Tax alert: Sale of Indian company shares not taxable in India as per India-Mauritius tax treaty

8 July 2025

The Delhi Bench of the Income-tax Appellate Tribunal (ITAT), based on facts, has held that the taxpayer was entitled to benefit under Article 13(4) of the India-Mauritius tax treaty in respect of capital gains from sale of shares of an Indian company, prior to 1 April 2017.

In a nutshell

Special purpose vehicles (SPVs)/ investment companies are very common in holding structures and have been accepted as a legitimate business practice. Multinational companies develop corporate structures, joint ventures for operational efficiency, tax planning, risk, mitigation etc. such that better returns can be offered to their shareholders. The burden is entirely on the Revenue to demonstrate that such incorporation has been affected to achieve a fraudulent, dishonest purpose to defeat the law.

Tax authorities cannot go behind the TRC issued by the foreign tax authorities as the same is sufficient evidence for accepting the status of residence as well as the beneficial ownership for the purpose of claiming treaty benefits.

The absence of LOB clause makes the scope of the tax treaty positive from the perspective of an SPV created specifically to route investments into India and, the tax authorities cannot at the time of sale/disinvestment deny benefit on the grounds that the investment was only routed through Mauritius.

Scroll down to read the detailed alert

Background:

- The taxpayer[1] is a company incorporated in Mauritius and held a valid Tax Residency Certificates (TRC) issued by the Mauritius Revenue Authority (MRA) and Category 1 Global Business License (GBL) issued by the Financial Services Commission, Mauritius, since its inception. The principal activity of the taxpayer is to make and hold investments.
- During the Financial Year (FY) 2011-12 corresponding to Assessment Year (AY) 2012-13, the taxpayer sold the shares held by it in an Indian company (say ABC Co) to another non-resident (X Co) and received gross consideration after deduction of tax at source (TDS).

  Certain facts relating to the sale of shares

  - Initially, an Indian company (I Co) held certain equity shares of ABC Co. The taxpayer had made investment in I Co in various tranches during January 2007 and February 2007. Majority of the funding for the investment by the taxpayer in I Co was from funds infused in the taxpayer by its holding company (H Co) in Mauritius.
  - H Co in turn had taken loan from a consortium of banks in the UK, which was upsized in June 2007 and August 2007. For the loans, shares of ABC Co held by I Co were pledged as security.
  - In order to have greater enforceability over security of ABC Co shares, the lenders wanted direct pledge on ABC Co shares. Accordingly, an application for direct pledge of ABC Co shares was made in February 2007 to the Reserve Bank of India (RBI) by I Co. Since no approval from the RBI was forthcoming, the consortium of lenders required liquidation of I Co in order to migrate the shares to the taxpayer, so that ABC Co shares could be directly pledged with the lenders.
  - The RBI vide letter dated 4 October 2007 rejected the application made by I Co to pledge ABC Co shares. Thereafter, in order to address lenders' stipulations, I Co was liquidated in July 2008 against the loan agreement. Pursuant to such liquidation, ABC Co's shares were distributed to the taxpayer, and it became a direct owner of ABC Co shares. Subsequently, an application for pledge of ABC Co shares was filed by the taxpayer with the RBI, in line with the loan agreement which was approved.
  - In terms of Offshore Underwritten Put Option agreement, H Co had a put option to either sell shares of the taxpayer, thereby, effectively transferring ABC Co shares (alternate put option) or procure sale of ABC Co shares by the taxpayer (direct put option). H Co exercised the direct put option and accordingly, the taxpayer sold all the shares held in ABC Co to X Co.
  - The taxpayer claimed that the capital gain arising on sale of shares was not chargeable to tax in India by virtue of Article 13(4) of the India-Mauritius tax treaty [related to capital gains exemption]. Consequently, the taxpayer claimed a refund of taxes withheld in its return of income.
- During the course of audit proceedings, the Assessing Officer (AO) denied the benefit of Article 13(4) of the India-Mauritius tax treaty, on the following grounds:
  - The taxpayer was a resident of India under section 6(3) of the Income-tax Act, 1961 (ITA) as the control and management of its affairs was wholly situated in India.
  - The taxpayer had no substance and was a sham entity incorporated only to take benefit of India-Mauritius tax treaty.
- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings, the matter reached before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

[1] ITA No. 339&340/DEL/2022 (Delhi – Trib.)

