falls under proviso (iii) to section 245R(2) which bars this Authority to allow the application.

.....

15. In order to determine as to whether there was any design, several factors have to be taken into consideration and on isolated or a combination of few circumstances, conclusion cannot be arrived at either to hold that there was a design or not. No straight jacket formula can be laid down as to in which case inference of design can be arrived at and in which case not.

16. It is not the legitimacy of the transaction with which we are concerned. What is the legal effect if it is legitimate tax avoidance within the framework of law is not the consideration while dealing with a situation envisaged under proviso (iii) to Section 245R(2). If on detailed examination of materials

adduced the applicant satisfies the Revenue officials that the transaction is a legitimate tax avoidance arrangement, naturally the consequences will follow as mandated in law. For dealing with a situation envisaged under proviso (iii) to sub-section (2) of Section 245R detailed and in depth analysis to arrive at a definite conclusion about the nature of the transaction is impermissible.

17. In our considered view, the factual scenario projected by the Revenue clearly establishes that the transaction in question was designed prima facie for avoidance of income tax. We, therefore, decline to give ruling on the application, which is accordingly rejected.”

17. The observation in paragraph-6 of the order that the petitioner was reluctant in submitting the documents/particulars required by the Revenue is no longer relevant. All the documents have infact been furnished. To leave no room for doubt, we asked Mr. Joshi whether there was anything else that the Revenue required even at this stage. He replied in the negative. He did not contend that any document remains to be furnished or any query remains to be answered.

18. In view of the general observations made in the impugned order, it is necessary to note the manner in which the matter progressed before the first respondent.

19. The application for advance ruling was made on 31.05.2011. Mr. Kaka submitted that under sub section (6) of Section 245R the Authority for Advance Ruling is to pronounce its advance ruling in writing within six months of the receipt of the application. We do not think that this aspect can be carried much further for it is possible that due to the exigencies of the docket of the Advance Ruling Authority it was not possible to adhere to this

time limit. The other aspects are, however, important. To the preliminary objections raised by respondent No.2, namely, Assistant Commissioner of Income Tax, the petitioner had filed a detailed response. Between June, 2012 and August, 2012, written submissions were filed and several hearings were conducted. The matter was infact heard finally by the previous Chairman and was placed for orders/rulings. By an order dated 27.08.2012, the previous Chairperson recorded that the Revenue harped upon the need to gather further information before the ruling was given. The Chairman, therefore, recorded that he was satisfied that the parties must be heard afresh and directed the matter to be posted for hearing again under section 245R(4) of the Act at a later date. The Revenue was also granted liberty to gather any further information that it may deem relevant. The order was passed on 27.08.2012 and the learned Chairperson retired the next day. It was, therefore, necessary for the hearing to be conducted de novo.

The petitioner by a letter dated 26.03.2013 set out the details of the hearing and the fact that it had submitted all the documents and information relevant to the application over the course of four sets of submissions submitted on 31.05.2011, 31.01.2012, 23.07.2012 and 14.08.2012. It further stated that much of the information requested for had already been submitted with the earlier submissions. The letter also contains a detailed response to the ACIT's letter. A voluminous record was filed by the petitioner before the authorities at the instance of the respondents. Charts were prepared. The petitioner also furnished details of the transactions, corporate structure, share purchase agreements, confidential valuation report of SKR BPO, details of incorporation of Blackstone Mauritius and Barclays, Memorandum & Article of Association of Blackstone Mauritius and

Barclays, Tax Residency Certificates, details of the activities of these companies, details of the Directors including their addresses and PAN details, balance sheets and profit & loss accounts, Board Minutes, FIPB approvals, complete details of initial investment into SKR BPO and the consideration paid for the shares, details of source of funds for initial investment into SKR BPO, bank account statements from the date of initial acquisition of SKR BPO shares till sale of the shares to the petitioner, details of the consideration received, addresses and details of the holding of these two companies and details, names and addresses of the share holders of these two companies, bank account statements and details of SKR BPO.

Further hearings were again held before the first respondent in May, 2012 and December, 2013, during the course of which submissions were filed and notices were issued. The matter was finally heard on 09.12.2013. The impugned order was passed on 02.05.2014.

20. It is surprising that the Revenue from time to time kept asking for the documents and received the documents and claims to have made submissions before the first respondent. However, not a single document finds mention in the entire order impugned in this writ petition.

It is apparent that the Department made only general submissions regarding the merits and did not endeavour to substantiate them on the basis of the documents or any other evidence or to correlate the evidence with its submissions. We say this is apparent as the impugned order does not disclose any such exercise by the Department. Had the Department analyzed the evidence, correlated the documents with its submissions, the first respondent would certainly have dealt with the same in the order. An analysis of the order makes this apparent.

