INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'I' BENCH, MUMBAI
[Coram: Pramod Kumar, Vice President, and,
Vikas Awasthy Judicial Member]

ITA No.: 7388/Mum/19
Assessment year: 2015-16

Morgan Stanley Mauritius Co Ltd …………………….. **Appellant**
14th Floor, The Ruby, 29 Senapati Bapat Marg
Dadar (West), Mumbai 400 028 [PN: AADCM5927G]

Vs.

Deputy Commissioner of Income Tax
International Taxation Circle 3(2)(2), Mumbai ………………….**Respondent**

Appearances:
Dr Sunil M Lala *along-with* **Harsh Bafna and Vishesh Srivastava,** *for the appellant*
Sanjay Singh, *for the respondent*

Dates of hearing the appeal : 9th February and 28th May, 2021
Date of pronouncing the order : 28th day of May 2021.

O R D E R

Per Pramod Kumar, VP:

1. By way of this appeal, the assessee appellant has challenged the correctness of the order dated 7th October 2019, passed by the Assessing Officer in the matter of assessment under section 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961, for the assessment year 2015-16.

2. The short issue that we are required to adjudicate in this appeal is whether or not the Assessing Officer was justified in holding that the receipts of Rs 9,74,66,600, from India based depository, i.e., Standard Chartered Bank- India, in respect of shares of Standard Chartered Bank plc- UK represented by the India Depository Receipts (IDRs), were chargeable to tax in India in the hands of the assessee. The way the assessee puts it, by way of a ground of appeal is that "**On the facts and circumstances of the case, the learned AO,**

based on the directions of Hon’ble DRP erred in making an addition of Rs 9,74, 66,600, being the dividend income received by the Appellant in respect of shares represented by IDRs of SC Plc, as chargeable to tax in India. In this regard, the learned AO, based on the directions of Hon'ble DRP, erred on the following grounds”. The assessee has raised several sub grounds of appeal, but, in substance, these sub grounds of appeal are arguments in support of the aforesaid ground of appeal.

3. The issue in appeal lies in a narrow compass of material facts. The assessee before us is a company incorporated in, and fiscally domiciled in, Mauritius. The assessee is thus a tax resident of Mauritius and holds a valid Tax Residency Certificate issued by the Mauritius Revenue Authorities. The assessee is an investor in the Indian Depository Receipts (**IDR**, in short) by “Standard Chartered Bank- India Branch” (**SCB-India**, in short), with the underlying asset in the form of shares in a UK based company by the name of Standard Chartered Bank plc (**SCB-UK**, in short) held by the depository’s custodian, i.e., Bank of New York Mellon, USA (**BNY-US**, in short). SCB-UK is a company listed in London Stock Exchange, and the IDRs so issued, i.e., in respect of the shares of SCB-UK, are listed in India. There is no dispute that the Indian Depository Receipts are issued in terms of Companies (Issue of Indian Depository Receipts) Rule, 2004, and that listing of IDRs are listed in India in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009. During the relevant financial period, the assessee had received Rs 9,74,66,595, from SCB-India, in respect of dividends for the underlying shares relatable to the IDRs in which the assessee had invested. When the assessee was put to notice, as to why the receipt in question not be taxed as a dividend income in the hands of the assessee, elaborate submissions were made in support of the contention that this receipt is not taxable in India inasmuch as the dividends are in respect of a foreign company, namely SCB-UK, the dividends are received abroad by BNY-US, and, as such, these dividends neither accrue or arise in India nor are received or deemed to be received in India. It was submitted that “SCB-India was a bare trustee (i.e., akin to a nominee) under the English law for the IDR holders”. It was then pointed out that the dividend was first received outside India, and, accordingly, “such dividend cannot be regarded as received/ deemed to be received in India”. It was contended that “subsequent remittance of the dividend to the IDR holders in and Indian bank

