Delhi High Court faults the Revenue for treating Equity-Oriented Mutual Funds as Equity Shares – Declares that gains arising to Mauritian resident on redemption of units of Mutual Funds are not liable to tax in India

Hon'ble Delhi High Court in a recent judgment[1] has repudiated the argument of the Indian Income Tax Department that gains arising to a Mauritian resident on redemption of equity-oriented mutual funds are liable to tax in India since the underlying asset of such mutual funds were equity shares in Indian companies. While deciding the said issue in favour of the non-resident Assessee, the Hon'ble Court unequivocally concluded that such gains can be taxed only in Mauritius and not in India.

In arriving at such a conclusion, the Hon'ble Court has in depth analyzed provisions of India-Mauritius DTAA ('DTAA') as well as other relevant Indian statutes such as – Income Tax Act, 1961 ('the Act'); Companies Act, 2013; Securities Contracts (Regulation) Act, 1956; Indian Trust Act, 1882; SEBI (Mutual Fund) Regularions, 1996, etc.

Brief facts and background:

- Assessee, being a tax resident of Mauritius, was carrying on investment activity in India.
- During relevant AY 2022-23 Assessee earned gains from sale of equity-oriented mutual funds (acquired prior to 01.04.2017). In the ITR such gains were claimed to be exempt from tax in India.
- The AO however, disagreed with such claim and held that on sale of equity-oriented mutual funds, the Assessee becomes beneficiary of gains arising on alienation of equity shares of Indian companies, i.e., the underlying asset.
- Aggrieved therefrom, Assessee filed objections before the DRP and argued that under Article 13(3A) of the DTAA only gains arising from *alienation of shares* may be taxed in India; gains arising on redemption of mutual funds would fall under the purview of Article 13(4) and therefore, be exempt from tax in India.
- The DRP disagreed with the Assessee and affirmed with the view taken by AO. In doing so, the DRP stated that the intention of the Legislature was always to treat units of equity-oriented mutual funds to be equivalent to equity shares '*since they carry inherent characteristics of equity shares*'.
- ITAT decided this issue in favour of Assessee and opined that under Indian Laws, equity shares and mutual funds are different forms of securities having significant differences in terms of rights, regulations, nature of return, tax implications, etc. It was thus, held

[1] *CIT vs. Emerging India Focus Funds* [2026:DHC:10191-DB]

that gains arising to the Assessee on sale of mutual funds would be covered under Article 13(4), and not under Article 13(3A); hence, such gains were not liable to tax in India.

Decision of the Hon'ble Delhi High Court:

In the appeal filed by the IT Dept, Hon'ble High Court formulated the following question of law – "*whether capital gains arising out of units of equity-oriented mutual funds would be liable to be taxed in India under Article 13(3A) of the DTAA*" which was answered in favour of the Assessee and the appeal filed by Revenue was dismissed on the following reasons:

- ✓ **Unit holder of a mutual fund is not a shoreholder of the company:** Unit holder of a mutual fund does not have the same rights and liabilities of a shareholder. It only holds a unit in the mutual fund which invests in equity shares/ other securities. Such a unit holder can only claim his proportionate share in the investment/ gains derived by the Mutual Fund.

- ✓ **The term "*mutual fund*" omitted in Article 13(3A):** By virtue of Article 13(3A) India has been given a limited right to tax gains arising on '*alienation of shares*'. Contracting countries have consciously omitted to include '*mutual funds*' under the purview of said provision. Thus, gains arising on sale of mutual funds to a Mauritian resident would fall under Article 13(4) and be liable to tax only in Mauritius and not in India.

- ✓ **Setion 10(38) indicates difference between two types of securities:** Section 10(38) of the Act itself indicates the difference between equity shares and equity-oriented mutual funds. Therefore, both cannot be equated.

- ✓ **DTAA must be interpreted strictly:** DTAA, being a contract between two countries is to be interpreted strictly. It cannot be subjected to purporsive interpretation as argued by Revenue. It is apparent that true intention of the countries was to tax gains arising from alienation of securities (other than shares) in Mauritius only, and not in India.

VA Comments:

In this welcome judgment, the Hon'ble High Court has decided a quaint question of law in favour of the Assessee by balancing the position emanating from various Indian statutes with the rights/ obligations agreed upon between contracting nations under the India-Mauritius DTAA. In doing so, the Hon'ble Court – (i) lent credence to principles of mutuality in treaty interpretation by barring Revenue from raising unliateral pleas of purporsive interpretation; and (ii) tempered Revenue's attempt to "*tax the underlying asset*" by piercing the veil of equity-oriented mutual funds which otherwise is a genuine, valid and legally compliant mode of investment for foreign investors in India.

The judgment is equally incisive in recognizing that each DTAA carries distinct provisions that may specifically allocate taxing rights insofar as other securities (such as mutual funds) are concerned, and that cases will have to be decided having regard to the specific text of the DTAA as well as the intention of the contracting nations.

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