21. There is not a single finding of fact in relation to the prima-facie finding that the transaction/arrangement in this case was designed for avoidance of income tax in India. These findings have been rendered in one sentence in paragraph-6 and in one sentence in paragraph-17. The first respondent has referred to the documents in general. The order, however, does not refer to a single document which led the first respondent to this prima-facie finding. There is no co-relation between any document on record and the findings. Infact, the prima-facie finding in paragraph-6 of the impugned order that the transaction/arrangement was designed for avoidance of income-tax is contrary to the observations in that paragraph itself. In the very next sentence in that paragraph where it is stated that in order to find out the true nature of the transactions, it will be necessary to investigate and examine number of things like fund flows, commercial purpose of the Mauritius companies, commercial expediency of the transactions etc. The order does not co-relate any document to the prima-facie finding. Nor does the order indicate what aspect the first respondent had in mind in respect of the said things, namely, fund flows, commercial purpose of the Mauritius companies and commercial expediency of the transactions etc. which are necessary for determining the true nature of the transactions. The order does not state that any information or documents necessary for the consideration of these aspects were not furnished or were not on record. Paragraph-16 of the impugned order observes that for dealing with a situation envisaged under proviso (iii) to sub-section (2) of Section 245R detailed an in-depth analysis to arrive at a definite conclusion about the nature of the transaction is impermissible. There was no indication in the order and there was no indication even before us as to the direction or the nature of the analysis.

We repeatedly asked Mr. Joshi if there was anything that the Revenue wanted to know even now regarding these aspects viz. fund flows, commercial purpose of the Mauritius companies and commercial expediency of the transactions. He did not indicate any requirement. We asked Mr. Joshi whether the Revenue wanted any material or had any other queries for the purpose of determining the true nature of the transactions. He did not indicate the need for the same either.

Mr. Kaka on the other hand stated that the petitioner was willing to furnish any information required and to answer any question raised by the Revenue in respect of the transactions and the parties thereto.

22. The first respondent was of the view that there is a prima-facie case of the transaction/arrangement being designed for avoidance of income tax in India as submitted by the Revenue.

23. We are with the greatest respect unable to find a basis on which such a finding albeit a prima-facie finding could be rendered. We have set out the findings of the Authority for Advance Rulings (AAR) dated 04.04.2012 which are only in paragraphs 6, 15, 16 and 17 of the impugned order. These are the only findings of the first respondent. The rest of the order comprises of the submissions of the parties as well as the legal provisions and the authorities.

24. The record infact indicates the contrary. Blackstone Mauritius subscribed to about 80% of the equity shares almost from its inception. Barclays purchased 12.75% shares from Blackstone Mauritius on 01.10.2010. Almost from the time of its incorporation in June, 2007 till they sold their shares to the petitioner under the agreement dated 31.05.2011, SKR BPO has been run by Blackstone Mauritius and/or Barclays. They thus ran and

managed SKR BPO for about six years employing about a thousand persons. The intention to acquire the shares was almost from its inception as is evident from the fact that while SKR BPO was incorporated on 01.06.2007, the application to the FIBP by Blackstone Mauritius to purchase its shares was made on 27.06.2007. There is nothing which even remotely suggests that the investment in June, 2007 was only with a view to profiting from the sale of the shares four years later. It was not even suggested that the Share Purchase Agreement dated 31.05.2011 under which Blackstone Mauritius and Barclays sold their shares in SKR BPO to the petitioner was actually conceived at the time Blackstone Mauritius subscribed to the shares in June, 2007 and that such a plan was only implemented in the year 2011. The record certainly does not indicate the same. It indicates to the contrary.

25. We may have considered remanding the matter to the first respondent for a fresh hearing to enable the Department to present its case afresh. We, however did not do so and instead heard the matter ourselves for more than one reason. Firstly, the legislative mandate is that the application is to be decided within six months. The application was made on 31.05.2011 and the six month's period expired on 31.11.2011. The matter had been heard between May, 2011 and May, 2014. The matter was once part heard and thereafter ordered to be heard afresh. By that time the constitution of the first respondent changed and therefore, the matter had to be heard de novo. Considering the nature of this matter, we decided to hear it on-merits. Moreover, the Revenue did not demand any further evidence and had no further queries to raise. No purpose would be served, therefore, by remanding the matter.

