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FEATURED PERSPECTIVE

'Company' and 'Shares' Under the 2016 India-Mauritius Protocol and the U.N. Model Treaty

by Dhruv Sanghavi

Dhruv Sanghavi is a PhD candidate and lecturer at Maastricht University in the Netherlands and a visiting scholar at Northwestern Pritzker School of Law in Chicago.

In this article, the author discusses the meaning of ''company'' and ''shares'' in the new protocol to the India-Mauritius tax treaty and the U.N. model treaty and how the interpretation of those terms could affect the taxation of capital gains.

The protocol amending the 1982 India-Mauritius tax treaty has attracted much attention since it was announced in May. Perhaps most significantly, the protocol brings article 13 (capital gains) of the treaty on par with most of India's other tax treaties, and now allocates primary taxing rights on ''gains arising from the alienation of shares on or after April 1, 2017, in a company that is a resident of a contracting state'' to that state.[1] In other words, under the protocol, India will retain the primary taxing rights over capital gains from the alienation of shares in a company that is a resident of India.

Some Indian tax advisers have commented on the limits of source taxing rights provided for capital gains in the protocol.[2] They contend that article 4 of the protocol does not cover capital gains arising from participations in an Indian limited liability partnership because the protocol only refers to gains from the alienation of ''shares in a company.'' This view raises some interesting issues concerning the interpretation of the terms ''company'' and ''shares.''

Even though an LLP would not be considered a company under the Indian Income Tax Act, 1961,[3] ''company'' is defined for the purposes of the tax treaty and would quite clearly include an LLP. Article 3(1)(f)[4] of the tax treaty defines company to mean ''*any body corporate* or any entity which is treated as a company or a body corporate under the taxation laws in force'' (emphasis added). An LLP is a ''body corporate'' as defined under of the LLP Act, 2008.[5] It is quite clear that the term ''any body corporate'' is not qualified by the words ''under the taxation laws in force,'' which only applies to non-body corporates.[6] Therefore, courts would be unlikely to agree with the tax advisers based solely on the interpretation of the term ''company.'' Given that LLPs are also taxed as separate entities in the ITA, the criterion of the company being a resident would also be satisfied for the purposes of the LLP Act, as long as any part of its control and management is situated in India.[7]

The term ''shares,'' on the other hand, is an undefined term, which, according to article 3(2) of the tax

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[1]Article 4 of the 2016 protocol to the India-Mauritius tax treaty.

[2]*See* Jayesh Sanghvi, ''Finally, a Done Deal With Mauritius,'' *The Hindu*, May 15, 2016; and Linesh Lalwani and Shipra Padhi, ''India-Mauritius Treaty: The Protocol — Through the Looking Glass,'' Tax Hotline (Nishith Desai Associates), June 8, 2016.

[3]Section 2(17) ITA.

[4]Equivalent to article 3(1)(b) of the OECD model treaty.

[5]Section 2(1)(d) LLP Act.

[6]*See* para. 3 of the OECD commentary on article 3; for a detailed discussion on the interpretation of the term ''company,'' see John F. Avery Jones et al., ''The Definitions of Dividends and Interest in the OECD Model: Something Lost in Translation,'' 4 *British Tax Review* 406 (2009), at 408-415.

[7]Section 6(4) ITA.

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treaty, should be interpreted according to the internal law of the state applying the tax treaty, unless the context otherwise requires. The LLP Act does not mention the term ''shares,'' but only refers to a ''partnership interest,''[8] ''partner's transferable interest,''[9] or partner's ''right to a share of the profits and losses and to receive distributions.''[10] The ITA also does not use the term ''shares'' in connection with an LLP. Therefore, an argument could be made that it is impossible to alienate shares of an Indian LLP, since its partners are not owners of shares but mere holders of interests in the LLP. Also, the context of a tax treaty, which can be gauged by reading a tax treaty as a whole,[11] should exclude the possibility of interests in an LLP being considered to be shares. Article 10(4) of the tax treaty appears to use ''shares'' in the definition of ''dividends,'' in contradistinction to ''other corporate rights,'' suggesting that shares are different from interests in an LLP, which should be considered to be ''other corporate rights.''[12]

It is surprising that the drafters of the protocol did not take this peculiarity into consideration while amending the tax treaty. It is especially odd considering that the issue has long been identified in the context of article 13(4) of the OECD model treaty, and the proposal[13] to deal with the issue has been further refined in action 6 of the OECD's base erosion and profit-shifting project.[14] A similar solution was adopted in article 13(4) of the 2011 U.N. model treaty.[15] As long as the substance requirements of the Indian general antiavoidance rule[16] — which will enter into force along with the protocol on April 1, 2017 — are satisfied, it appears that article 4 of the protocol would not secure India's tax claims over the alienation of interests in an Indian LLP.

