

Tax Hotline

February 09, 2023

DELHI HIGH COURT QUASHES REASSESSMENT PROCEEDINGS AND UPHOLDS SANCTITY OF TRC!

- Satisfaction of beneficial ownership not required to take benefit under capital gains article under relevant tax treaty
- TRC is statutorily the only evidence required to be eligible for the benefit under tax treaties.
- The tax authorities cannot go behind the TRC issued by the other tax jurisdiction and such an attempt is not tenable in law.

BACKGROUND

Recently, the Hon'ble Delhi High Court ("HC") exercised its writ jurisdiction and quashed reassessment proceedings initiated by the tax department against Blackstone Capital Partners (Singapore) VI FDI Three Pte Ltd ("Taxpayer")¹. The HC held that tax department cannot go behind the tax residency certificate ("TRC") issued by the Taxpayer's jurisdiction and considered the TRC as sufficient evidence to claim treaty eligibility, residence status and legal ownership.

FACTS OF THE CASE

The Taxpayer, a Singapore resident, acquired equity shares of Agile Electric Sub Assembly Private Ltd ("Agile"), a company incorporated in India in two tranches in assessment year ("AY") 2014-15. The Taxpayer subsequently sold all the equity shares of Agile to Igarashi Electric Works Ltd. ("Igarashi") and other parties during the AY 2016-17 ("Transaction"). The Taxpayer claimed that the capital gains arising from the Transaction were not taxable in India in light of Article 13(4) of the India-Singapore Double Tax Avoidance Agreement ("DTAA") based on the TRC. The return of income was processed with no demand. Thereafter, in 2021, notice for re-assessment was issued to the Taxpayer under Section 148 of the Income-tax Act, 1961 ("ITA") for AY 2016-17 by the assessing officer ("AO"). The Taxpayer requested for reasons for reopening of assessment and was supplied with the same (after 8 months of request), stipulating that the genuineness and taxability of the Transaction remained unverified mandating the reopening of the proceedings.

The Taxpayer objected to reopening of the assessment, however, the income-tax department disposed of such objections. Aggrieved by the disposition, the Taxpayer filed a writ petition before the HC.

DECISION OF THE HON'BLE HIGH COURT

The HC after undertaking a detailed analysis inter-alia held the following:

- Maintainability: On revenue's contention with respect to maintainability of petition, the HC held that the 'reasons to believe' for reopening the proceedings is amenable to writ jurisdiction.
- Recourse to section 147 to extend time period for verification is illegal: The reason for reopening of assessment by revenue authorities was to verify the nature and genuineness of Transaction. In this regard, the HC held that the return of income had been filed by the Taxpayer within the stipulated time with complete particulars as required, and the timeline for verification and seeking clarifications or additional documents had already expired. In such a case, the order for reopening of assessment was held untenable in law.
- Impugned notice issued on borrowed satisfaction held illegal: the AO sought to place reliance upon data extracted from a 3rd party source to initiate the reassessment proceedings. In this regard, the HC held that while information from 3rd party sources can form a basis for investigation but the decision to reopen assessment has to be formed by the AO. The HC noted that reassessment proceedings were initiated based on the information forwarded by the TDS officer of Igarashi without the independent application of mind of the AO. In light of this, the HC held issuance of such a notice to be legally impermissible.
- No close nexus between the material and formation of belief: The HC enunciated that the reasons for reopening proceedings should exhibit that the AO had reached a view after due consideration of all the facts, so as to avoid an arbitrary exercise of power. Further, a close nexus or a live link must be shown to exist between the material available before the AO and the belief that income chargeable to tax has escaped assessment. The HC held that such a link or nexus was missing in the instant case.
- Concept of beneficial ownership under the DTAA was not required for capital gains: The HC held that satisfaction of beneficial ownership was required only qua dividend, interest and royalty.
- Reasons recorded cannot evolve or be allowed to grow with time: Considering that the AO raised additional pleas which did not form part of reasons for reopening of assessment, the HC held that reasons recorded cannot evolve

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or be allowed to grow with age and ingenuity. The reasons which are recorded cannot be supplemented by affidavits.