Relevant provisions in brief:

Relevant extract of section 6(3)[2] of the ITA and Article 13(4) of the India-Mauritius tax treaty[3]:

"6. For the purposes of this Act, —

(3) A company is said to be resident in India in any previous year, if

(i) it is an Indian company; or

(ii) during that year, the control and management of its affairs is situated wholly in India."

"Article 13(4) of the India-Mauritius tax treaty:

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."

Decision of the ITAT:

The ITAT, inter-alia, noted /observed the following:

Whether taxpayer was a conduit incorporated with sole objective of tax avoidance?

- Special Purpose Vehicles (SPVs) / investment companies are very common in holding structures and have been accepted as a legitimate business practice in various judicial precedents. Courts have recognised the use of tax efficient SPVs and that corporate structures are created for genuine business purposes generally at the time when investment is being made[4].

  Multinational companies develop corporate structures, joint ventures for operational efficiency, tax planning, risk, mitigation etc. such that better returns can be offered to their shareholders. The burden is entirely on the Revenue to demonstrate that such incorporation has been affected to achieve a fraudulent, dishonest purpose to defeat the law - reliance in this regard was placed on an earlier ruling[5] in this regard.

- In the current case, H Co, other group companies and the taxpayer collaborated for their collective best interests in relation to the agreements/ arrangements. Hence, there was nothing unusual in the fact that the investment in ABC shares was itself the legitimate business of the taxpayer. Accordingly, it could **not** be said that the taxpayer was a conduit and had **not** undertaken any business activity or that there was lack of commercial/ business substance.

Acquisition of ABC Co shares by the taxpayer

- The foreign lenders insisted that the taxpayer must hold the shares of ABC Co directly and through the Indian subsidiary viz. I Co. Therefore, it became necessary for the taxpayer to become the direct owner of ABC Co shares and thus, I Co went into voluntary liquidation. I Co's liquidator sought permission from the Indian Income-tax Department for distribution of shares held by I Co in ABC Co to the taxpayer which was granted.

  Accordingly, the taxpayer being the 100% shareholder of I Co, received the shares in ABC Co.

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[2] Prior to amendment vide Finance Act 2016 w.e.f. 1 April 2017

[3] Prior to amendment w.e.f. 1 April 2017

[4] Vodafone International Holdings B.V. vs UOI [2012] 17 taxmann.com 202 (SC) and Sanofi Pasteur Holdings SA [2013] 354 ITR 316 (AP HC).

[5] Bid Services Division (Mauritius) Ltd. (WP No. 713 of 2021) (Bombay HC)

- Even in the absence of liquidation of I Co, if the taxpayer had sold the shares of I Co the capital gains arising to the taxpayer would have been non-taxable in India under Article 13(4) of the India-Mauritius tax treaty.
- Hence it could not be said that the motive of the liquidation was tax avoidance as no tax benefit was obtained by undertaking the liquidation. Thus, the conclusion of the Revenue that the shares belong to an Indian entity and entities were created in Mauritius to migrate and monetize the shares without paying taxes was factually incorrect and contrary to the evidence on record.

Whether the transactions undertaken by the taxpayer were colourable device to avoid tax in India?

- In the case under consideration, the transactions undertaken by the taxpayer were all ordinary commercial transactions based on commercial expediency and could not be termed as colourable device/ design to avoid taxes by any stretch of imagination nor could it be said that there was lack of commercial / business substance.
- The following parameters / tests laid down by the Supreme Court (SC) in an earlier ruling[6] stood satisfied:
  - Time duration test
  - Business operations in India test
  - Generation of taxable revenues in India test
  - Timing of exit
  - Continuity of business on exit

  As the transaction in the case under consideration satisfied all the parameters of investment to participate laid down by the SC, the transaction could not be said to be for the purposes of the avoidance of tax.
- The approach to be adopted is to 'look at' and not 'look through' an arrangement/ transaction to determine whether or not a colourable device exists. Adopting this approach, in the case under consideration, there was no question of a colourable device as the taxpayer was a genuine Mauritian corporation holding valid TRC and was formed for genuine investment business.
- Tax planning within the four corners of law is held to be legitimate right of a taxpayer and hence, to be respected.
- Accordingly, all the transactions were undertaken for commercial reasons and there was no colourable device adopted or avoidance of tax attempted.

