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Beneficial Owner of Capital Gains

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Agenda

- Understanding Beneficial Ownership
- History of Beneficial Ownership
- Beneficial Ownership in DTAAs
- Interpretation of Beneficial Ownership
- Beneficial Ownership of Capital Gains
- Case Laws
- Case Studies

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Understanding Beneficial Ownership

Meaning of Beneficial Ownership

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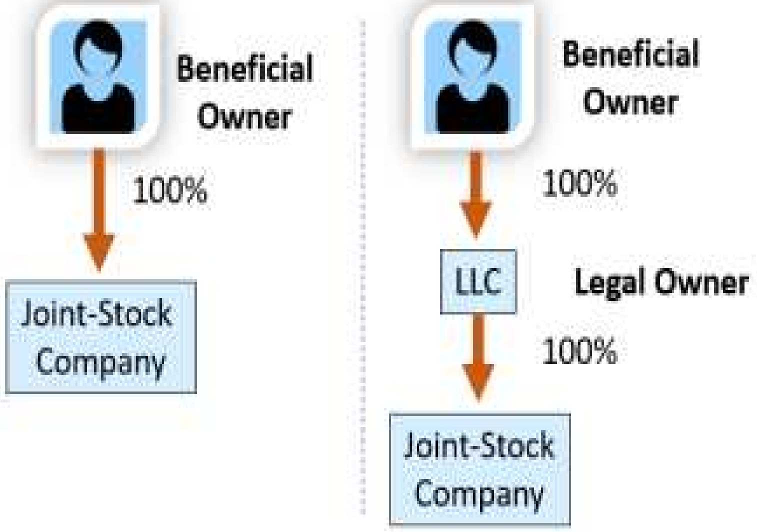
Beneficial	Owner
• relating to rights to the use or benefit of property, other than legal title • **entitling a person to receive the profits or proceeds of property**	• a person who owns something • one who has the legal or rightful title to something • one to whom property belongs



<u>Explanation 4 to Section 139(1)</u>- *For the purposes of this section "beneficial owner" in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.*

Who is a 'Beneficial Owner'?

- The natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. **<u>It also includes persons who exercise ultimate effective control over legal person or arrangement</u>**.
- Ultimately owns or controls and ultimate effective control refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.
- Hence, what emerges is:
    - Someone, <u>who besides being a legal owner, has "dominion and control" over the property</u>
    - An owner of the property <u>who holds its for its own benefits</u>
    - A person constrained by a contractual or legal obligation to pass on such receipt to another person
    - Agents, nominees, conduit companies acting as a fiduciary / administrator

Who is a ‘Beneficial Owner’? (Contd.)

Beneficial Ownership

- Anti-avoidance mechanism to protect the tax base of the Source State
- Included in domestic laws of countries as a ‘Special Anti Avoidance Regulations’
- Applied in domestic tax laws to combat ‘Benami arrangements and transactions’ as well as ‘Conduit arrangements’
- Not defined in any Double Taxation Avoidance Agreements (‘DTAA’)

History of Beneficial Ownership

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History of Beneficial Ownership

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<u>1942</u>
Applied in the Article dealing with dividend in the Canada- US DTAA

<u>1966</u>
Referred in the Treaty Protocol to the US-UK DTAA

<u>1977</u>
Introduced in the OECD Model Tax Convention ('MTC') and briefly in the commentary.

<u>1986</u>
OECD Conduit Companies Report explained the purpose of including the beneficial ownership requirement

<u>2003</u>
Amended the commentary to the OECD MTC to provide that the term beneficial owner is not to be used in a narrow technical sense

<u>2014</u>
Expanded the commentary to the OECD MTC and provided the definition of beneficial owner.

