taxsutra All rights reserved

taxsutra

Past, Present and Future of Tax Residency Certificate – Part 1

Date: October 10,2018

Priti Shah (Partner, T.P Ostwal & Associates LLP)

Mitali Shah

. 1. Introduction

While tax treaties emancipate tax payers from the burden of double taxation, the process involved in taking the benefit of such treaties might not be such a well-settled affair. Proving your tax residence remains an indispensible part of this process. Also, in the wake of the recent developments and judicial rulings, what constitutes a conclusive evidence of your tax residence might not be incontrovertible. For the purpose of granting tax treaty benefits, typically, most countries accept a certificate of residence issued by the competent tax authorities of the country of residence of the tax payer. Even in India, section 90(4) of the Income-tax Act, 1961 ("ITA"), provides that a Tax Residency Certificate ("TRC") is required from the authorities of the country of residence to claim applicable relief under the relevant Double Taxation Avoidance Agreement ("DTAA"). If one requires a TRC in India, an application is required to be made in Form 10FA to the income tax-authorities. The TRC is then issued in Form 10FB, on successful processing of the said application. CBDT has also notified Form 10F for furnishing 'prescribed' information to be submitted by a non-resident under provisions of Sec 90(5) for claiming DTAA relief, in addition to TRC. The information prescribed therein is more or less similar to those originally prescribed for TRC. Such information is to be self-certified in Form 10F by the non-resident and is not required to be certified by the Government of residence country. Further, where the prescribed information is already contained in the TRC obtained by the non-resident, the non-resident is still required to furnish Form 10F.

The genesis of introducing the concept of substantiation of tax residence was to support the principle of substance over form to determine beneficial ownership and to prevent treaty shopping. However, a certificate of residence may not always be the only testament for this purpose. Recently, as per the decision of the Ahmedabad Tribunal in the case of Skaps Industries India Private Limited[1], it was concluded that any document apart from TRC would also be considered as a valid document for proving residency in a foreign country if it is certified by the tax authorities of the Resident State. This ruling is a welcome move that has turned out to be a ray of light for non-resident tax payers who find it cumbersome to obtain a TRC from their country of residence. However, looking at the Indian perspective, where no issue is settled without prolonged litigation, even the matter of validating one's tax residency for the purpose of obtaining tax treaty benefits has not been left untouched.

There have been various judicial rulings pronounced by the Indian judiciary authorities which have dealt with the issue of accepting tax residency based on mere submission of TRC. Before venturing into these, we shall take a look at the chronicle of the legislative history of TRC in India.

2. Rewind - Legislative history of TRC in India

Going back to the times when the quantum of cross-border transactions were relatively less, the ITA did not consist of a specific provision for furnishing of a TRC. Then in absence of such provisions in law, TRC was believed to be sufficient documentary evidence for claiming treaty benefits. However, what initially triggered the opening of a Pandora's Box was Circular No. 682 dated 30.3.1994 issued by the CBDT in exercise of its powers under Section 90 of the Act. Through the said Circular, the Government of India clarified that capital gains of any resident of Mauritius by alienation of shares of an Indian company shall be taxable only in Mauritius according to Mauritius taxation laws and will not be liable to tax in India. Relying on this, a large number of Foreign Institutional Investors ("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. However, sometime in the year 2000, income-tax authorities issued show cause notices to FIIs as to why they should not be taxed for dividends accrued to them in India. The basis on which such notices were issued was that such FIIs were suspected to be mere shell companies incorporated in Mauritius, operating through Mauritius, whose

taxsutra All rights reserved

main purpose was investment of funds in India. These show cause notices resulted in panic and consequent hasty withdrawal of funds by the FIIs. Thereafter, the Indian Finance Minister issued a Press Note dated April 4, 2000 to clarify that the views taken by some income-tax authorities pertained to specific cases only and did not represent the policy of the Government of India with regard to denial of tax benefits to such FIIs. To further clarify the situation, Circular No. 789 dated 13th April 2000 was issued by the CBDT which supported the previously issued Circular No. 682 and further provided 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 DTAA accordingly. Placing reliance on the said Circulars, non-residents from countries other than Mauritius also claimed treaty benefits by providing TRC to residents in India.