Note, however, that this problem is not peculiar to the protocol to the India-Mauritius tax treaty; it also affects the U.N. model treaty.[17] The underlying policy behind granting source taxing rights for capital gains in article 13(5) appears to be to maintain symmetry with article 10.[18] In other words, the policy appears to be that dividends paid on shares, and capital gains from the alienation of shares, should both be taxable in the source state.[19] It may, therefore, be useful if the language of article 13(5) of the U.N. model treaty broadly followed the language of article 10(3) in order to avoid scenarios where states following the U.N. model treaty suffer from the same issues as the protocol to the India-Mauritius tax treaty.

Article 10(3) defines income from the following assets (which can be clustered in the three limbs as follows) to mean dividends:

- shares, ''jouissance'' shares or ''jouissance'' rights, mining shares, founders' shares; or
- other rights, not being debt claims, participating in profits; and
- other corporate rights (income from which is subjected to the same taxation treatment as income from shares).[20]

It may seem adequate to expand the text of article 13(5) to include each of these rights. However, note that article 10(3) excludes debt claims, income from which is covered by article 11 (interest). Since article 11 also grants primary taxing rights to the source state, it would be symmetrical that taxing rights over gains from the alienation of debt claims, whether or not participating in profits, are also allocated to the source state. Therefore, the following text may be considered for revising article 13(5) of the U.N. model treaty:

> Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares, *''jouissance'' shares or ''jouissance'' rights, mining shares, founders' shares, or other rights, whether or not debt-claims, whether or not participating in profits, or other corporate rights (income from which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company is a resident) in* ~~of~~ a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least ___ percent (the percentage is to be

[8]Section 24 LLP Act.

[9]Section 42 LLP Act.

[10]*Id*.

[11]*Hindalco Industries Ltd. v. ACIT*, (2005) 94 TTJ 944; and *T.D. Securities v. Queen*, 2010 TCC 186. *See also* F.A. Engelen, *Interpretation of Tax Treaties Under International Law*, section 6.6.2.5 (2004).

[12]*See* para. 26, OECD commentary on article 10.

[13]*See* para. 28.5 (added in 2003), OECD commentary on article 13.

[14]*See* paras. 41-44, ''Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 — 2015 Final Report,'' at 71-72.

[15]Article 13(4) of the U.N. model treaty: ''Gains from the alienation of *shares of the capital stock of a company, or of an interest in a partnership, trust or estate*, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State'' (emphasis added). *See also* para. 8, sixth sentence, U.N. commentary on article 13.

[16]Chapter XA ITA.

[17]Article 13(5) also refers to ''alienation of shares of a company, which is a resident of the other Contracting State.''

[18]Jinyan Li, ''Article 13: Capital Gains,'' in *Global Tax Treaties Commentaries*, at section 1.1.2.2 (2015).

[19]However, the commentary to the U.N. model treaty does not state this reasoning.

[20]For a detailed discussion on the three limbs, see Jones et al., *supra* note 6, at 416-434.

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established through bilateral negotiations) of the capital of that company.[21]

However, such an amendment, if adopted in the context of Indian tax treaties, would not, by itself, allocate taxing rights over capital gains from the alienation of interests in an LLP, since distributions from such interests are not subject to the same taxation as income from shares under the ITA.[22] Appropriate amendments to the proposed treaty language, or the ITA for the tax treatment of partners of an LLP, may be necessary to secure its taxing rights. ◆

[21]Italicized text indicates proposed additions to, and struck-through text indicates proposed deletion from, the current text of article 13(5) of the U.N. model.

[22]Section 10(2A) of the ITA exempts distributions from an LLP (which is treated as a partnership for tax purposes under section 2(23)) to a partner.

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