Beneficial Ownership Not to Be Confused with a Substance Requirement

History of Beneficial Ownership: Indian Perspective

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Circular No. 789 dated 13 April'2000	Azadi Bachao Andolan	Universal International Music B.V.	Press Clarification dated 1 March 2013	HSBC Bank (Mauritius) Ltd.
• TRC constitutes sufficient status of residence and beneficial ownership • India-Mauritius DTAA • In the context of dividend and capital gain on sale of shares	• SC held that Circular No. 789 does not interfere with Section 90 and Section 119 and is well within the ambit of the IT Act	• Relied on Circular No. 789 in the context of India-Netherlands DTAA • Extended the scope to royalty income	• Finance Ministry clarified that Circular No. 789 continues to be in force.	• Relying on circular 789, extended the scope to interest income

Beneficial Ownership in DTAAs

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Beneficial Ownership in DTAAs

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Article	Provisions
10	Dividend – lower rate applied if the recipient is the beneficial owner of dividend
11	Interest – lower rate applied if the recipient is the beneficial owner of interest
12	Interest – lower rate applied if the recipient is the beneficial owner of royalty or FTS
13	Capital gains –lower or no taxation on capital gains in the Source State if the transferors of assets holds specified percentage of holding or voting powers in the company located in the Source State – India-Netherlands.

Interpretation of Beneficial Ownership

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Dominion and Control v Substance

- The doctrine of substance over form mandates taxing transaction pursuant to its economic effect rather than its form and that a valid transaction must have both a substantial purpose apart from reduction of tax liability.
- Beneficial ownership is not linked to substance or lack thereof in a particular jurisdiction rather it is the determination of dominion and control over the source of income.

Tests of Substance	Tests of Dominion and Control
• Office address, total floor area of the office, go-downs and seeking details of any other premise owned; • Whether there are multiples companies with common address; • Employee register with the details of all the employees; • Whether the directors of the company hold multiple directorships, etc.; • Bank statements for relevant periods; • Explanations as to the source of funds out of which investments have been made; and • Filings with authorities of the home jurisdiction such as financials, tax returns, etc. for relevant periods; etc.	• Formed for business objectives and not to exploit tax benefits alone • Makes independent decisions vis-à-vis investment, expenditure, etc. • Enjoys unrestricted right to use and enjoy income earned by the taxpayer; and • Bears business risks (such as currency risk, investment risk, etc.) commensurate with its activities and income earned

Direct and Indirect Ownership and Control

- Ownership of Shares
- Ownership of Voting Rights
- Other Ownership Arrangements
- Contractual Associations or Personal Connections with management or directors
- Management Control
- Recipient of loan or other benefit having conditions granting controlling rights
- Other ability to exert significant influence on corporate activity (eg: veto rights, decision rights, right to profit)

Beneficial Ownership v Beneficial Interest

Beneficial Ownership	Beneficial Interest
Refers to ultimate control on the benefits from the property	Refers to a right to income or use of assets in a trust.
Entitled to the benefit, directly or indirectly	It is distinguished from the rights of a trustee or nominee or such other person who has the responsibility to perform and hold title to the
Beneficial Interest apart from legal interest in the property	Do not own title to the property, but they have some right to benefit from the property

Beneficial Ownership of Capital Gains

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Case Laws

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Mumbai Tribunal on Beneficial Ownership

(Blackstone FP Capital Partners Mauritius V Ltd)