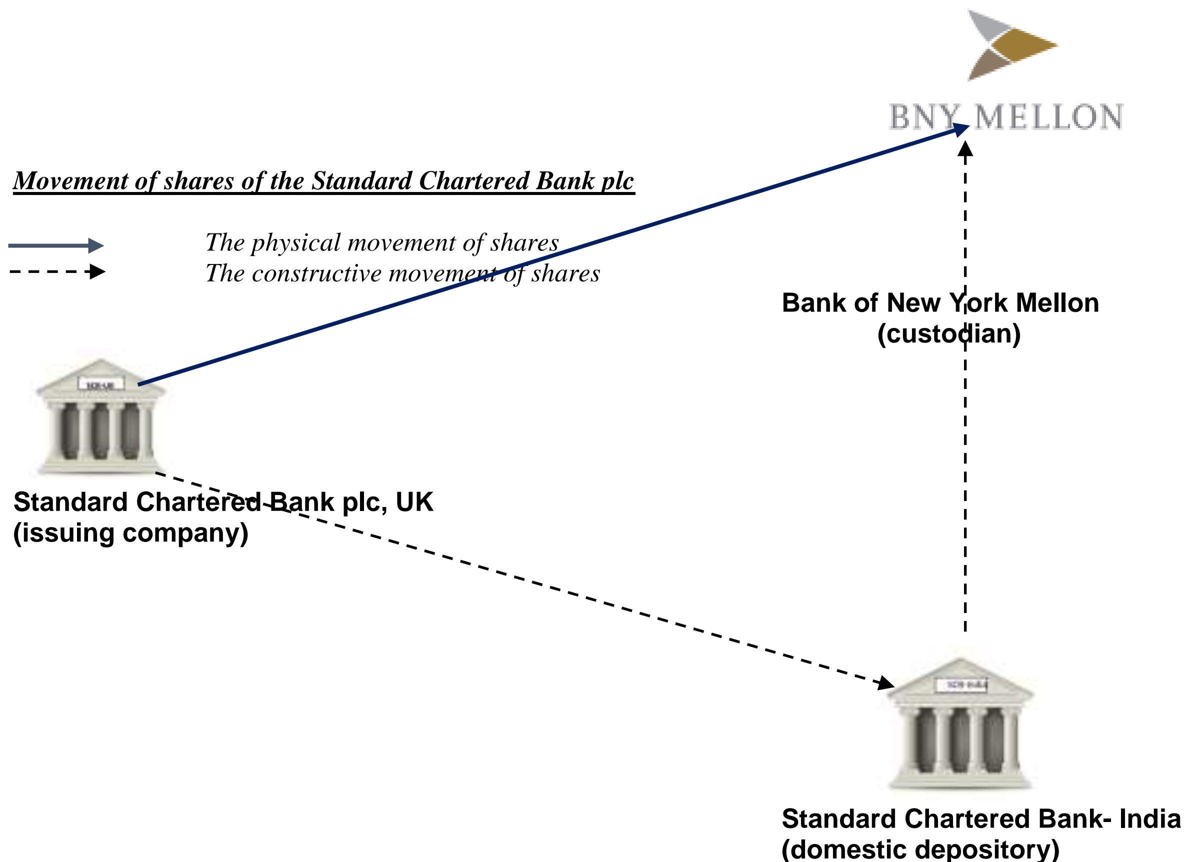
account will not trigger receipt based taxation as per the provisions of the Act". Without prejudice to this contention about non-taxability of this receipt under the Income Tax Act, 1961, it was further contended that, in terms of the India Mauritius Double Taxation Avoidance Agreement [(1984) 146 ITR (St) 214; **Indo-Mauritius tax treaty**, in short), as these payments did not meet the requirements of the definition of dividends under article 10, such receipts can only be subjected to tax under article 22 which is in the domain of exclusive taxation in the residence jurisdiction, i.e., Mauritius. None of these submissions, however, impressed the Assessing Officer. With a very detailed analysis of the factual position with respect to the Indian Depository Receipts and legal framework thereof, and with a very detailed analysis of the legal framework regarding taxability thereof, the Assessing Officer concluded that so far as the IDR holders are concerned, the first point of receipt of dividend is when it is deposited in the bank accounts of the IDR holders in India, and, therefore, it cannot be said that the income in question is received outside India. He noted the claim of the assessee that the money dividend was received outside India as it was deposited in the bank account of SCB-India in SCB-UK, as maintained abroad, and then distributed by the SCB-India upon conversion, but rejected the same on the ground, inter alia, that the money continued to be in the possession of the person who was to pay the same, i.e. SCB-UK, and that, in reality as also in substance, the payment was made in India in the Indian bank accounts of the IDR holders, including, of course, the assessee. References were also made to the contents of Red Herring Prospectus (RHP) of the IDR issue to highlight the fact that even according to the RHP, 'dividends paid to the non-resident IDR holders shall be taxable in India, if it is received in India or is deemed to be received in India, that the exemption from dividend taxation in India is not available under section 10(34) as no dividend distribution tax is paid in India and as IDRs are not subjected to securities transaction tax, corresponding exemption from long term capital gains under section 10(38), as also concessional tax rate under section 111A, is not available. The Assessing Officer thus proceeded to propose tax these dividends under section 115(1)(a) @ 20% plus applicable surcharge and cess. Aggrieved, the assessee raised objections before the Dispute Resolution Panel but without any success. While learned DRP confirmed the action of the Assessing Officer, so far as the treaty protection claimed by the assessee was concerned, it declined to grant the same on the ground that "it is noted that the company making the distribution of dividend income is a resident of India, for the purpose of the definition of dividend under article 10 of India

Mauritius DTAA. In the light of the above facts, the receipt of the dividend from IDR is liable to be taxed under the Income Tax Act as also under the DTAA. The objection in this regard is thus rejected". The Assessing Officer thus proceeded with the proposed draft assessment order, and brought the IDR dividends to tax in the hands of the assessee. The assessee is aggrieved and is in appeal before us

4. We have heard Dr. Sunil Lala, learned counsel for the assessee, and Shri Sanjay Singh, learned Commissioner (DR), at length, we have perused the material on record, and we have duly considered facts of the case in the light of the applicable legal position.