Whether TRC issued by MRA is conclusive proof of beneficial ownership of shares?

- The tax authorities cannot go behind the TRC issued by the foreign tax authorities as the same is sufficient evidence for accepting the status of residence as well as the beneficial ownership for the purpose of claiming treaty benefits. Reliance was placed on earlier rulings[7] in this regard.
- The entire attempt of the Revenue in seeking to question the TRC was wholly contrary to the Government of India's repeated assurances to foreign investors by way of CBDT Circulars as well as press releases and legislative amendments and decisions of the courts.

  Accordingly, the Revenue cannot go behind the TRC issued by the Mauritius tax jurisdiction as the same

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[6] Vodafone International Holdings B.V. vs UOI [2012] 17 taxmann.com 202 (SC)

[7] UOI v. Azadi Bachao Andolan [2003] 132 Taxman 373 (SC), Vodafone International Holdings B.V. vs UOI [2012] 17 taxmann.com 202 (SC), Blackstone Capital Partners (Singapore) VT FDI Three Pte. Ltd. [2023] 146 taxmann.com 569 (Delhi HC), Bid Services Division (Mauritius) Ltd. v. AAR [2023] 148 taxmann.com 215 (Bombay HC), MIH India (Mauritius) Ltd. [ITA No.1023/Del/2022], Reverse Age Health Services Pte. Ltd. v. DCIT [2023] 147 taxmann.com 358 (Delhi Trib.)

was sufficient evidence to claim treaty eligibility, residence status and legal ownership.

Whether tax treaty benefit can be denied in absence of Limitation of Benefit (LOB) clause?

- The India-Mauritius tax treaty as it was in force for the year under consideration did not contain LOB clause which restricted the benefit available under Article 13(4) of the tax treaty nor provided for any condition to be fulfilled for claiming the benefit of Article 13(4) of the tax treaty.
- However, the India-Mauritius tax treaty did not have any of the clauses incorporated by India in the tax treaties executed with other countries (such as Article 24 of the India-USA tax treaty relating to LOB and Article 24 of the India-Singapore tax treaty relating to Limitation of Relief) and, therefore, in the absence of any restriction placed in the India-Mauritius tax treaty, the treaty benefits cannot be denied by the tax authorities invoking the conditions which were not part of the tax treaty.
- In the absence of a LOB clause in the India-Mauritius tax treaty, there was no justification in prohibiting the incorporation of companies in Mauritius for deriving benefits of the tax treaty. The absence of LOB clause makes the scope of the tax treaty positive from the perspective of a SPV created specifically to route investments into India and, the tax authorities cannot at the time sale/disinvestment deny benefit on the ground that the investment was only routed through Mauritius. Reliance was placed on earlier ruling[8] in this regard.
- The LOB clause was inserted as Article 27A in the India-Mauritius tax treaty only w.e.f. 1 April 2017 which provided that a company shall not be entitled to the benefits of Article 13 if the primary purpose was to take advantage of the tax treaty and the company was a shell company incurring expenditure on operations of less than Mauritian Rupee 1.5 million in Mauritius.
- The CBDT press release[9] clarified that the amendments made to the India-Mauritius tax treaty will be applicable only from AY 2018-19 that too on capital gains arising on the securities purchased after 1 April 2017. Therefore, the LOB clause did not apply to the year under consideration.

Whether capital gains on shares purchased before 1 April 2017 could be brought to tax in India?

- Article 13 of the India-Mauritius tax treaty has been amended w.e.f. 1 April 2017. The amended Article 13(4) effectively provides that the capital gain arising on alienation of shares acquired before 1 April 2017 cannot be brought to tax in India in any situation. Hence, the jurisdiction to tax capital gain in India is vested only w.e.f. 1 April 2017, that too only for the capital gain arising on alienation of shares acquired on or after 1 April 2017.