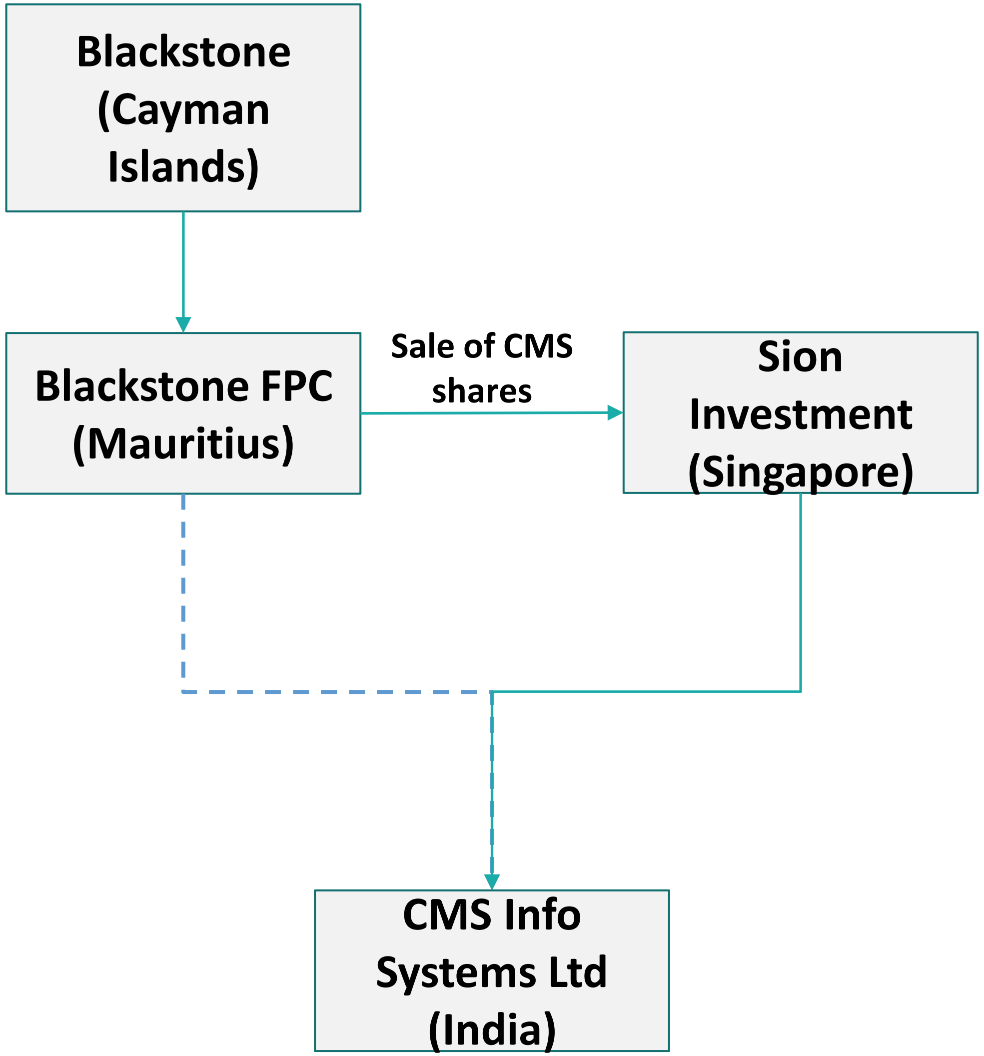
Facts

- Blackstone held a global business license (GBL) and TRC issued by Mauritius Authorities.
- The Indian tax authorities held that it had no independent existence and that its entire activity was controlled and directed by Cayman Island parent entity.

Issue: Whether the concept of beneficial ownership is a *sine qua non* for entitlement to treaty benefits?

Held

- The condition of Beneficial Ownership is absent from Article 13 of the India-Mauritius Treaty - Tax on capital gains from the alienation of shares.
- Unless a condition is specifically set out in the treaty provision itself, it cannot possibly be inferred or added – Against principles of interpretation (Good Faith principle) under VCLT.
- The matter was restored to the file of the AO to decide vide a speaking order as to 'whether the concept of 'beneficial ownership' is inbuilt in the scheme of article 13'. (Subsequently recalled).



Delhi HC on Beneficial Ownership

(Blackstone Capital Partners (Singapore) Vi Fdi Three Pte. Ltd. v. ACIT [2023] 452 ITR 111 (Delhi)- 30.01.2023

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CONCEPT OF BENEFICIAL OWNERSHIP UNDER DTAA WAS ONLY QUA DIVIDEND, INTEREST AND ROYALTY AND NOT FOR CAPITAL GAINS

Under the India-Singapore DTAA, at the relevant time, capital gain was to be taxed on the basis of legal ownership and not on the basis of beneficial ownership. In fact, the concept of beneficial ownership, at the relevant time under the India Singapore DTAA, was attracted for taxation purposes only *qua* three transactions *i.e.* dividend, interest and royalty and not for capital gains. [Para 61]

AAR Delhi on Beneficial Ownership
(Tiger Global International II Holdings, Mauritius-2020)