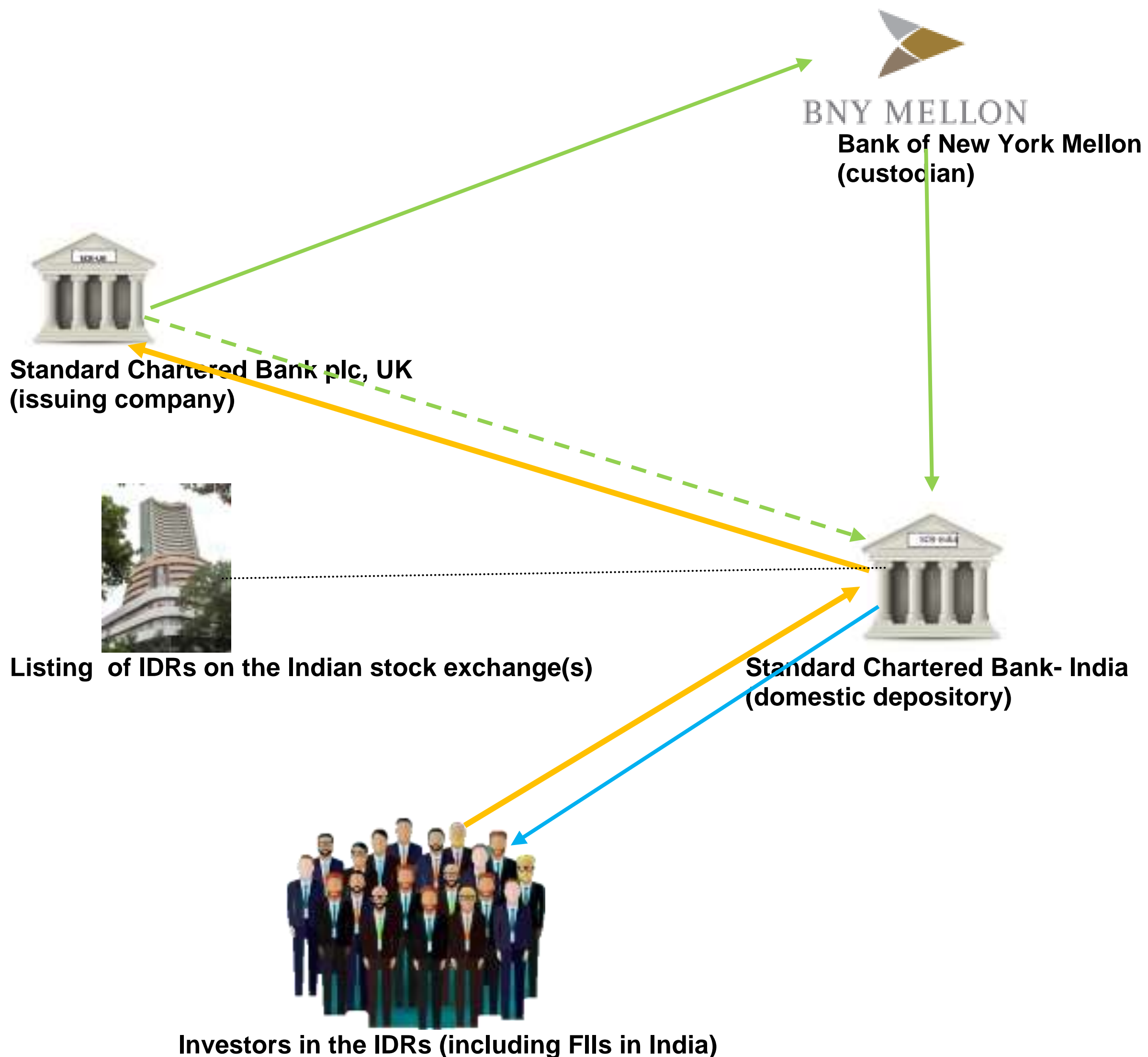
5. It would perhaps be appropriate that we have a basic understanding, so far as relevant to, and necessary for, us, as to what 'Indian Depository Receipts' actually mean and stand for. It is a derivative financial instrument, i.e., a financial instrument that draws its value from the underlying asset and is tradable on one or more approved stock exchanges in India. While this financial instrument, tradable in one or more of the Indian stock exchanges, is issued by an Indian Depository, it derives its value from the underlying asset in the form of equity shares of a foreign company. The benefits accruing from the shares in question are, subject to terms on which depository issues the IDRs, are passed on to the IDR holders, and, in that sense, the IDR holders are beneficiaries of the underlying shares in the foreign company. While IDRs may be convertible, subject to certain conditions and requirements about the holding period of IDRs, into underlying equity shares of the foreign company, the IDRs are not necessarily convertible in the equity shares in question. In effect, thus, the IDRs provide a mechanism in which an investor in the Indian market can have the benefits flowing from the shareholding in participating foreign companies. Coming to more specifics about the IDRs, we may add that 'Indian Depository Receipt' is defined, under rule 3(i)(d) of the Companies (Issuance of Indian Depository Receipts) Rule 2004, as "means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company". Rule 3(i)(e) restricts the natural meaning of the expression 'issuing company' but defining it as "means a company incorporated outside India, making an issue of IDRs through a domestic depository". As for the connotations of

