

Tax Hotline

May 16, 2025

DELHI ITAT UPHOLDS CLAIM OF TREATY BENEFITS BY CYPRUS TAXPAYER

- The Delhi ITAT (“ITAT”) holds that a valid Tax Residency Certificate would entitle the Cyprus based Investment Company to benefits under the India–Cyprus Double Taxation Avoidance Agreement (“DTAA”) on capital gains and income received on account of dividend.
- The ITAT affirmed that approvals granted by SEBI, RBI, and FIPB are based on rigorous scrutiny, and could not be dismissed as routine or mere paper work, thereby supporting the genuineness of the Taxpayer's investment structure.
- On basis of review of the governance structure and minutes of board meetings, ITAT held that the Taxpayer was managed from Cyprus and rejected AOs allegation of being managed from USA

BACKGROUND

The Hon'ble Delhi ITAT in a recent ruling¹ allowed Gagil FDI Ltd. (“Taxpayer”), a company incorporated in Cyprus, to claim exemption on capital gains arising from transfer of shares of an Indian company and benefit of lower tax rate of dividend income under the India–Cyprus Double Taxation Avoidance Agreement.

The Taxpayer is a wholly owned subsidiary of GA Global Investments Ltd. (“Parent Company”) which is also a Cyprus based company, The Parent Company raise monies from several feeder funds based in Bermuda (91.15 %), Germany (8.65%) and Delaware (0.20%). The Parent Company had acquired the equity shares of the National Stock Exchange of India Ltd. (“NSEIL”) after receiving approval from RBI in 2007 from institutional investors. Such acquisition was made after receipt of approvals from Indian authorities including SEBI, RBI and FIPB unit of Department of Economic Affairs, Ministry of Finance.

NSEIL is a one of the biggest stock exchanges in India and the purchase and sale of its shares are regulated by SEBI.² The acquirer must satisfy the ‘fit and proper’ criteria prescribed by SEBI and must obtain SEBI's approval.

In 2014, the Taxpayer purchased the equity shares of NSEIL from the Parent Company, in exchange of issuance of its shares at a premium. The transaction was disclosed, and necessary approvals were obtained by the Taxpayer for such acquisition from Indian authorities.

The Taxpayer sold shares of NSEIL to multiple buyers and filed its return of income declaring long-term capital gains and claimed exemption under the DTAA. It also offered dividend income from NSEIL to tax at the concessional tax rate of 10% under the DTAA.

The Assessing Officer (“AO”) denied the DTAA benefits holding that the control and management of the Taxpayer was with a company based in USA. The AO held that certain directors and authorized signatories were affiliated with USA, indicating that the Taxpayer was merely a conduit. As per AO's contentions, the true beneficiaries of the gains were located in the USA, and the Taxpayer was created solely to access tax benefits. This was also upheld by the Dispute Resolution Panel (“DRP”).

ITAT'S OBSERVATION

- The ITAT observed that the AO's allegation of treaty abuse by the Taxpayer was unfounded, misconceived, and contrary to the evidentiary record. It was noted by the ITAT that the Taxpayer had a Tax Residency Certificate (“TRC”) issued by the Cyprus Revenue Authorities and it had placed on record various evidence showing that its business activities, including key decision-making, were conducted in Cyprus and not in USA. The ITAT noted that the Taxpayer was able to successfully proof that the decision for investment / divestment in NSEIL were also taken by the Taxpayer in Cyprus.
- The ITAT further held that approvals are granted by SEBI, RBI, and FIPB after rigorous scrutiny, and thorough due diligence which should not be disregarded as mere paper formalities. The ITAT held that any shell company making an endeavour to make such investment shall be caught under the checks and balances incorporated in the applicable legal framework. As per the regulatory framework of SEBI, any acquisition of shares in a recognized stock exchange made above certain thresholds (2% or 5%) requires prior approval, and have to fulfil the “fit and proper person” criteria which involves examination on financial soundness, integrity, and regulatory compliance history.
- It finally concluded that the Taxpayer was not a mere conduit or shell entity and therefore held that the Taxpayer is entitled to the benefits under the DTAA. The ITAT also relied on the case of Saif II-Se Investments Mauritius Ltd. vs.

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ACIT,³ which had similar facts involving acquisition of NSEIL shares and subsequent transfer to its subsidiary which was further sold by the subsidiary to third parties. Delhi ITAT had allowed treaty benefits to Saif on exit from NSEIL on basis of the settled principle that TRC issued by tax authority of another jurisdiction is the most credible evidence to prove the residential status if an entity.

NDA COMMENTS

The decision of Delhi ITAT is another favourable ruling upholding sanctity of grandfathering under tax treaties. It is likely to act as a direct precedent on transactions relating to investment / divestments from Indian stock exchanges. It is common for parties to seek approvals from regulators in M&A transactions due to several reasons – approvals may have to be sought from regulator due to change in shareholding of target entity or trigger of thresholds under Competition Act or approval from RBI in relation to foreign exchange laws etc. The principle that approvals from regulatory authorities should not be dismissed as routine is also welcome.

While the decision is silent on why Cyprus was chosen as a jurisdiction for investment or the need to have a two-layer structure, it is clear that proper documentation evidencing decision making from host jurisdiction is imperative to satisfy the substance test. Lastly, while the ITAT granted the Taxpayer to claim concessional tax rate on dividend income, there is no specific finding on beneficial ownership.

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¹Gagil FDI Ltd [TS-567-ITAT-2025(DEL)]

²As per Securities Contracts (Regulation) (Stock Exchange & Clearing Corporations) Regulations, 2012 and Securities Contracts (Regulation) (Manner of increasing and maintaining public shareholding in recognized stock exchange) Regulations, 2006

³154 taxmann.com 617 (Delhi-Trib)

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