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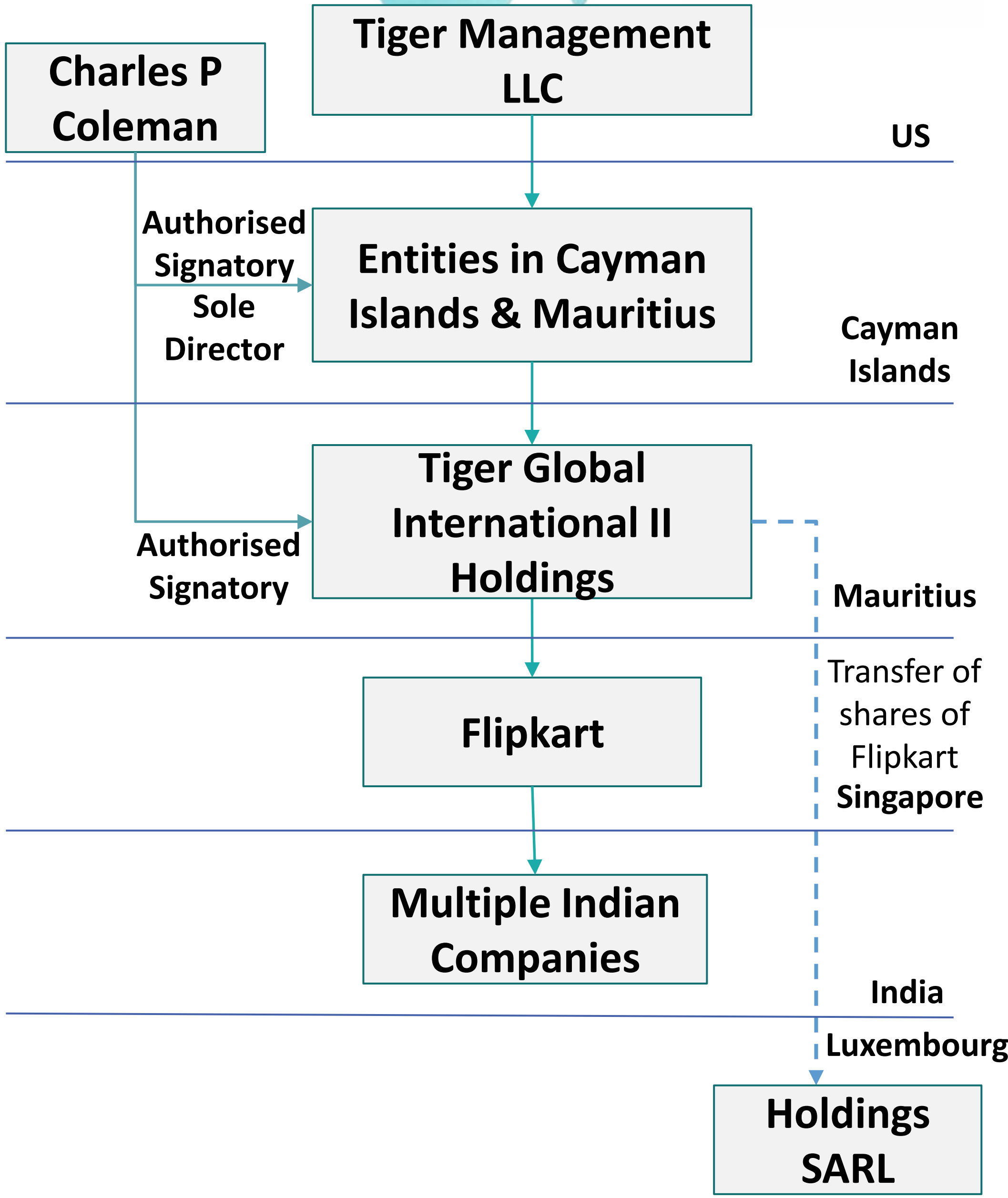
Facts

- Applicants were Mauritius-based investment company. They were granted a Category-1 Global Business Licence and regulated by the Financial Services Commission in Mauritius.
- The Applicants acquired shares of the Singapore Co. in 2011 which in turn made investments in India. In 2018, the Applicants transferred its shares of the Singapore Co. to the Luxembourg Co.

Held

- Entire transaction of acquisition as well as the sale of shares **'as a whole'** was required to be evaluated. The **'Head and Brain'** and consequently the control and management of the Applicants was not in Mauritius but in USA (signing authority)
- US residents were the beneficial owner of the immediate parent companies of the Applicants and were responsible for the entire major decision making. Thus, the Applicants were only a **'see-through'** entity.



THANK YOU!

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