- Requirements of Limitation of Benefit (“LOB”) clause stood satisfied: On perusal of the audited financial statement of the Taxpayer and an independent chartered accountant’s certificate, the HC held that the Taxpayer was satisfying the LOB condition provided in the DTAA.
- Respondent-revenue cannot go behind the TRC: The HC categorically enunciated that “it is a fundamental rule of international taxation that every nation has a sovereign right to impose tax on the global income of its residents and on income that accrues or arises within its territorial limits”, and that the “respondent’s attempt in seeking to question the TRC is wholly contrary to the Government of India’s repeated assurances to foreign investors.” The HC referred to various provisions of the DTAA, Section 90 of the ITA, judicial decisions and CBDT Circulars to interpret that the Taxpayer was eligible to the benefits of the DTAA. The HC further noted that the TRC is statutorily the only evidence required to be eligible for the benefit under the DTAA. The HC thus conclusively ruled that the tax authorities cannot go behind the TRC issued by the other tax jurisdiction and such an attempt is not tenable in law.

NDA ANALYSIS

The decision of the HC is a big win for the Taxpayers and foreign investors. It is common for the tax department to challenge availability of benefit under tax treaty. While most tax treaties have been amended to provide India the right to tax capital gains income from transfer of equity shares, tax department has often challenged availability of benefit under tax treaty even in cases where investment has been grandfathered. In order to make such challenge, typically, the tax department would either initiate withholding tax proceedings on the buyer or initiate assessment / reassessment proceedings on the sellers (depending on statutory limitations).

The instant case emanates from challenge by the Taxpayer to the reasons provided by the tax department for initiation of reassessment proceedings. The HC has succinctly laid several important principles with respect to reassessment proceedings. Considering that the Taxpayer had made all disclosures with respect to investment in Agile and the Transaction and the expiry of time period for verification/ seeking clarifications, the HC held that recourse to section 147 is untenable. The HC also considered the documentary evidence (like Form 10K filed by the Blackstone group in USA) shown by the tax department and concluded that there was no link between such material and formation of such belief. While provisions with respect to reassessment proceedings have undergone substantial change post Finance Act, 2021, the principles laid down by the HC should still hold importance.

In relation to beneficial ownership, the HC clarified that satisfaction of ‘beneficial ownership’ is not required to claim exemption under Article 13 of the DTAA. Tax authorities often deny tax treaty benefits alleging that the taxpayer is not the beneficial owner of capital gains income. The HC has rightly pointed out that the language of the Article 13 (capital gain) of the DTAA does not necessitate the fulfilment of the beneficial ownership test for availing its benefit.

This is in line with the recent decision by the Mumbai ITAT². Nevertheless, the HC noted that the tax department had not been able to prove that the Taxpayer was a tax resident of USA or was controlled or managed from USA. The fact that the Taxpayer had maintained appropriate documents and was managed by its board of directors from Singapore worked in its favour.

Importantly, the HC has categorically upheld the sanctity of the TRC issued by Singaporean tax authorities. The HC relied on the Supreme Court decision in case of Azadi Bachao Andolan³ wherein TRC was held to be conclusive evidence for determining the status of residence and beneficial ownership of an asset under the tax treaty. The HC decision is yet another decision wherein the court has followed the ratio laid down in landmark cases like Azadi Bachao and Vodafone⁴.

Considering the high risk of challenge and amendment to certain tax treaties pursuant to the multilateral instrument, while existence of TRC may be a starting point for claiming benefits under tax treaty, it is equally important to ensure appropriate substance in form of employees, presence and documentation. Further, it is also very important to have a strong commercial rationale for structuring transactions in a certain manner and recording such rationale in minutes.

— Ipsita Agarwalla & Ashish Sodhani

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You can direct your queries or comments to the authors

¹ Blackstone Capital Partners (Singapore) VI FDI Three Pte Ltd vs ACIT; Neutral Citation Number 2023/DHC/000634

² Blackstone FP Capital Partners v. DCIT ITA Nos. 981 and 1725/Mum/202

³ Azadi Bachao Andolan v. Union of India [2003] 263 ITR 706 (SC)

⁴ Vodafone International Holdings B.V. vs. Union of India and Anr., (2012) 6 SCC 613

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