However, despite the same, TRC has not yet been considered as a well-settled conclusive evidence for tax residency and the tax authorities have often raised the question of its sufficiency for claiming tax treaty relief especially in the context of the India-Mauritius tax treaty which allocated[2] the right to tax the capital gains arising on transfer of shares to Mauritius if the tax payer is a resident of Mauritius.

The rationale behind the tax authorities' reluctance to accept the TRC as the final word on the tax residency in the case of India-Mauritius tax treaty appears to be that the Mauritius entities claiming the tax residency of Mauritius were merely shell entities having no business operations in Mauritius and were set up only for claiming the capital gains exemption under the India-Mauritius tax treaty. The tax authorities further contended that allowing the benefits of the India-Mauritius tax treaty to these entities, results into double non-taxation since the capital gains on sale of shares are exempt from tax in Mauritius. However, this stand of the Revenue authorities has turned out to be cumbersome for genuine tax payers.

What settled the dust was an important foundation laid by the Supreme Court ("SC") in a landmark judgement in the case of Azadi Bachao Andolan[3]. While the Delhi High Court quashed Circular no. 789 on the ground that the impugned circular is inconsistent with the provisions of the ITA, the SC held that the contention of the High Court is a total *non-sequitur* i.e. an invalid argument. It further observed that the said Circular is within the meaning of section 90 and therefore, it must have the legal consequences contemplated by sub-section (2) of section 90. Thus, it was held that the circular shall prevail even if it is inconsistent with the provisions of the ITA insofar as assessees covered by the provisions of the DTAA are concerned.

Thereafter, the absence of a standardised format or guidelines issued by the Central Government for furnishing of TRC created ambiguity. Also, it was noticed that tax payers who were not residents of a contracting country claimed benefits under the DTAA entered into by the Government with that country. Thereby, even third party residents claimed unintended treaty benefits. In light of this, section 90 of the ITA was amended vide Finance Act, 2012 to provide that TRC containing the prescribed details would be mandatorily required to be furnished by a non-resident for claiming tax treaty benefits. However, the Explanatory Memorandum to the Finance Bill, 2012 mentioned that the TRC would be a necessary but not a sufficient condition for the purposes of availing tax treaty benefits. To further support this position, the same words were proposed to be introduced in the ITA and a clause had been inserted in the Finance Bill, 2013 to insert sub-section (5) to sections 90 and 90A. This caused severe anxiety amongst the non-residents since it seemed to suggest that the TRC would not be a conclusive evidence of tax residency and the tax authorities can tear the veil of TRC and examine the factual matrix for determining the residential status of the entity and thereby deny treaty benefits.

This issue was then sought to be addressed by a Press Release dated 01st March 2013 issued by the then Finance Minister stating that the TRC would be accepted for evidencing the tax residence under the tax treaty and the tax authorities would not go beyond the TRC to examine the residential status. The Press Release also reiterated the Circular No. 789 would still be applicable. This was reflected by an alteration to the Finance Bill, 2013 whereby the originally proposed sub-section (5) was dropped Thus, in lieu of the same, a new sub-section (5) was inserted in section 90 requiring the taxpayers to provide other documents and information, as may be prescribed, along with a TRC, for availing the tax treaty benefits.

It is quite interesting to note that Income-tax (Seventeenth Amendment) Rules, 2016 inserted rule 37BC in the Income-tax Rules, 1962 which required a non-resident not having a PAN to submit *inter alia* a certificate of residence to obtain relaxation from deduction of tax at higher rate under section 206AA of the ITA on payments in the nature of interest, royalty, FTS and payments on transfer of any capital asset.

Despite the Supreme Court decision in case of Azadi Bachao Andolan (supra) and the CBDT Circular / Press Release, the Indian tax authorities have raised questions over the tax treaty eligibility claims of the non-residents and there has been subsequent litigation on this front. Fortunately, the principles enunciated by the Supreme Court have been consistently applied by the Indian judiciary authorities in the subsequent decisions, some of which have been discussed hereunder.

The article has been assisted by Ms. Trupti Savant and Mr. Divya Jain.

taxsutra All rights reserved

The views and opinions expressed in this article are those of the authors and the analysis performed within this article are based only on information available in public domain.

---

[1] [2018] 94 taxmann.com 448 (Ahmedabad – Trib.)

[2] With effect from 1st April 2017, gains from alienation of shares acquired on or after 1st April 2017 in a company which is resident of contracting state may be taxed in that state.

[3] [2003] 263 ITR 706 (SC)