expression ‘domestic depository’, rule 3(i)(c) explains it as “means custodian of securities registered with the Securities and Exchange Board of India, hereinafter referred to as SEBI and authorised by the issuing company to issue Indian Depository Receipt”. Under rule 5, no foreign company can raise the funds through the IDRs except with the prior approval of the SEBI. Rule 6 *inter alia* provides that the repatriation of the funds so raised by the foreign company, through the issuance of IDRs, will be subject to applicable foreign exchange laws in India, that IDRs will be denominated only in Indian Rupees, and that the IDRs can be converted, if at all, only after a certain limit. Rule 9 provides that these IDRs shall be listed on the recognized Stock Exchange(s) in India as specified in clause (iii) of rule 5 and such IDRs may be purchased, possessed and freely transferred by a person resident in India as defined in section 2(v) of Foreign Exchange Management Act, 1999, subject to the provisions of the said Act. What essentially follows is that an Indian Depository Receipt (IDR) is an instrument issued by a custodian of underlying shares of a foreign company, registered with the SEBI, and authorised by the foreign company in this respect. This instrument is required to be denominated in INRs, listed on one or more recognized stock exchanges, the funds so raised through the IDRs can be remitted to the foreign company, as may be permissible under the foreign exchange law from time to time, and that such IDRs are freely transferable by residents as well. In effect thus, the IDRs are means of tapping the Indian investor market by the foreign companies. However, it is not the same thing as subscribing to the share capital of a foreign company, and the IDR holders are not shareholders in the foreign company. While technically the foreign company issues the equity shares to the domestic depository on the strength of which the domestic depository issues the IDRs, these shares never come to the possession of the domestic depository. There is a custodian involved, Bank of New York Mellon in this case, which actually holds custody of these shares- though technically on behalf of the domestic depository, which itself is a trustee of the issuing company. The physical movement of shares is thus between the issuing company, i.e., Standard Chartered Bank plc, the custodian, Bank of New York Mellon, while the constructive movement is from the Standard Chartered Bank plc (i.e., issuing company) to the Standard Chartered Bank-India (domestic depository) to the Bank of New York Mellon (the custodian). In terms of a diagram, this movement could be explained as follows:



6. On the strength of the equity shares of SCB-UK so held through the custodian, with the authorization of the SCB-UK and with the approval of the SEBI, after listing of the IDRs on the Indian Stock Exchanges, the SCB-India issues the IDRs in question and raises the funds in the Indian capital markets. The funds so raised presumably get repatriated to the SCB-UK as well, but that's not material anyway. What is material is the dividend distribution by the domestic depository to the IDR holders, and that is what has led to this litigation before us. The SCB-India receives dividends from SCB-UK in respect of the shares held by SCB-India, and under the applicable arrangements "if the domestic depository receives any cash dividends or any other cash distribution in respect of the deposited shares (including any amounts received in the liquidation of the *foreign* company) or otherwise in connection with the deposited property", the amounts are to be converted into Indian Rupees and paid in Indian Rupees by cheque, pay orders and demand drafts and payable at par at the place where the IDR holders reside". While making these payments, "the domestic depository may deduct and retain from all monies dues Once again, let us look at the transaction of investing in

IDRs and receiving monies, on account of dividends by the SCB-UK, by way of a diagram as below:



[Light green broken line- the constructive movement of dividends, light green and blue lines- cash flow on dividend distribution; orange lines- cash flow on the IDR investment

7. As highlighted in the above chart, the dividend physically flows from SCB-UK to BNY Mellon but then it BNY Mellon is only a custodian and the actual recipient is SCB-India because the shares are held by SCB-India though through a custodian, i.e. BNY. The shares are held by the SCB-India, and as the SCB-India has issued IDRs on the basis of this underlying asset, the benefits of this asset, in the manner in which the relationship between the SCB-India and the IDR holders is governed, go to the IDR holders. So far as the inter se

relationship between the SSCB-India and the IDR holders is concerned, we find that under rule 12 of Companies (Issuance of Indian Depository Receipts) Rules, 2004, "on receipt of dividend or other corporate actions on the IDRs as specified in the agreement between the issuing company and the domestic depository, the domestic company shall distribute them to the IDRs in proportion to their holding of the IDRs". It is, however, important to bear in mind the fact that the IDR holders are not the shareholders and they donot thus get these dividends in their right as a shareholder as such. The IDR holders are entitled to the benefits of the shareholding related to the IDR, and, to that extent, they are entitled to get the proportionate amount of cash dividends, as much as of any other receipts by the depository in respect of the equity shares of the foreign company, received by the SCB-India net of "any fees, taxes, duties, charges, costs and expenses".

8. The question that arises for our consideration in this context is as to when is the amount, so distributed to the IDR holders on account of dividend receipts, can be said to be received in the hands of the IDR holders- at the point of time when the amount is received by BNY Mellon outside India, on behalf of the SCB-India, or when is it received by the IDR holders in India from the SCB-India. This question assumes significance that the IDR holders include non-resident FIIs (Foreign Institutional Investors) and these IDR holders can be taxed in respect of these receipts only when the amounts in question are received, or deemed to be received, in India. Learned counsel's line of reasoning, as implicit from his complex web of arguments, is that since the SCB India, acting as a bare trustee, has first received the dividends, through its UK based custodian BNY-Mellon, the income is received outside India and is subsequently transferred to its Indian account. It cannot thus be said that the income is received in India. Elaborating upon this point, it is contended that an income which can be taxed in the hands of the non-resident assessee before us, a Mauritius based FII, can only be brought to tax under section 5(2) only such income as is received in India or is deemed to be received in India, accrue or arise in India or is deemed to accrue or arise in India. It is then pointed out that the SCB- India, under the terms of depository receipts, was to act "as bare trustee under the English law and the IDR holders will accordingly be tenants in common of such deposited property to the extent of the deposited property is represented by the IDRs in respect of which they are the IDR holders" (clause 7.1 of the depository agreement dated 8th May 2010; @ pages 8-88 of the paper-book). As a bare trustee of the IDR holders, the SCB-

India has first received the dividends through NYB-Mellon, UK, and, for this short reason, the dividends are received outside India, which cannot be taxed in the hands of the non-resident assessee before us. It is then pointed out that under section 9(1)(iv) a dividend paid by an Indian company outside India is deemed to be an income or arising in India but since the dividend is in respect of a UK based company, this deeming fiction does not come into play. On business connection under section 9(1)(i), learned counsel invites our attention to the CBDT circular # 4/2015[F.NO. 500/17/2015-FT&TR-IV], dated 26th March 2015, which states that the dividends paid by the foreign companies, even if such companies have underlying assets in India, cannot be brought to tax.