26. This brings us to a consideration of Mr. Joshi's submission on merits before us.

Mr. Joshi contended that the real beneficiaries of the transaction do not actually reside and carry on business for gain in Mauritius and therefore, the entire transaction was nothing but a device for taking advantage of the DTAC between India and Mauritius. This he contended was a clear case of treaty shopping. He submitted that Blackstone Mauritius and Barclays cannot be considered to be residents of Mauritius as they have absolutely no business interest in Mauritius. They do not do any business in Mauritius. They have no manufacturing unit in Mauritius. They do not render any services in Mauritius and therefore, they cannot even to be considered to be residents of Mauritius. He submitted that in any event the real beneficiaries are the share holders of these companies and they do not reside in Mauritius. Therefore, the Residency Certificate issued in favour of Black Stone Mauritius and Barclays are irrelevant and is of no consequence whatsoever. He further contended that these companies are not liable to pay capital gains tax in Mauritius.

27. The matter is covered in favour of the petitioner by the provisions of the Income Tax Act, the said Circulars issued under Section 119 of the Act and most important by the judgment of the Supreme Court in *Union of India vs. Azadi Bachao Andolan, (2004) 10 SCC 1 (supra)*.

28. The first question is whether Blackstone Mauritius and Barclays are residents of Mauritius. It is important firstly to note that Tax Residence Certificates were issued to Barclay (H&B) Mauritius Limited and Blackstone Mauritius both valid till 10.12.2011. The Tax Residence Certificates which

are identical in both the cases are of considerable importance in this matter read as under:-

“TAX RESIDENCE CERTIFICATE

**BLACKSTONE GPV CAPITAL PARTNERS
MAURITIUS V-B LTD.**

(Issued under Convention between the Government of Mauritius and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on income and Capital Gains and for the Encouragement of Mutual Trade and Investment)

IT IS HEREBY CERTIFIED THAT BLACKSTONE GPV CAPITAL PARTNERS MAURITIUS V-B LTD. incorporated in Mauritius on 10May 2006 is a company resident in Mauritius for income tax purposes under the Income Tax Act.

This certificate is valid for the period 21 January 2011 to 20 January 2012.

This eleventh day of February, two thousand and eleven.

Sd/-
V.Ramdin (Mrs)
For Director-General
Mauritius Revenue Authority.”

The authenticity of these certificates is not doubted.

29. As per Article 1 the convention applies to persons who are residents of one or both of the contracting States. Blackstone Mauritius and Barclays are both residents of Mauritius. The residency certificates referred to above establish the same. Clause 2 of the CBDT circular No. 789 expressly clarifies that Certificates of Residence issued by the Mauritius authorities constitute sufficient evidence for accepting the status of residence as well as the beneficial ownership for applying the DTAC. The certificate of residence issued by the Mauritian authorities in favour of Blackstone Mauritius and Barclays was accepted by the authorities. Its genuineness and validity was fairly not questioned either before the first respondent or before

us. The certificates of residence issued by the Mauritius Authorities, therefore, establish that Blackstone Mauritius and Barclays are residents of Mauritius within the meaning of Article-1.

30. In view of the circular, it is incumbent upon the authorities in India to accept the certificates of residence issued by the Mauritian authorities. Circular No. 789 is a statutory circular issued under section 119 of the Act. It is obviously based upon the trust reposed by the Indian authorities in the Mauritian authorities. Once it is accepted that the certificate has been issued by the Mauritian authorities, the validity thereof cannot be questioned by the Indian authorities. This is a convention/treaty entered into between two sovereign States. A refusal to accept the validity of a certificate issued by the contracting States would be contrary to the convention and constitute an erosion of the faith and trust reposed by the contracting States in each other. It is for the Government of India to decide whether or not such a certificate ought to be accepted. Once it is established that it has been issued by the contracting State i.e. Mauritius, a failure to accept the residence certificate issued by the Mauritian authorities would be an indication of break down in the faith reposed by the Government of India in the Government of Mauritius and the Mauritian authorities reiterated in and evidenced by statutory Circulars issued under section 119 of the Act.

31. Consequently, the convention applies to Blackstone Mauritius and Barclays being persons who are residents of one or both the contracting States-India and Mauritius.

32. Mr. Kaka's reliance in this regard upon the proposed amendment to section 90 of the Act is well founded. It sets at rest the doubt, if any, in this regard.

(A) Section 90 (4) of the Act as is stood at the relevant time i.e. in respect of the assessment year 2010-11 reads as under:-

“90 (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.”

(B) The Finance Bill, 2013 as introduced in the Loksabha on 28.02.2013 was to give effect to the financial proposals of the Central Government for the financial year 2013-14. Clause 21 of the bill proposed the following amendment:-

“21. In section 90 of the Income Tax Act,-

a)

b)

(c) after sub-section (4) and before Explanation 1, the following sub-section shall be inserted, namely:-

“(5) 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.”