  Therefore, the capital gain arising from the shares purchased before 1 April 2017 would not be chargeable to tax in India and the provisions of pre-amended Article 13(4) would continue to protect the taxpayer.

In view of the above, the ITAT held that the taxpayer was eligible for benefit of Article 13(4) of the India-Mauritius tax treaty. Accordingly, the capital gains arising on sale of shares of ABC Co were not chargeable to tax in India.

Comments:

Eligibility to claim tax treaty benefits, especially in case of capital gains exemption on sale of an Indian company shares has often been questioned by the tax authorities. The key question is whether tax treaty benefits can be claimed by a taxpayer based on holding of a valid TRC issued by the country of residence or whether the tax taxpayer also needs to prove that the arrangement is not a sham or colourable device

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[8] Vodafone International Holdings B.V. vs UOI [2012] 17 taxmann.com 202 (SC)

[9] Dated 10 May 2016 and 29 August 2016

designed to obtain tax benefit under the relevant tax treaty. Also, whether the taxpayer needs to prove that it is beneficial owner of shares with respect to capital gains transactions, has been a subject of litigation.

The India-Mauritius tax treaty has undergone change effective from 1 April 2017 including introduction of LOB clause for claiming capital gains exemption with respect to sale of shares. Further, the Multi-lateral Instrument (MLI) ratified by India also brings in principal purpose test.

The ITAT in this ruling has upheld the following:

- SPVs/ investment companies are very common in holding structures and have been accepted as a legitimate business practice. Multinational companies develop corporate structures, joint ventures for operational efficiency, tax planning, risk, mitigation etc. such that better returns can be offered to their shareholders. The burden is entirely on the Revenue to demonstrate that such incorporation has been affected to achieve a fraudulent, dishonest purpose to defeat the law.
- Tax authorities cannot go behind the TRC issued by the foreign tax authorities as the same is sufficient evidence for accepting the status of residence as well as the beneficial ownership for the purpose of claiming treaty benefits.
- The absence of LOB clause makes the scope of the tax treaty positive from the perspective of an SPV created specifically to route investments into India and, the tax authorities cannot at the time of sale/disinvestment deny benefit on the grounds that the investment was only routed through Mauritius.

  The CBDT press release[10] clarified that the amendments made to the India-Mauritius tax treaty will be applicable only from AY 2018-19 that too on capital gains arising on the securities purchased after 1 April 2017. Therefore, the LOB clause did not apply to the year under consideration.

It may be pertinent to note that the Delhi High Court in an earlier ruling[11] had laid down, amongst others, that the issuance of a TRC by the competent authority must be sacrosanct and due weightage must be accorded to the same as it constitutes certification of the TRC holding entity being a bona fide entity. However, the matter is now before SC and the verdict is awaited on this issue.

Further, on the residential status of the taxpayer, the ITAT noted the following:

- As per section 6(3)(ii) of the ITA (as applicable to the year under consideration), a company incorporated outside India can be considered as a resident of India only **when the control and management is 'wholly' situated in India**. Therefore, if any part of the control and management is situated outside India, the company cannot be considered a resident of India.
- **There exists difference between management control and shareholder control.** For the purpose of section 6(3) of the ITA, what is required to be seen is de facto control, i.e., where the control and management is actually exercised.
- In the case under consideration, all the decisions relating to the affairs of the company including sale of ABC shares, were taken by the BOD in the meeting held at its registered office in Mauritius and the tax authorities failed to bring any material on record which showed that persons other than the directors had taken any decision, let alone any person based in India.

  Hence, the control and management of the taxpayer was <u>not</u> situated in India and the taxpayer qualified as non-resident.

[10] Dated 10 May 2016 and 29 August 2016

[11] [W.P.(C) 6764/2020] (Delhi HC)

It is pertinent to note that section 6(3) of the ITA has been amended vide Finance Act 2016 w.e.f. 1 April 2017. Now, for a company to be a resident in India, the requirement of control and management of the affairs situated 'wholly' in India is removed, instead 'place of effective management' in India is to be determined.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.