9. What this line of reasoning, however, overlooks is that the shares are owned by the SCB-India but held by the BNY-Mellon only as a custodian. The ownership of these shares belongs to the SCB-India, and NYB-Mellon has received it as a custodian for the assessee. The business connection between this income and India is thus clearly evident and beyond any doubt or controversy. SCB-India is Indian depository of the underlying shares in questions, the IDRs, in respect of which these monies are received, are issued in India by SCB-India; these IDRs are listed in Indian Stock Exchanges, the entire management and operations of the depository is admittedly in India. Let us, in this backdrop, look at Section 9(1)(i) which provides that "**all incomes accruing or arising, <u>whether directly or indirectly</u>, through or from <u>any business connection in India</u>, or though or from <u>any property in India</u>, or through or from any <u>assets or source of income in India</u>**" will be deemed to accrue or arise in India. The shares may be held by an overseas custodian but these shares constitute property of the Indian depository, i.e. SCB-India. In other words, the assets are held by the SCB-India as property of the SCB-India, though through a custodian abroad., i.e., BNY-Mellon. The source of income is equity shares of the foreign company and shares are held by an Indian depository and constitute assets of the SCB-India, even if as a trustee. It is not, therefore, a dividend *simplicitor* from a foreign company. It has a clear, significant, and crucial business connection with India. When one takes a look at the diagrams set out earlier in this order, it would be preposterous to suggest that the receipts in question have no business connection with India. As for learned counsel's reliance on the CBDT circular # 4/2015 (supra), it is important to bear in mind the fact that this circular was issued in view of the apprehensions that on account of Explanation 5 having been inserted in Section 9(1)(i)

"an extended application of the provisions of the Explanation may result in taxation of dividend income declared by a foreign company outside India" and that such a situation "may cause unintended double taxation and would be contrary to the generally accepted principles of source rule as well as the object and purpose of the amendment made by the Finance Act, 2012". The question of taxability of these dividends was in the hands of the persons who had no other connection, except the underlying asset of the related companies in India, and such a situation is materially different in the sense that here is a domestic depository that holds the IDRs with underlying assets abroad, the IDRs are listed in India as a derivative financial instrument, and the central point of the investment-related activity is in India. Such a situation cannot be compared with a direct shareholding in a foreign company, who has no other business connection in India except for what may be perceived to be covered by extended scope of Explanation 5 to Section 9(1)(i) and which remains confined to the company in question holding underlying assets in India. In fact, the present case is diametrically opposed to the fact situation that the CBDT intended to cover. Here is a case in which IDRs are in India with underlying shares, from which an IDR derives the value, are situated abroad, and, in any event, IDR holder is not simply a shareholder. He is entitled to the benefits of the shareholding but the derivate securities yielding him these benefits is in India, though these derivative securities derive their value and benefits from the underlying assets abroad. When we pointed it out, leaned counsel submitted that these facts are much better than the facts dealt by the CBDT. That aspect of the material is, even if that be so, immaterial. The circulars issued under section 119(2), as the circular in question inherently is, bind the field authorities on what these circulars hold, and not on what could be the underlying principles which could be deduced from these circulars. If a case does not fit in the words of the circular, it is not covered by the circular. One cannot claim that since relaxation from the rigour of law is granted in even worse cases, such cases, even if these cases donot fit into the cases referred to by a circular, must also get the same relaxation from the rigour of the law. Coming back to the Section 9(1)(i), as Shri Sanjay Singh, learned Commissioner (DR), aptly puts it, the requirements of Section 9(1)(i) are clearly fulfilled. Section 9(1)(iv) does not start with a non-obstante clause or in any manner restricts the scope of Section 9(1)(i) in the sense that only such dividends can be taxed in the hands of a non-resident which fulfill the requirements of Section 9(1)(iv). The receipt in question is a dividend from a foreign company, even if that is how it is treated, which has clear business connection with Indian domestic depository and