The proposed sub section (5) was not implemented. Parliament was obviously, therefore, conscious of the Circular No. 789 of 2000 and the effect thereof, namely, that the certificate of Residence issued by the Mauritian authorities would constitute sufficient evidence for accepting the status of residence as well as the beneficial ownership for applying the DTAC accordingly. Though an amendment in the

Finance Bill was proposed which would affect the circular, the same was never implemented.

- (C) The reason for Parliament not implementing the amendment is also evident from the clarification dated 01.03.2013 issued by the Finance Ministry specifically regarding Tax Residency Certificates. It is necessary to set out the entire circular as it is of vital importance. It establishes beyond doubt now that the Circular No. 789 was in full force and ought to have been given effect to. The circular reads as under:-

“Finance Ministry Clarification Regarding Tax Residency Certificate (TRC)

March 2, 2013

Concern has been expressed regarding the clause in the Finance Bill that amends section 90 of the Income-tax Act that deals with Double Taxation Avoidance Agreements. Sub-section (4) of section 90 was introduced last year by Finance Act, 2012. That sub-section requires an assessee to produce a Tax Residency Certificate (TRC) in order to claim the benefit under DTAA.

DTAAs recognize different kinds of income. The DTAAs stipulate that a resident of a contracting state will be entitled to the benefits of the DTAA.

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 sub-section (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)

33. Sub Section (4) merely requires a certificate of being resident. The newly added sub section (5) requires the person to also provide such other documents and information as may be prescribed. Nothing has been prescribed to date.

34. The entire sequence of events namely the Finance Bill, 2013, the clarification issued by the Finance Ministry regarding the Tax Residency Certificate dated 01.03.2013 and the Finance Act, 2013 establish beyond doubt that the Residence Certificate issued by the Mauritius authorities must be accepted provided ofcourse it is established that it has been issued by the appropriate Mauritius Authorities. As we mentioned earlier it is not disputed that the Residence Certificate relied upon by Blackstone Mauritius and Barclays were issued by the Mauritius authorities.

35. This is a convenient stage to introduce the judgment of the Supreme Court in *Union of India and another v. Azadi Bachao Andolan and another* 2003 (263) Income Tax Reports, 706. We will be referring to this

judgment more than once for it also answers the other questions conclusively.

The Supreme Court considered the very provisions that we have referred to as well as the said Circulars issued by the Central Board of Direct Taxes. With reference to the Circular No. 682 dated 30.03.1994, the Supreme Court observed that relying on this circular a large number of foreign institutional investors (hereinafter referred to as “FIIs”), which were resident in Mauritius, invested large amounts of capital in shares of Indian companies with expectations of making profits by sale of such shares without being subjected to tax in India. In the year 2000, the Income Tax Authorities issued notices to some FIIs calling upon them to show cause why they should not be taxed for profits and for dividends accrued to them in India. The basis on which the notices were issued was that the FIIs were mostly “shell companies” incorporated in Mauritius, operating through Mauritius, whose main purpose was investment of funds in India. It was alleged before the Supreme Court as it was before us, that these companies were controlled and managed from countries other than India or Mauritius and as such they were not ‘residents’ of Mauritius so as to entitle them to the benefits of the DTAC. This resulted in panic and consequent hasty withdrawal of funds by FIIs from India. The Finance Ministry issued a press note dated 04.04.2000 clarifying that the views taken by some of the Income Tax Officers pertained to specific cases of assessment and did not represent or reflect the policy of the Government of India with regard to denial of tax benefits to such FIIs. After these observations, the Supreme Court referred to the said Circular No.789. This Circular was challenged in the Delhi High Court in two writ petitions. The Supreme Court set-out the grounds on which the Delhi High Court quashed the said circular, three of which viz. grounds (D), (E) and (L) are as follow:-

- “(D) Conclusiveness of a certificate of residence issued by the Mauritian Tax Authorities is neither contemplated under DTAC, nor under the Income Tax Act; whether a statement is conclusive or not, must be provided under a legislative enactment such as the Indian Evidence Act and cannot be determined by a mere circular issued by CBDT.
- (E) “Treaty shopping”, by which the resident of a third country takes advantage of the provisions of the Agreement, is illegal and thus necessarily forbidden.
- (L) By reason of the impugned circular the power of the assessing authority to pass appropriate orders in this connection to show that the assessee is a resident of a third country having only paper existence in Mauritius, without any economic impact, only with a view to take advantage of the Double Taxation Avoidance Agreement, has been taken away.”

It is not necessary for us to refer to the various judgments that were considered by the Supreme Court. It is sufficient to note that the Supreme Court overruled the judgment of the Delhi High Court. In respect of such circulars and even the findings of the Delhi High Court, the Supreme Court held:-

“.....28. A survey of the aforesaid cases makes it clear that 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 implementation of the terms of a Double Taxation Avoidance Agreement. When that happens, the provisions of such an agreement, with respect to cases to which they apply, would operate even if inconsistent with the provisions of the Income Tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the legislature to make a departure from the general principle of chargeability to tax under Section 4 and the general principle of ascertainment of total income under Section 5 of the Act, then there was no purpose in making those sections “subject to the provisions of the Act”. The very object of

grafting the said two sections with the said clause is to enable the Central Government to issue a notification under Section 90 towards implementation of the terms of DTACs which would automatically override the provisions of the Income Tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of DTAC.

29. The contention of the respondents, which weighed with the High Court viz. that the impugned Circular No. 789 is inconsistent with the provisions of the Act, is a total non-sequitur. As we have pointed out, Circular No. 789 is a circular within the meaning of Section 90, therefore, it must have the legal consequences contemplated by sub-section (2) of Section 90. In other words, the circular shall prevail even if inconsistent with the provisions of the Income Tax Act, 1961 insofar as assessee covered by the provisions of DTAC are concerned.

.....

.....

The challenge being only to the exercise of the power emanating from the section, we are of the view that Section 90 enables the Central Government to enter into a DTAC with a foreign Government. When the requisite notification has been issued thereunder, the provisions of sub-section (2) of Section 90 spring into operation and an assessee who is covered by the provisions of DTAC is entitled to seek benefits thereunder, even if the provisions of DTAC are inconsistent with the provisions of the Income Tax Act, 1961."

36. Dealing with Section 119 of the Act, the Supreme Court relying upon several earlier decisions held that the circulars issued by the CBDT under Section 119 of the Act are binding on all the officers and employees employed in the execution of the Act, even if they deviate from the provisions of the Act. It was held that the decision of the High Court that the circular

was ultra-vires, the power of the CBDT was erroneous. The Supreme Court held:-

“ The High Court has held, and the respondents so contend, that the assessing officer under the Income Tax Act is entitled to lift the corporate veil, but the circular effectively bars the exercise of this quasi-judicial function by reason of a presumption with regard to the certificate issued by the competent authority in Mauritius; conclusiveness of such a certificate of residence granted by the Mauritian Tax Authorities is neither contemplated under DTAC, nor under the Income Tax Act a provision as to conclusiveness of a certificate is a matter of legislative action and cannot form the subject-matter of a circular issued by a delegate of legislative power.

53. As early as on 30-3-1994, CBDT had issued Circular No. 682 in which it had been emphasised that any resident of Mauritius deriving income from alienation of shares of an Indian company would be liable to capital gains tax only in Mauritius as per Mauritian tax law and would not have any capital gains tax liability in India. This circular was a clear enunciation of the provisions contained in DTAC, which would have an overriding effect over the provisions of Sections 4 and 5 of the Income Tax Act, 1961 by virtue of Section 90(1) of the Act. If, in the teeth of this clarification, the assessing officers chose to ignore the guidelines and spent their time, talent and energy on inconsequential matters, we think that CBDT was justified in issuing “appropriate” directions vide Circular No. 789, under its powers under Section 119, to set things on course by eliminating avoidable wastage of time, talent and energy of the assessing officers discharging the onerous public duty of collection of revenue. Thus, Circular No. 789 does not in any way crib, cabin or confine the powers of the assessing officer with regard to any particular assessment. It merely formulates broad guidelines to be applied in the matter of assessment of the assessee covered by the provisions of DTAC.

We do not think the circular in any way takes away or curtails the jurisdiction of the assessing officer to assess the income of the assessee before him. In our view, therefore, it is erroneous to say that the impugned Circular No. 789 dated 13-4-2000 is ultra vires the provisions of Section 119 of the Act. In our judgment, the powers conferred upon CBDT by sub-sections (1) and (2) of Section 119 are wide enough to accommodate such a circular.(emphasis supplied)".

These observations are a complete answer to Mr. Joshi's submissions on behalf of the respondents on this point.

37. We must proceed, therefore, on the basis that the certificates of residence issued to Blackstone Mauritius and Barclays are valid and that, Blackstone Mauritius and Barclays are residents of Mauritius.

38. Faced with this, Mr. Joshi submitted that there is no tax leviable in Mauritius on the gains in respect of the above transactions. That, however, is irrelevant. That probably is the reason why several companies choose to route their investments through Mauritius. The Government of India is obviously aware of the same. It would be absurd to suggest that it was not or is not.