this derivative instrument, i.e. a financial instrument deriving its value from the underlying asset, was created in India and listed on Indian stock exchanges. It is true that dividends from an Indian company are deemed to be income accruing or arising in India, but to suggest that since dividend income can be brought to tax in the hands of a non-resident only in case it is from dividend from an Indian company is fallacious in logic. Just because it is a dividend income other than that from an Indian company, which cannot be taxed in Section 9(1)(iv), it cannot escape the rigour of Section 9(1)(i). Viewed thus, the receipt of dividends from the SCB-UK by the assessee, if that is how it can be treated, is an income deemed to be accruing or arising in India. Let us see it from a different perspective as well. It would, however, appear that what is received by the assessee is the net dividend amount as declared by the Indian depository and not the dividend of the foreign company. The dividend declared by the Indian depository could be, and is indeed is, on the basis of the dividend declared by the SCB-UK but then what the assessee is entitled to are the benefits flowing from the shareholdings in SCB-UK as an underlying asset of the IDRs. What is rightfully due to the assessee in income character is the net amount received from the Indian depository and not the dividend *simplictor* as declared by the SCB-UK. The income, therefore, accrues to the IDR holder at the point of time when the Indian depository works out the amount payable to IDR holders and then pays it accordingly. Viewed thus, the point of time when income accrues to the IDR holder is when the Indian depository declares the outgo and is received when the Indian depository pays the money. In such a situation, so far as the IDR holder is concerned, the amount in question is received in India in reality and in law. There is one more argument of the assessee that is required to be dealt with. Learned counsel has repeatedly highlighted the position that the Indian depository is a "bare trustee in the English law and a tenant in common in respect of the shares represented by the IDRs held by the IDR holder". It is on this basis that he has contended that whatever the Indian depository receives is as trustee of the IDR holders and the receipt in the hands of the IDR holders is the receipt when, as their trustee, Indian depository receives the money aboard, i.e. though its custodian NYB-Mellon. However, no arguments are advanced on the precise scope of the expressions 'bare trustees' and 'tenants in common', particularly under the English law. Whatever be the terminology employed in the agreements, there cannot be any, and there is no, dispute that ownership of the equity shares in SCB-UK is with SCB-India, the Indian depository, and that the dividend income is received by SCB-India, through its custodian BNY Mellon. If BNY

Mellon, without a business connection in India, was to be bare trustees of the IDR holders, maybe one could have argued that the dividends are received as income outside India, and not taxable as such. That is, however, not the case before us. Whatever may be physical flow of funds i.e. via foreign custodian under instructions from the Indian depository, it is clearly evident from the chart set out below paragraph 6 earlier in this order, the constructive flow of dividends is from the UK based company to the Indian depository. Learned counsel has also pleaded that the income in question cannot be considered to be deemed to be received in India because the requirements of Section 7, which defines the expression 'income deemed to be received' are not satisfied. This plea proceeds on the fallacy that the expression income **"deemed to be received in India in such year by or on behalf of such person** *(i.e. non-resident)***"** appearing in Section 5(2)(a) will be governed by the definition assigned to expression **"incomes deemed to be received in a previous year"** appearing in Section 7 which deals with the timing, rather the factum, of an income, and is relevant only for the salaries employees as it covers only three items namely- (i) the annual accretion in the previous year to the balance at the credit of an employee participating in a recognised provident fund, to the extent provided in rule 6 of Part A of the Fourth Schedule ; (ii) the transferred balance in a recognised provident fund, to the extent provided in sub-rule (4) of rule 11 of Part A of the Fourth Schedule ; and (iii) the contribution made, by the Central Government or any other employer in the previous year, to the account of an employee under a pension scheme referred to in section 80CCD. None of these items have anything to do with any situation other than a situation becoming relevant for an employee, which is not the case. All that this provision deals with is as to when the income is deemed to be received, even though there is no actual receipt in the relevant previous year, and not with whether an income is deemed to be received by, or on behalf of, such a person- referring to a non-resident. If the interpretation canvassed by the learned counsel is to be accepted, section 5(2)(a) will become meaningless, so far as deeming fiction of receipt is concerned, for persons other than the individuals holding salaried employments in in India but then, because of their presence on account of employment, such persons will be residents in India under section 6(1)(a) anyway. That is an incongruous position. The law is being interpreted in a manner so as to make it redundant. It is only elementary that law is to be interpreted in a manner so as to make it workable rather than redundant ***(ut res magis valeat quam pereat)*** and any interpretation leading to absurdities is to be avoided. For this short reason alone, this

hyper pedantic plea of the assessee cannot meet any judicial approval. In any event, this interpretation is incorrect for the simple reason, as we have noted earlier, that Section 7 defines '**income deemed to be received in a previous year'** whereas the expression required to be interpreted, in the context of Section 5(2)(a), is **'income deemed to received <u>in India</u> by or on behalf of such a person** *(i.e. non-resident)*'. The payment to the foreign custodian was for, and on behalf of, the Indian depository. When this proposition was put to the learned counsel, in the course of hearing, he submitted that a deeming fiction is to be strictly construed. If a situation does not meet the situation envisaged in the deeming fiction, it cannot be brought into the scope of deeming fiction by a liberal interpretation thereof. This plea is simply incorrect. The deeming fiction envisaged in Section 5, at the cost of repetition, for the scope of income **"deemed to be received in India in such year by or on behalf of such person** *(i.e. non-resident)***"** is irrelevant so far as the scope of **"incomes deemed to be received in a previous year"** is concerned. The former deals with *situs* of an income and the latter, as the scope of Section 7 would clearly demonstrate, deals with the timing of an income. The submissions of the learned counsel, on this point as well, donot appeal to us. In view of these discussions, it is quite clear that the dividend income, in the hands of the assessee, is received in India, and is deemed to accrue or arise in India. The authorities below, therefore, cannot be held to be in error in holding that the monies received by the assessee from the Indian depository, in respect of the dividends paid by the SCB-UK as attributable to the IDRs held by the assessee, were taxable in India. We confirm the action of the authorities below on this point and decline to interfere in the matter.