39. Article 4 provides that for the purpose 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 inter-alia of his domicile residence, place of management or any other criterion of similar nature. The words "is liable to taxation" mean that the income of the person may be liable to taxation and not that he is actually taxed or pays tax. The words mean that the Government is entitled to tax the person and not whether under the laws he actually pays the tax. A person liable to pay tax may not be

required to pay tax for variety of reasons. For instance, his income may not be within the taxable bracket. There may be a special provision exempting the payment of the taxes by him. Even such a person is liable to taxation. This is clear from the words “any person who, under the laws of that State” which immediately precede the words “liable to taxation therein”. Had it been otherwise, Article 4 would have been worded differently. A view to the contrary would make the DTAC unworkable and erode the basis thereof.

40. As we mentioned while dealing Article-4, the term ‘resident of a Contracting State’ means any person who under the laws of that State i.e. Mauritius 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. Whether a person is actually required to pay tax or not in respect of a particular transaction is irrelevant in determining whether he is liable to taxation. A view to the contrary could result in the entire DTAC being rendered unworkable. Take for instance a case where the Government of one of the countries introduces a tax holiday or grants an exemption for a specified period or where a tax exemption is introduced or revoked. If the respondent’s submission is to be accepted, the position would be fluid and fluctuating depending upon whether a person is required to pay tax or not at a given point of time in Mauritius. It would mean that the person would be liable to pay taxes in India when there is an exemption or no liability to pay any tax in Mauritius and would not be liable to pay taxes in India when he actually pays tax in Mauritius. If that had been the intention, the Government would have also provided the extent to which the tax can be levied by the countries. There would in that event in all the probability have been a

provision for liability to the extent of the difference, if any, between the tax to be payable in one country and the taxes actually paid in the other.

If as contended by Mr. Joshi, the intention had been that Article 13(4) operates only where a person pays tax in Mauritius, it could never be that the extent of payment is irrelevant. It would be irrational then to assume that it would have meant nothing whether the tax paid was only a rupee or crores of rupees.

41. This issue is also considered by the judgment of the Supreme Court in *Union of India v. Azadi Bachao Andolan* (supra). The Supreme Court dealing with the expression 'liable to taxation' held :-

“.....the respondents contend that FIIs incorporated and registered under the provisions of the law in Mauritius are carrying on no business there; they are, in fact, prevented from earning any income there; they are not liable to income tax on capital gains under the Mauritian Income Tax Act. They are liable to pay income tax under the Indian Income Tax Act, 1961, since they do not pay any income tax on capital gains in Mauritius, hence, they are not entitled to the benefit of avoidance of double taxation under DTAC.

.....

.....

It is urged by the learned Attorney General and Shri Salve for the appellants that the phrase “liable to taxation” is not the same as “pays tax”. The test of liability for taxation is not to be determined on the basis of an exemption granted in respect of any particular source of income, but by taking into consideration the totality of the provisions of the income tax law that prevails in either of the contracting States. [See in this connection *K.V.A.L.M. Ramanathan Chettiar v. CIT*, (1973) 88 ITR 169] Merely because, at a given time, there may be an exemption from income tax in respect of any particular head of income, it cannot be contended that the taxable entity is not liable to taxation. They urge that upon a

proper construction of the provisions of the Mauritian Income Tax Act it is clear that FIIs incorporated under Mauritian laws are liable to taxation; therefore, they are “residents” in Mauritius within the meaning of DTAC.”

42. The Supreme Court also referred to the Organization for Economic Co-operation and Development Council (OECD), Model Convention, 1977 and commentaries in relation thereto in support of this view and concluded there from as follows:-

“It is, therefore, not possible for us to accept the contentions so strenuously urged on behalf of the respondents that avoidance of double taxation can arise only when tax is actually paid in one of the contracting States.”

43. Capital gains arising from the sale of the said shares can only be brought to tax in Mauritius. This is also clear from Article 13.

44. Clause-4 of Article 13 provides that the gains derived by a resident of a contracting State (Blackstone Mauritius and Barclays are residents of Mauritius a contracting State), from the alienation of any property other than those mentioned in paragraphs (1) (2) and (3) thereof (the shares of SKR BOP sold by Blackstone Mauritius and Barclays do not fall within paragraphs (1), (2) and (3) of Article 13 shall be taxable only in that State i.e. Mauritius. The gains derived from the alienation of any property would include the gains derived on account of the sale of shares. The words ‘any property’ are wide enough to cover shares in a company incorporated under the Companies Act, 1956. The gains from the sale of shares are taxable under the Income Tax Act, 1961. Article 2 of the DTAC, which stipulates the existing taxes to which the convention applies in the case

of India, includes income tax including any surcharge thereon imposed under the Income Tax Act, 1961.

45. The words 'contracting States' obviously refers to Mauritius. This is obvious as the reference in first part of paragraph-4 of Article 13 is to the 'Contracting State'. The concluding words therein viz. 'that State' therefore refer to the Contracting State. Thus the capital gains that arose on account of the sale of the shares of SKR BPO by Blackstone Mauritius and Barclays are derived by a resident of a Contracting State from the alienation of property other than property mentioned in paragraphs 1, 2 and 3 of the Article 13 and are, therefore, taxable only in 'that State' i.e. Mauritius.

46. As Mr. Kaka rightly submitted, the words 'any property' in paragraph 4 of Article 13 are not qualified by the situs of the property. This is in contrast to paragraph Nos. 1, 2 and 3 thereof. Paragraph Nos. 1, 2 and 3 stipulate the situs' of the property. Paragraph-1 refers to the gains from alienation of immovable property and provides that such gains may be taxed in the Contracting State 'in which such property is situated'. There is no such stipulation or limitation in paragraph 4. Shares are movable and not immovable property. Thus where the Government intended taxing gains from the alienation of property situated in India, it provided for the same specifically. Similarly, gains from the alienation of the properties referred to in paragraph-2 of Article 13 may be taxed in that other State. The words 'other State' clearly refer to the State other than the contracting State which in this case would be India. Here again the situs of such property as is included in paragraph-2 entitles India to tax the gains on account of the alienation thereof. Similarly, paragraph-3 of Article 13 specifically provides that the gains from 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. The entitlement to tax a gain from the alienation of such property is determined on the basis of the place i.e. situs of the effective management of the enterprise. There is no such stipulation in paragraph-4 which applies to the present case. Thus, under the DTAC it is clear that the capital gain from the alienation of the shares situated in India can only be taxed in Mauritius and not in India where the other requirements are as they are in this case.

47. Mr. Joshi contended that this is a case of treaty shopping. Blackstone Mauritius and Barclays do not do any business in Mauritius and that it is the share holders of these companies who actually gain from the transactions in question. These share holders are not residents of Mauritius. Therefore, the provisions of the DTAC are not available to them.

48. The case of ‘treaty shopping’ was dealt with by the Supreme Court in *Union of India v. Azadi Bachao Andolan* (supra), in detail. The following observations are important:-

“Treaty shopping — is it illegal?”

The respondents vehemently urge that the offshore companies have been incorporated under the laws of Mauritius only as shell companies, which carry on no business there, and are incorporated only with the motive of taking undue advantage of DTAC between India and Mauritius. They also urged that “treaty shopping” is both unethical and illegal and amounts to a fraud on the Treaty and that this Court must be astute to interdict all attempts at treaty shopping.

“Treaty shopping” is a graphic expression used to describe the act of a resident of a third country taking advantage of a fiscal treaty between two contracting States. According to Lord McNair,

“provided that any necessary implementation by municipal law has been carried out, there is nothing to prevent the nationals of ‘third States’, in the absence of any expressed or implied provision to the contrary, from claiming the right or becoming subject to the obligation created by a treaty”. [Lord McNair: *The Law of Treaties*, p. 336 (Oxford, at the Clarendon Press, 1961).]

Reliance is also placed on the following observations of Lord McNair [*Ibid.*] :

“that any necessary implementation by municipal law has been carried out, there is nothing to prevent the nationals of ‘third States’, in the absence of any express or implied provision to the contrary, from claiming the rights, or becoming subject to the obligations, created by a treaty; for instance, if an Anglo-American Convention provided that professors on the staff of the universities of each country were exempt from taxation in respect of fees earned for lecturing in the other country, and any necessary changes in the tax laws were made, that privilege could be claimed by, or on behalf of, professors of those universities who were the nationals of ‘third States’ ”.

It is urged by the learned counsel for the appellants, and rightly in our view, that if it was intended that a national of a third State should be precluded from the benefits of DTAC, then a suitable term of limitation to that effect should have been incorporated therein. As a contrast, our attention was drawn to Article 24 of the Indo-US Treaty on Avoidance of Double Taxation which specifically provides the limitations subject to which the benefits under the Treaty can be availed of. One of the limitations is that more than 50% of the beneficial interest, or in the case of a company, more than 50% of the number of shares of each class of the company, be owned directly or indirectly by one or more individual residents of one of the contracting States. Article 24 of the Indo-US DTAC is in marked contrast with the Indo-Mauritius DTAC. The appellants rightly contend that in the absence of a limitation clause, such as the one

contained in Article 24 of the Indo-US Treaty, there are no disabling or disentitling conditions under the Indo-Mauritius Treaty prohibiting the resident of a third nation from deriving benefits thereunder. They also urge that motives with which the residents have been incorporated in Mauritius are wholly irrelevant and cannot in any way affect the legality of the transaction. They urge that there is nothing like equity in a fiscal statute. Either the statute applies *proprio vigore* or it does not. There is no question of applying a fiscal statute by intendment, if the expressed words do not apply. In our view, this contention of the appellants has merit and deserves acceptance. We shall have occasion to examine the argument based on motive a little later.