10. Learned counsel's armoury, however, is not exhausted. He seeks treaty protection under the Indo-Mauritius tax treaty. It is his submission that the assessee is admittedly a resident of Mauritius in terms of article 4(1) of the treaty, that the TRC is also placed on record, and that article 10 comes into play only when a resident of one of the contracting states, i.e., residents of India or Mauritius, pays a dividend to the resident of the other contraction state, i.e., Mauritius or India, but then since SCB-India is only an Indian branch office, i.e., permanent establishment, of a UK tax resident, these requirements of article 10 is not fulfilled. It is a payment by a UK resident to a Mauritius resident who is not covered by the scope of article 10. He contends that since the income in question cannot be treated as a

dividend as it does not fulfill the requirements of article 10 of the Indo-Mauritius tax treaty, it falls in the residuary head of 'other income' as covered by article 22 of said treaty and such an income can only be taxed in the residence jurisdiction i.e., Mauritius. It is then pointed out that the Dispute Resolution Panel has held that the amount in question is taxable under article 10 of the Indo-Mauritius tax treaty, and this finding is incorrect. Without prejudice to this line of argument, learned counsel contends that in any event, the rate at which dividends can be taxed under article 10 is only 10% whereas in the present case, taxability has been upheld under the domestic law @20% plus surcharge and other applicable cesses.

11. The plea of the assessee is indeed well taken. As article 1 of the Indo Mauritius tax treaty provides, "**(t)his Convention shall apply to persons who are residents of one or both of the Contracting States**". Article 4(1) of Indo-Mauritius tax treaty defines resident of a Contracting State by providing that "**(f)or the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of similar nature"**. There is no dispute that the assessee before us is a company incorporated in, and fiscally domiciled in, Mauritius. The Tax Residency Certificate filed by the assessee company is placed on record. The treaty entitlement of the assessee is not in doubt. What the treaty protects is, in terms of the provisions of Article 2 is, so far as India is concerned, "**the existing taxes to which this Convention shall apply are: (a) in the case of India,—(i) the income-tax including any surcharge thereon imposed under the Income-tax Act, 1961 (43 of 1961) ; (ii)the surtax imposed under the Companies (Profits) Surtax Act, 1964 (7 of 1964)"**. It is thus the fact of these tax levies in India which are sought to be protected by the treaty. As to who made the payment of income in question, i.e., a resident of the other Contracting State or any other person, is not relevant so far as treaty protection is concerned. What essentially follows is that when the person making the payment of income in question is not a resident of one of the Contracting States and yet such an income has tax implication in one of the Contracting States, the person resident in the other Contracting State will nevertheless, therefore, have treaty protection in the Contracting State where that income is being subjected to the taxes protected by the treaty. What is thus relevant is the fact of taxation in the other Contracting State. Once the eligibility for treaty

protection is established, the next thing is what is the treatment envisaged to that nature of income under the tax treaty. Let us, in this backdrop, take a look at the provisions of Article 10(1) of the Indo-Mauritius tax treaty, which provides that "**(d)ividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State**". Clearly, therefore, fact of dividend being paid "by a company which is resident of a Contracting State" to the resident of the other Contracting State is a *sine qua non* for application of article 10, which deals with taxability of dividends under the Indo- Mauritius tax treaty. Given the facts of this case, which we have discussed earlier in this order, the dividends can be treated as having been paid either by the SCB-UK itself or by the SCB-India. Whichever way one looks at it, none of these payments can be treated as by an Indian resident, i.e. one of the Contracting States. Whether we treat the person making the payment to the assessee as SCB-UK or as SCB-India, the fact remains that none of them is a resident in India- while former is a company incorporated in, and fiscally domiciled in, the United Kingdom, the latter is an Indian branch office, and permanent establishment, of a company, incorporated or fiscally domiciled in India. None of these entities, i.e., the foreign company or the Indian depository, can thus be treated as 'residents of a Contracting State' for the purpose of the Indo-Mauritius tax treaty. The dividend income in question, therefore, cannot be brought to tax in India under article 10 of the treaty. There is no other specific article of the Indo- Mauritius tax treaty under which this dividend income can be taxed. That carries it to the residuary head, i.e., Article 22, which provides as follows:

ARTICLE 22- OTHER INCOME

1. Subject to the provisions of paragraph (2) of this article, items of income of a resident of a Contracting State, wherever arising, which are not expressly dealt with in the foregoing articles of this Convention, shall be taxable only in that Contracting State.

2. The provisions of paragraph (1) shall not apply to income, other than income from immovable property as defined in paragraph (2) of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other

Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of article 7 or article 14, as the case may be, shall apply.

*(3) Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of Convention and arising in the other Contracting State may also be taxed in that other State.

[Inserted by the Notification No. SO 2680(E) {NO.68/2016 (F.No.500/3/2012-FTD-II){, dated 10-8-2016, w.e.f. 1-4-2017]*

12. What is clearly discernable from the above provision is that till 1st April 2017, the residuary income, which was not specifically covered by any of the specific treaty provisions and not covered by the exclusion clause in Article 22(2), could only be taxed in the residence jurisdiction to the exclusion of the powers of the source jurisdiction to tax the same. Once we come to the conclusion that the income in question, i.e., dividend income from the IDRs, is not covered by any of the specific provisions of the Indo-Mauritius tax treaty, is not covered by the exclusion clause in article 22(2), and it pertains to the period prior to 1st April 2017, it is a corollary to these findings that the said income cannot be taxed in the source jurisdiction, i.e. India, either. We, therefore, uphold the plea of the assessee that the IRD dividends in question cannot be taxed in India in the hands of the assessee on the facts of this case.