The decision of the Chancery Division in *F.G. (Films) Ltd., In re* [(1953) 1 WLR 483 : (1953) 1 All ER 615] was pressed into service as an example of the mask of corporate entity being lifted and account be taken of what lies behind in order to prevent “fraud”. This decision only emphasises the doctrine of piercing the veil of incorporation. There is no doubt that, where necessary, the courts are empowered to lift the veil of incorporation while applying the domestic law. In the situation where the terms of DTAC have been made applicable by reason of Section 90 of the Income Tax Act, 1961, even if they derogate from the provisions of the Income Tax Act, it is not possible to say that this principle of lifting the veil of incorporation should be applied by the court. As we have already emphasised, the whole purpose of DTAC is to ensure that the benefits thereunder are available even if they are inconsistent with the provisions of the Indian Income Tax Act. In our view, therefore, the principle of piercing the veil of incorporation can hardly apply to a situation as the one before us.....”

49. The Supreme Court also dealt with the interpretation of treaties with respect to ‘treaty shopping’ in considerable detail. It is sufficient to note only a few observations. It was observed that many developed countries

tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified, for other non-tax reasons unless it leads to a significant loss of tax revenues. Several countries allow use of their treaty network to attract foreign enterprises and offshore activities. In developed countries, treaty shopping is often regarded as a tax incentive to attract scarce foreign capital or technology. The countries take a holistic view keeping in mind the fiscal necessity and political compulsions. The Supreme Court observed that it could not judge the legality of treating shopping merely because one section of thought considers it improper. We would only add that entering into a treaty and terms and conditions thereof are the sovereign functions involving important aspects of policy. Such decisions must be left to the policy makers who are best equipped and have been entrusted with the responsibility of negotiating the treaty to the greatest advantage and good of the country.

50. Mr. Kaka raised another issue which we do not intend deciding in view of what we have already held. It is sufficient to only note the contention. It is as follows.

On 25.11.2011, respondent No.2 raised objection as to the maintainability of the application for advance ruling and requested for additional date. By an order dated 04.04.2012, the Chairman of the first respondent opined that the question raised by the Revenue on tax avoidance should be left to be decided at the final hearing under section 245R(4) of the Act. He held that it is not possible to come to a prima-facie finding at that stage on the basis of the material put forth one way or the other and that it would not be just to do so either. He was satisfied that the consideration of that question should also be postponed to the stage when the application is taken up for hearing to render the ruling. It was further observed that the

finding on such a plea would have a serious impact on the ruling to be given in the application, one way or the other. The Chairman, therefore, reserved the question whether the present scheme put forward by the petitioner is one for avoidance of tax in India for consideration at the stage of hearing under section 245R(4) of the Act. The order concluded as under:-

“Subject to the above reservation, the application is allowed under section 245R(2) of the Act for rendering a ruling on the two questions set out above. The application will be posted for hearing under section 245R(4) of the Act on 30.07.2012.”

Mr. Kaka's submitted that in view of this order the first respondent was bound to decide the application for advance ruling one way or the other. He submitted that the matter had by virtue of this order been admitted for hearing at the final stage i.e. at the stage of hearing under section 245R(4) of the Act. According to him, there was no question of the first respondent sending the matter to the Assessing Officer for regular assessment as the matter had already been admitted. He relied upon the operative part of the order which we quoted earlier to the effect that the application for advance ruling was allowed under section 245R(4) of the Act. He contended that there was a clear direction from the words, namely, “for rendering a ruling on the two questions set out above”. The doubt, if any, according to him, is set at rest by the last sentence that the application will be posted for final hearing under section 245R(4) of the Act. As we have decided the matter on-merits it is not necessary to consider this submission.

51. In the circumstances, the impugned order is quashed and set-aside. It is declared that no capital gain tax was payable by Barclays (H&B) Mauritius Limited. and Blackstone GPV Capital Partners (Mauritius) V-B

Ltd. in respect of the sale of the shares of SKR BPO by them to the petitioner.

The petitioner was, therefore, not liable to withhold the tax in respect thereof under the Act. The questions raised by the petitioner before the Authority for Advance Ruling are answered in the affirmative in its favour.

(S.J.VAZIFDAR)
ACTING CHIEF JUSTICE

(G.S.SANDHAWALIA)
JUDGE

26.08.2015
'ravinder'

Whether to be referred to the Reporter or not.	√ Yes.	No.
--	--------	-----