13. As we hold so, we may also briefly deal with the reasoning adopted by the Dispute Resolution Panel in rejecting the aforesaid plea of the assessee. The relevant observations of the DRP are as follows:

"It is noted that the Standard Chartered Bank Mumbai, <u>which is assessed to tax in India on account of place of management</u>, is the Domestic Depository which has

made the payment of divided to the assessee company. It is noted the company making the distribution of the dividend income, is a resident of India for the purpose of the definition of dividend under Article 10 of the India Mauritius DTAA"

14. The reasoning given by the DRP is *ex facie* incorrect inasmuch as the SCB-India, being a permanent establishment of a company fiscally domiciled in the United Kingdom, and is not a taxable unit in India, and the taxability is in the name of its general enterprise- i.e UK based company, though only in respect of its profits attributable to the permanent establishment. The unit of taxability is not SCB- India, i.e. PE of the UK-based foreign company, but the foreign company itself, and the place of management of the UK-based company is obviously United Kingdom. As observed by Hon'ble Supreme Court, in the case of **CIT Vs Hyundai Heavy Industries Ltd [(2007) 291 ITR 482 (SC)]**, "**it is clear that under the Act, a taxable unit is a foreign company and not its branch or PE in India**". Clearly, therefore, the observations of the DRP so far as the basis of taxability, i.e. "assessed to tax on account of place of management" is incorrect.

15. Shri Singh, learned Commissioner (DR), however, seeks to justify the stand so taken by the Dispute Resolution Panel on the ground that under rule 3(i)(b) a depository has to be a depository as defined under section 2(1)(e) of the Depositories Act 1996, which in turn defines depository as "a company formed and registered under the Companies Act, 1956 (1 of 1956) and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)". It is thus contended that since only a domestic company can be a depository, the depository is required to be treated as a domestic company. He then also points out that there are a number of entities in the Standard Chartered Bank Group, and one does not know which is the entity represented by the SCB-India. He also points out that it is a case of triple non-taxation inasmuch as here is a company which is owned by a US-based business house, it forms a subsidiary in Mauritius, holds the shares in a UK company through an Indian depository, and it does not pay taxes at any of these places of operations. He submits that it's a blatant case of treaty abuse that must be discouraged.

16. We find that it is an admitted position all along that SCB-India is a branch office of Standard Chartered Bank UK, and there is no material before us to dislodge this position. Because a depository must only be an Indian company under the law, even if that be so, does not mean that even when a domestic depository is admittedly branch of a foreign company, it must be treated as an Indian company. The approval by the SEBI to SCB-India, being a domestic depository for the issuance of IDRs representing equity shares in SCB-UK is a reality; we cannot wish it away, and we must interpret the tax liability in the light of this reality. Even today, there is nothing more than a suspicion lurking in the mind of the learned Commissioner (DR) that the SCB-India could be a company incorporated in India. If the approval given by the SEBI to the Indian depository is given wrongly, that is something which has no bearing on the issue that we are dealing with, and that is tax implications flowing from distribution of dividend by the domestic depository. That apart, learned counsel has also pointed out that the expression ‘depository’ and ‘domestic depository’ are expressions with distinct connotations and the requirements of ‘depository’ cannot be read into the requirements of ‘domestic depository’. As learned counsel rightly points out, the expression ‘domestic depository’ is defined, under rule 3(i)(c) of the Companies (Issue of Indian Depository Rules, 2004), as “custodian of securities registered with the Securities and Exchange Board of India, hereinafter referred to as SEBI and authorised by the issuing company to issue Indian Depository Receipts”. The objection raised by the learned Departmental Representative is thus devoid of legally sustainable merits.

17. As regards the submissions about unintended benefit to the assessee, from an overall global perspective, we are not really concerned with such a question at this stage. All we have to examine is whether the impugned income taxable in India is treaty-protected in the hands of this assessee or not, and, so far as this question is concerned, for the detailed reasons set out above, our answer is in affirmative. The income in question is treaty-protected inasmuch as it cannot be taxed in the hands of the assessee, in India, by virtue of Article 22(1) of the Indo Mauritius tax treaty. In view of the above discussions, the reasoning adopted by the Dispute Resolution cannot meet our judicial approval. We reject the stand of the DRP as devoid of legally sustainable merits.

18. As the taxability of the IDR dividends fails, in terms of the provisions of the applicable tax treaty, i.e., Indo-Mauritius tax treaty, and as the provisions of the applicable tax treaty, being more beneficial to the assessee, override the provisions of the domestic law, the taxability of the dividends on the IDRs fails. The addition of Rs 9,74,66,600, being IDR dividend received from SCB-India, thus stands deleted. It must, however, be clarified that relevant treaty provision of Article 22 having been subjected to significant change by insertion of sub-article (3) thereto, this decision on treaty protection will hold good only for the pre-amendment period i.e., pre-1st April 2017.

19. In the result, the appeal is allowed in the terms indicated above. Pronounced in the open court today on the 28th day of May, 2021.

Sd/xx | ***Sd/xx***
Vikas Awasthy | **Pramod Kumar**
(Judicial Member) | (Vice President)

Mumbai, dated the 28th day of May, 2021

Copies to: *(1) The appellant* *(2) The respondent*
(3) CIT *(4) CIT(A)*
(5) DR *(6) Guard File*

By order

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai