REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. OF 2012

(arising out of S.L.P. (C) No. 26529 of 2010)

Vodafone International Holdings B.V. ... Appellant(s)

versus

Union of India & Anr. ...Respondent(s)

J U D G M E N T

S.H. KAPADIA, CJI

1. Leave granted.

Introduction

2. This matter concerns a tax dispute involving the Vodafone Group with the Indian Tax Authorities [hereinafter referred to for short as "the Revenue"], in relation to the acquisition by Vodafone International Holdings BV [for short "VIH"], a company resident for tax purposes in the Netherlands, of the entire share capital of CGP Investments

(Holdings) Ltd. [for short "CGP"], a company resident for tax purposes in the Cayman Islands ["CI" for short] vide transaction dated 11.02.2007, whose stated aim, according to the Revenue, was "acquisition of 67% controlling interest in HEL", being a company resident for tax purposes in India which is disputed by the appellant saying that VIH agreed to acquire companies which in turn controlled a 67% interest, but not controlling interest, in Hutchison Essar Limited ("HEL" for short). According to the appellant, CGP held indirectly through other companies 52% shareholding interest in HEL as well as Options to acquire a further 15% shareholding interest in HEL, subject to relaxation of FDI Norms. In short, the Revenue seeks to tax the capital gains arising from the sale of the share capital of CGP on the basis that CGP, whilst not a tax resident in India, holds the underlying Indian assets.

Facts

A. <u>Evolution of the Hutchison structure and the Transaction</u>

3. The Hutchison Group, Hong Kong (HK) first invested into the telecom business in India in 1992 when the said

Group invested in an Indian joint venture vehicle by the name Hutchison Max Telecom Limited (HMTL) – later renamed as HEL.

4. On 12.01.1998, CGP stood incorporated in Cayman Islands, with limited liability, as an **“exempted company”**, its sole shareholder being Hutchison Telecommunications Limited, Hong Kong [“HTL” for short], which in September, 2004 stood transferred to HTI (BVI) Holdings Limited [“HTIHL (BVI)” for short] vide Board Resolution dated 17.09.2004. HTIHL (BVI) was the buyer of the CGP Share. HTIHL (BVI) was a wholly owned subsidiary (indirect) of Hutchison Telecommunications International Limited (CI) [“HTIL” for short].

5. In March, 2004, HTIL stood incorporated and listed on Hong Kong and New York Stock Exchanges in September, 2004.

6. In February, 2005, consolidation of HMTL (later on HEL) got effected. Consequently, all operating companies below HEL got held by one holding company, i.e., HMTL/HEL. This was with the approval of RBI and FIPB. The ownership of the said holding company, i.e.,

HMTL/HEL was consolidated into the tier I companies all based in Mauritius. Telecom Investments India Private Limited ["TII" for short], IndusInd Telecom Network Ltd. ["ITNL" for short] and Usha Martin Telematics Limited ["UMTL" for short] were the other shareholders, other than Hutchison and Essar, in HMTL/HEL. They were Indian tier I companies above HMTL/HEL. The consolidation was first mooted as early as July, 2003.

7. On 28.10.2005, VIH agreed to acquire 5.61% shareholding in Bharti Televentures Ltd. (now Bharti Airtel Ltd.). On the same day, Vodafone Mauritius Limited (subsidiary of VIH) agreed to acquire 4.39% shareholding in Bharti Enterprises Pvt. Ltd. which indirectly held shares in Bharti Televentures Ltd. (now Bharti Airtel Ltd.).

8. On 3.11.2005, Press Note 5 was issued by the Government of India enhancing the FDI ceiling from 49% to 74% in telecom sector. Under this Press Note, proportionate foreign component held in any Indian company was also to be counted towards the ceiling of 74%.

9. On 1.03.2006, TII Framework and Shareholders Agreements stood executed under which the shareholding of

HEL was restructured through “TII”, an Indian company, in which Analjit Singh (AS) and Asim Ghosh (AG), acquired shares through their Group companies, with the credit support provided by HTIL. In consideration of the credit support, parties entered into Framework Agreements under which a Call Option was given to 3 Global Services Private Limited [“GSPL” for short], a subsidiary of HTIL, to buy from Goldspot Mercantile Company Private Limited [“Goldspot” for short] (an AG company) and Scorpios Beverages Private Limited [“Scorpios” for short] (an AS company) their entire shareholding in TII. Additionally, a Subscription Right was also provided allowing GSPL a right to subscribe to the shares of Centrino Trading Company Private Limited [“Centrino” for short] and ND Callus Info Services Private Limited [“NDC” for short]. GSPL was an Indian company under a Mauritius subsidiary of CGP which stood indirectly held by HTIL. These agreements also contained clauses which imposed restrictions to transfer downstream interests, termination rights, subject to objection from any party, etc.

10. The shareholding of HEL again underwent a change on 7.08.2006 through execution of 2006 IDFC Framework Agreement with the Hinduja Group exiting and its shareholding being acquired by SMMS Investments Private Limited [“SMMS” for short], an Indian company. Hereto, the investors (as described in the Framework Agreement) were prepared to invest in ITNL provided that HTIL and GSPL procured financial assistance for them and in consideration whereof GSPL would have Call Option to buy entire equity shares of SMMS. Hereto, in the Framework Agreement there were provisions imposing restrictions on Share Transfer, Change of Control etc. On 17.08.2006, a Shareholders Agreement stood executed which dealt with governance of ITNL.

11. On 22.12.2006, an Open Offer was made by Vodafone Group Plc. on behalf of Vodafone Group to Hutchison Whampoa Ltd., a non-binding bid for US $11.055 bn being the enterprise value for HTIL’s 67% interest in HEL.

12. On 22.12.2006, a press release was issued by HTIL in Hong Kong and New York Stock Exchanges that it had been approached by various potentially interested parties

regarding a possible sale of "its equity interests" (not controlling interest) in HEL. That, till date no agreement stood entered into by HTIL with any party.

13. On 25.12.2006, an offer comes from Essar Group to purchase HTIL's 66.99% shareholding at the highest offer price received by HTIL. Essar further stated that any sale by HTIL would require its consent as it claimed to be a co-promoter of HEL.

14. On 31.01.2007, a meeting of the Board of Directors of VIH was held approving the submission of a binding offer for 67% of HTIL's interest at 100% enterprise value of US $17.5 bn **by way of acquisition** by VIH of one share (which was the entire shareholding) in CGP, an indirect Cayman Islands subsidiary of HTIL. The said approval was subject to:

(i) reaching an agreement with Bharti that allowed VIH to make a bid on Hutch; and

(ii) entering into an appropriate partnership arrangement to satisfy FDI Rules in India.

15. On 6.02.2007, HTIL calls for a binding offer from Vodafone Group for its aggregate interests in 66.98% of the issued share capital of HEL controlled by companies owned, directly or indirectly, by HTIL together with inter-related loans.

16. On 9.02.2007, Vodafone Group makes a **revised offer** on behalf of VIH to HTIL. The said revised offer was of US $10.708 bn for 66.98% interest [at the enterprise value of US $18.250 bn] and for US $1.084 bn loans given by the Hutch Group. The offer further confirmed that in consultation with HTIL, the consideration payable may be reduced to take account of the various amounts which would be payable directly to certain existing legal local partners in order to extinguish HTIL's previous obligations to them. The offer further confirmed that VIH had come to arrangements with HTIL's existing local partners [AG, AS and Infrastructure Development Finance Company Limited (IDFC)] **to maintain the local Indian shareholdings in accordance with the Indian FDI requirements.** The offer also expressed VIH's willingness to offer Essar the same financial terms in HEL which stood offered to HTIL.

17. On the same day, i.e., 9.02.2007, Bharti conveys its no objection to the proposal made by Vodafone Group to purchase a direct or indirect interest in HEL from the Hutchison Group and/ or Essar Group.

18. On 10.02.2007, a **re-revised offer** was submitted by Vodafone valuing HEL at an enterprise value of US $18.80 bn and offering US $11.076 bn for HTIL's interest in HEL.

19. On 11.02.2007, a Tax Due Diligence Report was submitted by Ernst & Young. The relevant observation from the said Report reads as follows:

> "The target structure now also includes a Cayman company, CGP Investments (Holdings) Limited, CGP Investments (Holdings) Limited was not originally within the target group. After our due diligence had commenced the seller proposed that CGP Investments (Holdings) Limited should be added to the target group and made available certain limited information about the company. Although we have reviewed this information, it is not sufficient for us to be able to comment on any tax risks associated with the company."

20. On 11.02.2007, UBS Limited (Financial Advisors to VIH) submitted a financial report setting out the methodology for valuation of HTIL's 67% effective interest in HEL through the acquisition of 100% of CGP.

21. On 11.02.2007, VIH and HTIL entered into an Agreement for Sale and Purchase of Share and Loans ("SPA" for short), under which HTIL agreed to procure the sale of the entire share capital of CGP which it held through HTIHL (BVI) for VIH. Further, HTIL also agreed to procure the assignment of Loans owed by CGP and Array Holdings Limited ["Array" for short] (a 100% subsidiary of CGP) to HTI (BVI) Finance Ltd. (a direct subsidiary of HTIL). As part of its obligations, HTIL undertook to procure that each Wider Group Company would not terminate or modify any rights under any of its Framework Agreements or exercise any of their Options under any such agreement. HTIL also provided several warranties to VIH as set out in Schedule 4 to SPA which included that HTIL was the sole beneficial owner of CGP share.

22. On 11.02.2007, a Side Letter was sent by HTIL to VIH inter alia stating that out of the purchase consideration, up to US $80 million could be paid to some of its existing partners. By the said Side Letter, HTIL agreed to procure that Hutchison Telecommunications (India) Ltd. (Ms) ["HTIL Mauritius" for short], Omega Telecom Holdings Private

Limited [“Omega” for short] and GSPL would enter into IDFC Transaction Agreement prior to the completion of the acquisition pursuant to SPA, which completion ultimately took place on 8.05.2007.

23. On 12.02.2007, Vodafone makes public announcement to Securities and Exchange Commission [“SEC” for short], Washington and on London Stock Exchange which contained two assertions saying that Vodafone had agreed to acquire a controlling interest in HEL via its subsidiary VIH and, second, that Vodafone had agreed to acquire companies that control a 67% interest in HEL.

24. On the same day, HTIL makes an announcement on HK Stock Exchange stating that it had agreed to sell its entire direct and indirect equity and loan interests held through subsidiaries, in HEL to VIH.

25. On 20.02.2007, VIH applied for approval to FIPB. This application was made pursuant to Press Note 1 which applied to the acquisition of an indirect interest in HEL by VIH from HTIL. It was stated that “CGP owns directly and indirectly through its subsidiaries an aggregate of 42.34% of the issued share capital of HEL and a further indirect

interests in 9.62% of the issued share capital of HEL". That, the transaction would result in VIH acquiring an indirect controlling interest of 51.96% in HEL, a company competing with Bharti, hence, approval of FIPB became necessary. It is to be noted that on 20.02.2007, VIH held 5.61% stake (directly) in Bharti.

26. On the same day, i.e., 20.02.2007, in compliance of Clause 5.2 of SPA, an **Offer Letter** was issued by Vodafone Group Plc on behalf of VIH to Essar for purchase of its entire shareholding (33%) in HEL.

27. On 2.03.2007, AG wrote to HEL, confirming that he, through his 100% Indian companies, owned 23.97% of a joint venture company-TII, which in turn owned 19.54% of HEL and, accordingly, his indirect interest in HEL worked out to 4.68%. That, he had full and unrestricted voting rights in companies owned by him. That, he had received credit support for his investments, but primary liability was with his companies.

28. A similar letter was addressed by AS on 5.03.2007 to FIPB. It may be noted that in January, 2006, post dilution of FDI cap, HTIL had to shed its stake to comply with 26%

local shareholding guideline. Consequently, AS acquired 7.577% of HEL through his companies.

29. On 6.03.2007, Essar objects with FIPB to HTIL's proposed sale saying that HEL is a joint venture Indian company between Essar and Hutchison Group since May, 2000. That, Bharti is also an Indian company in the "same field" as HEL. Bharti was a direct competitor of HEL in India. According to Essar, the effect of the transaction between HTIL and VIH would be that Vodafone with an indirect controlling interest in HEL and in Bharti violated Press Note 1, particularly, absent consent from Essar. However, vide letter dated 14.03.2007, Essar gave its consent to the sale. Accordingly, its objection stood withdrawn.

30. On 14.03.2007, FIPB wrote to HEL seeking clarification regarding a statement by HTIL before US SEC stating that HTIL Group would continue to hold an aggregate interest of 42.34% of HEL and an additional indirect interest through JVCs [TII and Omega] being non-wholly owned subsidiaries of HTIL which held an aggregate of 19.54% of HEL, which added up to 61.88%, whereas in

the communication to FIPB dated 6.03.2007, the direct and indirect FDI held by HTIL was stated to be 51.96%.

31. By letter of the same date from HEL to FIPB, it was pointed out that HTIL was a company listed on NY SE. Accordingly, it had to file Statements in accordance with US SEC. That, under US GAAP, HTIL had to consolidate the assets and liabilities of companies even though not majority owned or controlled by HTIL, because of a US accounting standard that required HTIL to consolidate an entity whereby HTIL had "risk or reward". Therefore, this accounting consolidation required that even though HTIL held no shares nor management rights still they had to be computed in the computation of the holding in terms of the Listing Norms. It is the said accounting consolidation which led to the reporting of additional 19.54% in HEL, which leads to combined holding of 61.88%. On the other hand, under Indian GAAP, the interest as of March, 2006 was 42.34% + 7.28% (rounded up to 49.62%). After the additional purchase of 2.34% from Hindujas in August 2006, the aggregate HTIL direct and indirect FDI stood at 51.96%. In short, due to the difference in the US GAAP and

the Indian GAAP the Declarations varied. The combined holding for US GAAP purposes was 61.88% whereas for Indian GAAP purposes it was 51.96%. Thus, according to HEL, the Indian GAAP number reflected the true equity ownership and control position.

32. By letter dated 9.03.2007, addressed by FIPB to HEL, several queries were raised. One of the questions FIPB had asked was "*as to which entity was entitled to appoint the directors to the Board of Directors of HEL on behalf of TIIL which owns 19.54% of HEL?*" In answer, vide letter dated 14.03.2007, HEL informed FIPB that under the Articles of HEL the directors were appointed by its shareholders in accordance with the provisions of the Indian company law. However, in practice the directors of HEL have been appointed pro rata to their respective shareholdings which resulted in 4 directors being appointed from the Essar Group, 6 directors from HTIL Group and 2 directors from TII. In practice, the directors appointed by TII to the Board of HEL were AS and AG. One more clarification was sought by FIPB from HEL on the *credit support received by AG for his investment in HEL.* In answer to the said query, HEL

submitted that the credit support for AG Group in respect of 4.68% stake in HEL through the Asim Ghosh investment entities, was a standby letter of credit issued by Rabobank Hong Kong in favour of Rabo India Finance Pvt. Ltd. which in turn has made a Rupee loan facility available to Centrino, one of the companies in AG Group.

33. By letter dated 14.03.2007 addressed by VIH to FIPB, it stood confirmed that VIH's **effective shareholding** in HEL would be 51.96%. That, following completion of the acquisition HTIL's shares in HEL the ownership of HEL was to be as follows :

(i) VIH would own 42% direct interest in HEL through its acquisition of 100% CGP (CI).

(ii) Through CGP (CI), VIH would also own 37.25% in TII which in turn owns 19.54% in HEL and 38% (45.79%) in Omega which in turn owns 5.11% in HEL (i.e. pro-rata route).

(iii) These investments combined would give VIH a controlling interest of 52% in HEL.

(iv) In addition, HTIL's existing Indian partners AG, AS and IDFC (i.e. SMMS), who between them held a 15% interest in HEL (i.e. option route), agreed to retain their shareholdings with full control, including voting rights and dividend rights. In other words, none of the Indian partners exited and, consequently, there was no change of control.

(v) The Essar Group would continue to own 33% of HEL.

34. On 15.03.2007, a Settlement Agreement was signed between HTIL and Essar Group. Under the said Agreement, HTIL agreed to pay US $415 mn to Essar for the following:

(a) acceptance of the SPA;

(b) for waiving rights or claims in respect of management and conduct of affairs of HEL;

(c) for giving up Right of First Refusal (RoFR), Tag Along Rights (TARs) and shareholders rights under Agreement dated 2.05.2000; and

(d) for giving up its objections before FIPB.

35. Vide Settlement Agreement, HTIL agreed to dispose of its direct and indirect equity, loan and other interests and rights, in and related to HEL, to VIH. These other rights and interests have been enumerated in the Order of the Revenue dated 31.05.2010 as follows :

1. Right to equity interest (direct and indirect) in HEL.
2. Right to do telecom business in India
3. Right to jointly own and avail the telecom licences in India
4. Right to use the Hutch brand in India
5. Right to appoint/remove directors from the Board of HEL and its subsidiaries
6. Right to exercise control over the management and affairs of the business of HEL (Management Rights)
7. Right to take part in all the investment, management and financial decisions of HEL
8. Right over the assigned loans and advances utilized for the business in India

9. Right of subscribing at par value in certain Indian companies

10. Right to exercise call option at the price agreed in Indian companies

11. Right to control premium

12. Right to non-compete against HTIL within the territory of India

13. Right to consultancy support in the use of Oracle license for the Indian business

14. Other intangible rights (right of customer base, goodwill etc.)

36. On 15.03.2007, a Term Sheet Agreement between VIH and Essar Teleholdings Limited, an Indian company which held 11% in HEL, and Essar Communications Limited, a Mauritius company which held 22% in HEL, was entered into for regulating the affairs of HEL and the relationship of the shareholders of HEL. In the recitals, it was stated that VIH had agreed to acquire the entire indirect shareholding of HTIL in HEL, including all rights, contractual or otherwise, to acquire directly or indirectly shares in HEL

owned by others which shares shall, for the purpose of the Term Sheet, be considered to be part of the holding acquired by VIH. The Term Sheet governed the relationship between Essar and VIH as shareholders of HEL including VIH's right as a shareholder of HEL:

(a) to nominate 8 directors out of 12 to the Board of Directors;

(b) nominee of Vodafone had to be there to constitute the quorum for the Board of Directors;

(c) to get a RoFR over the shares held by Essar in HEL;

(d) should Vodafone Group shareholder sell its shares in HEL to an outsider, Essar had a TAR in respect of Essar's shareholding in HEL.

37. On 15.03.2007, a Put Option Agreement was signed between VIH and Essar Group requiring VIH to buy from Essar Group Shareholders all the Option Shares held by them.

38. By letter dated 17.03.2007, HTIL confirmed in writing to AS that it had no beneficial, or legal or any other right in AS's TII interest or HEL interest.

39. On 19.03.2007, a letter was addressed by FIPB to VIH asking VIH to clarify as to under what circumstances VIH agreed to pay US $11.08 bn for acquiring 67% of HEL when the actual acquisition is only 51.96%. This query presupposes that even according to FIPB the actual acquisition was only 51.96% (52% approx.).

40. On the same day, VIH replied that VIH has agreed to acquire from HTIL, interests in HEL which included 52% equity shareholding for US $11.08 bn. That, the price included a control premium, use and rights to the Hutch Brand in India, a non-compete agreement with the Hutch Group, the value of non-voting non-convertible preference shares, various loans obligations and the entitlement to acquire a further 15% indirect interest in HEL as set out in the letter dated 14.03.2007 addressed to FIPB (see page 6117 of SLP Vol. 26). According to the said letter dated 19.03.2007, all the above elements together equated to 67% of the **economic value of HEL**.

41. Vide Agreement dated 21.03.2007, VIH diluted its stake in Bharti by 5.61%.

42. In reply to the queries raised by FIPB regarding break up of valuation, VIH confirmed as follows:

Various assets and liabilities of CGP included its rights and entitlements, including subscription rights, call options to acquire in future a further 62.75% of TII, call options to acquire in future a further 54.21% of Omega which together would give a further 15.03% proportionate indirect equity ownership of HEL, control premium, use and rights to Hutch brand in India and a non-compete agreement with HTIL. No individual price was assigned to any of the above items. That, under IFRS, consolidation included TII and Omega and, consequently, the accounts under IFRS showed the total shareholding in HEL as 67% (approx.). Thus, arrangements relating to Options stood valued as assets of CGP. In global basis valuation, assets of CGP consisted of: its downstream holdings, intangibles and arrangement relating to Options, i.e. Bundle of Rights acquired by VIH. This reply was in the letter dated 27.03.2007 in which it was further stated that HTIL had conducted an auction for sale of its interests in HEL in which HTIL had asked each bidder to name its price with reference to the enterprise value of HEL. As a consequence of the transaction, Vodafone will effectively step into the shoes of HTIL including all the rights in respect of its Indian investments that HTIL enjoyed. Lastly, the Indian joint venture partners would remain invested in HEL as the transaction did not involve the Indian investors selling any of their respective stakes.

43. On 5.04.2007, HEL wrote to the Joint Director of Income Tax (International Taxation) stating that HEL had no tax liabilities accruing out of the subject transaction.

44. Pursuant to the resolution passed by the Board of Directors of CGP on 30.04.2007, it was decided that on acquisition loans owed by CGP to HTI (BVI) Finance Ltd. would be assigned to VIH; the existing Directors of CGP would resign; Erik de Rijk would become the only Director of CGP. A similar resolution was passed on the same day by the Board of Directors of Array.

45. On 7.05.2007, FIPB gave its approval to the transaction, subject to compliance with the applicable laws and regulations in India.

46. On 8.05.2007, consequent upon the Board Resolutions passed by CGP and its downstream companies, the following steps were taken:

(i) resignation of all the directors of Hutch Group;

(ii) appointment of new directors of Vodafone Group;

(iii) resolutions passed by TII, Jaykay Finholding (India) Private Limited, UMT Investments Ltd., UMTL, Omega (Indian incorporated holding companies) accepting the resignation of HTIL's nominee directors and appointing VIH's nominee directors;

(iv) same steps were taken by HEL and its subsidiaries;

(v) sending of a Side Letter by HTIL to VIH relating to completion mechanics;

(vi) computation of net amount payable by VIH to HTIL including retention of a certain amount out of US $11.08 bn paid on 8.05.2007 towards expenses to operationalize the Option Agreements and adjustments for breach (if any) of warranties, etc.;

(vii) assignment of loans given by HTI (BVI) Finance Ltd. to CGP and Array in favour of VIH;

(viii) cancellation of share certificate of HTIHL (BVI) and entering the name of VIH in the Register of Members of CGP;

(ix) execution of Tax Deed of Covenant indemnifying VIH in respect of tax or transfer pricing liabilities payable by Wider Group (CGP, GSPL, Mauritius holding companies, Indian operating companies).

(x) a Business Transfer Agreement between GSPL and a subsidiary of HWP Investments Holdings (India) Ltd. (Ms) for sale of Call Centre earlier owned by GSPL;

(xi) payment of US $10.85 bn by VIH to HTIL (CI).

47. On 5.06.2007, under the Omega Agreement, it was agreed that in view of the SPA there would be a consequent change of control in HTIL Mauritius, which holds 45.79% in Omega, and that India Development Fund ("IDF" for short), IDFC and SSKI Corporate Finance Private Limited ("SSKI" for short) would, instead of exercising Put Option and Cashless Option under 2006 IDFC Framework Agreement, exercise the same in pursuance of Omega Agreement. That, under the Omega Agreement, GSPL waived its right to exercise the Call Option under the 2006 IDFC Framework Agreement.

48. On 6.06.2007, a Framework Agreement was entered into among IDF, IDFC, SMMS, IDFC PE, HTIL Mauritius, GSPL, Omega and VIH by which GSPL had a Call Option to buy the entire equity shares of SMMS. Consequently, on 7.06.2007, a Shareholders Agreement was executed by which the shareholding pattern of Omega changed with SMMS having 61.6% and HTIL Mauritius having 38.4%.

49. On 27.06.2007, HTIL declared a **special dividend** of HK $6.75 per share, on account of the gains made by sale of HTIL's entire interest in HEL.

50. On 5.07.2007, a **Framework Agreement** was entered into among AG, AG Mercantile Company Private Limited, Plustech Mercantile Co. (P) Ltd ["Plustech" for short], GSPL, Nadal Trading Company Private Limited ["Nadal" for short] and VIH. Under clause 4.4, GSPL had an unconditional right to purchase all shares of AG in AG Mercantile Company Pvt. Ltd. at any time and in consideration for such **call option**, GSPL agreed to pay to AG an amount of US $6.3 mn annually.

51. On the same day, i.e., 5.07.2007, a **Framework Agreement** was entered into among AS, his wife, Scorpios, MVH, GSPL, NDC and VIH. Under clause 4.4 GSPL had an unconditional right to purchase all shares of AS and his wife held in Scorpios at any time and in consideration for the **call option** GSPL agreed to pay AS and his wife an amount of US$ 10.2 mn per annum.

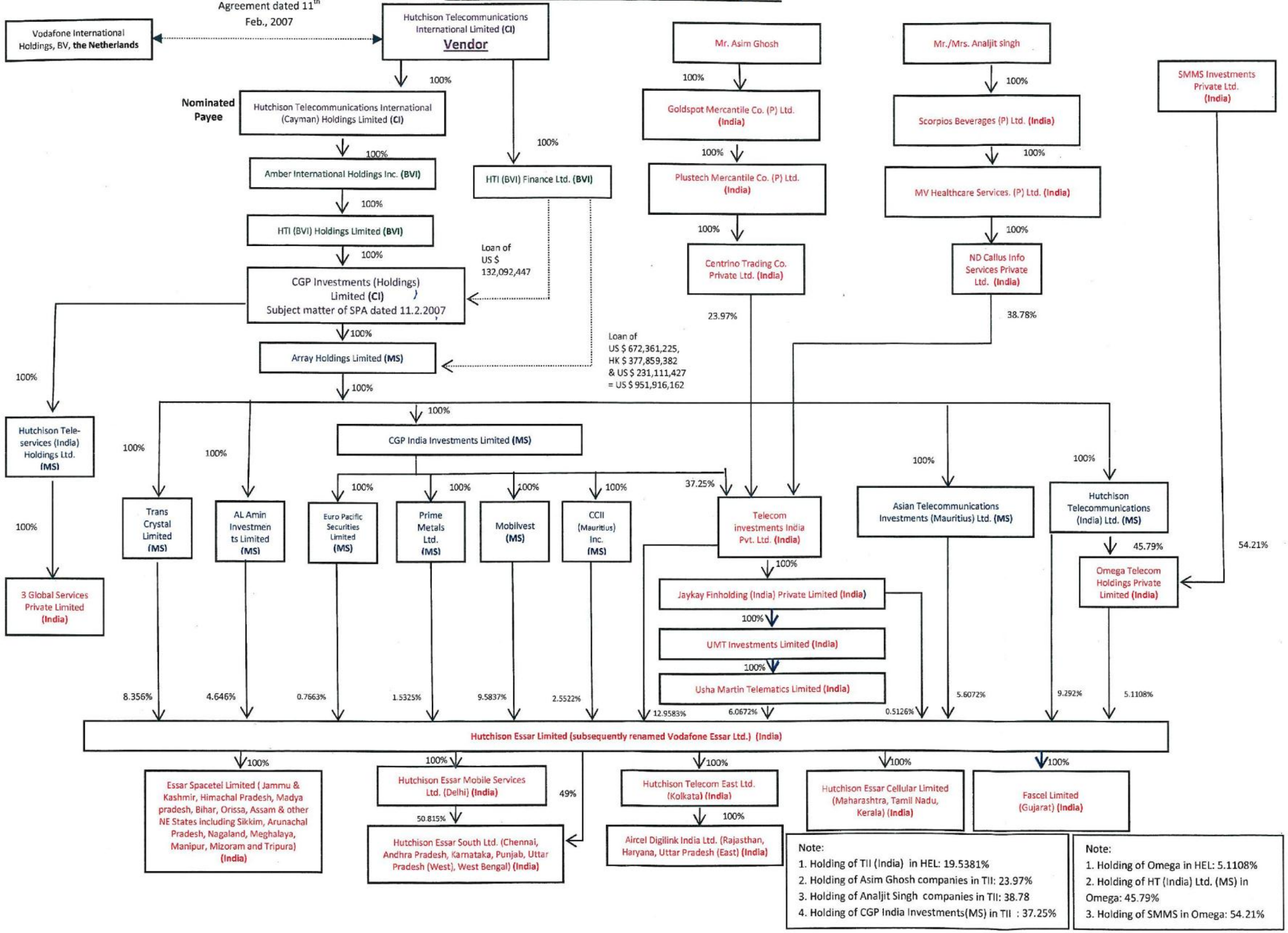
52. On 5.07.2007, **TII Shareholders Agreement** was entered into among Nadal, NDC, CGP India Investments Limited [“CGP India” for short], TII and VIH to regulate the affairs of TII. Under clause 3.1, NDC had 38.78% shareholding in TII, CGP India had 37.85% and Nadal had 23.57%.

53. It is not necessary to go into the earlier round of litigation. Suffice it to state that on 31.05.2010, an Order was passed by the Department under Sections 201(1) and 201(1A) of the Income Tax Act, 1961 [“the Act” for short] declaring that Indian Tax Authorities had jurisdiction to tax the transaction against which VIH filed Writ Petition No. 1325 of 2010 before the Bombay High Court which was dismissed on 8.09.2010 vide the impugned judgment [reported in 329 ITR 126], hence, this Civil Appeal.

B. Ownership Structure

54. In order to understand the above issue, we reproduce below the Ownership Structure Chart as on 11.02.2007. The Chart speaks for itself.

Ownership Structure Chart as at 11 February 2007



55. To sum up, CGP held 42.34% in HEL through 100% wholly owned subsidiaries [Mauritius companies], 9.62% indirectly through TII and Omega [i.e. pro rata route], and 15.03% through GSPL route.

56. To explain the GSPL route briefly, it may be mentioned that on 11.02.2007 AG Group of companies held 23.97% in TII, AS Group of companies held 38.78% in TII whereas SMMS held 54.21% in Omega. Consequently, holding of AG in HEL through TII stood at 4.68% whereas holding of AS in HEL through TII stood at 7.577% and holding of SMMS in HEL through Omega stood at 2.77%, which adds up to 15.03% in HEL. These holdings of AG, AS and SMMS came under the Option Route. In this connection, it may be mentioned that GSPL is an Indian company indirectly owned by CGP. It held Call Options and Subscription Options to be exercised in future under circumstances spelt out in TII and IDFC Framework Agreements (keeping in mind the sectoral cap of 74%).

<u>Correctness of Azadi Bachao case - Re: Tax Avoidance/Evasion</u>

57. Before us, it was contended on behalf of the Revenue that **Union of India v. Azadi Bachao Andolan** (2004) 10 SCC 1 needs to be overruled insofar as it departs from **McDowell and Co. Ltd. v. CTO** (1985) 3 SCC 230 principle for the following : i) Para 46 of **McDowell** judgment has been missed which reads as under: "on this aspect Chinnappa Reddy, J. has proposed a separate opinion with which we agree". [i.e. Westminster principle is dead]. ii) That, **Azadi Bachao** failed to read paras 41-45 and 46 of **McDowell** in entirety. If so read, the only conclusion one could draw is that four learned judges speaking through Misra, J. agreed with the observations of Chinnappa Reddy, J. as to how in certain circumstances tax avoidance should be brought within the tax net. iii) That, subsequent to **McDowell**, another matter came before the Constitution Bench of five Judges in **Mathuram Agrawal v. State of Madhya Pradesh** (1999) 8 SCC 667, in which Westminster principle was quoted which has not been noticed by **Azadi Bachao**.

<u>Our Analysis</u>

58. Before coming to Indo-Mauritius DTAA, we need to clear the doubts raised on behalf of the Revenue regarding the correctness of **Azadi Bachao** (supra) for the simple reason that certain tests laid down in the judgments of the English Courts subsequent to **The Commissioners of Inland Revenue v. His Grace the Duke of Westminster 1935 All E.R. 259** and **W.T. Ramsay Ltd. v. Inland Revenue Commissioners (1981) 1 All E.R. 865** help us to understand the scope of Indo-Mauritius DTAA. It needs to be clarified, that, **McDowell** dealt with two aspects. First, regarding validity of the Circular(s) issued by CBDT concerning Indo-Mauritius DTAA. Second, on concept of tax avoidance/evasion. Before us, arguments were advanced on behalf of the Revenue only regarding the second aspect.

59. The Westminster principle states that, "given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance". The said principle has been reiterated in subsequent English Courts Judgments as "the cardinal principle".

60. Ramsay was a case of sale-lease back transaction in which gain was sought to be counteracted, so as to avoid tax, by establishing an allowable loss. The method chosen was to buy from a company a readymade scheme, whose object was to create a neutral situation. The decreasing asset was to be sold so as to create an artificial loss and the increasing asset was to yield a gain which would be exempt from tax. The Crown challenged the whole scheme saying that it was an artificial scheme and, therefore, fiscally in-effective. It was held that Westminster did not compel the court to **look at** a document or a transaction, isolated from the context to which it properly belonged. It is the task of the Court to ascertain the legal nature of the transaction and while doing so it has to **look at** the entire transaction as a whole and not to adopt a dissecting approach. In the present case, the Revenue has adopted a dissecting approach at the Department level.

61. Ramsay did not discard Westminster but read it in the proper context by which "device" which was colourable in nature had to be ignored as fiscal nullity. **Thus, Ramsay lays down the principle of statutory interpretation**

rather than an over-arching anti-avoidance doctrine imposed upon tax laws.

62. **Furniss (Inspector of Taxes) v. Dawson (1984) 1 All E.R. 530** dealt with the case of interpositioning of a company to evade tax. On facts, it was held that the inserted step had no business purpose, except deferment of tax although it had a business effect. Dawson went beyond Ramsay. It reconstructed the transaction not on some fancied principle that anything done to defer the tax be ignored but on the premise that the inserted transaction did not constitute "disposal" under the relevant Finance Act. Thus, **Dawson** is an extension of **Ramsay** principle.

63. After **Dawson**, which empowered the Revenue to restructure the transaction in certain circumstances, the Revenue started rejecting every case of strategic investment/tax planning undertaken years before the event saying that the insertion of the entity was effected with the sole intention of tax avoidance. In **Craven (Inspector of Taxes) v. White (Stephen) (1988) 3 All. E.R. 495** it was held that the Revenue cannot start with the question as to whether the transaction was a tax deferment/saving device

but that the Revenue should apply the **look at** test to ascertain its true legal nature. It observed that genuine strategic planning had not been abandoned.

64. The majority judgment in **McDowell** held that "tax planning may be legitimate provided it is within the framework of law" (para 45). In the latter part of para 45, it held that "colourable device cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods". It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with para 46 where the majority holds "on this aspect one of us, Chinnappa Reddy, J. has proposed a separate opinion with which we agree". The words "this aspect" express the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colourable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible. Moreover, Reddy, J. himself says that he agrees with the majority. In the judgment of Reddy, J. there are repeated references to

schemes and devices in contradistinction to "legitimate avoidance of tax liability" (paras 7-10, 17 & 18). In our view, although Chinnappa Reddy, J. makes a number of observations regarding the need to depart from the "Westminster" and tax avoidance – these are clearly only in the context of artificial and colourable devices. Reading McDowell, in the manner indicated hereinabove, in cases of treaty shopping and/or tax avoidance, there is no conflict between McDowell and Azadi Bachao or between McDowell and Mathuram Agrawal.

International Tax Aspects of Holding Structures

65. In the thirteenth century, Pope Innocent IV espoused the theory of the legal fiction by saying that corporate bodies could not be ex-communicated because they only exist in abstract. This enunciation is the foundation of the **separate entity principle.**

66. The approach of both the corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on the abovementioned **separate entity principle**, i.e., treat a company as a separate person. The Indian Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies

and other entities subject to income-tax. Companies and other entities are viewed as economic entities with legal independence vis-a-vis their shareholders/participants. It is fairly well accepted that a subsidiary and its parent are totally distinct tax payers. Consequently, the entities subject to income-tax are taxed on profits derived by them on standalone basis, irrespective of their actual degree of economic independence and regardless of whether profits are reserved or distributed to the shareholders/ participants. Furthermore, shareholders/ participants, that are subject to (personal or corporate) income-tax, are generally taxed on profits derived in consideration of their shareholding/participations, such as capital gains. Now a days, it is fairly well settled that for tax treaty purposes a subsidiary and its parent are also totally separate and distinct tax payers.

67. It is generally accepted that the group parent company is involved in giving principal guidance to group companies by providing general policy guidelines to group subsidiaries. However, the fact that a parent company exercises shareholder’s influence on its subsidiaries does not

generally imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. Further, if a company is a parent company, that company's executive director(s) should lead the group and the company's shareholder's influence will generally be employed to that end. This obviously implies a restriction on the autonomy of the subsidiary's executive directors. Such a restriction, which is the inevitable consequences of any group structure, is generally accepted, both in corporate and tax laws. However, where the subsidiary's executive directors' competences are transferred to other persons/bodies or where the subsidiary's executive directors' decision making has become fully subordinate to the Holding Company with the consequence that the subsidiary's executive directors are no more than puppets then the turning point in respect of the subsidiary's place of residence comes about. Similarly, if an actual controlling Non-Resident Enterprise (NRE) makes an indirect transfer through "abuse of organisation form/legal form and without reasonable business purpose" which results in tax avoidance or avoidance of withholding tax, then the

Revenue may disregard the form of the arrangement or the impugned action through use of Non-Resident Holding Company, re-characterize the equity transfer according to its economic substance and impose the tax on the actual controlling Non-Resident Enterprise. Thus, whether a transaction is used principally as a colourable device for the distribution of earnings, profits and gains, is determined by a review of all the facts and circumstances surrounding the transaction. It is in the above cases that the principle of lifting the corporate veil or the doctrine of substance over form or the concept of beneficial ownership or the concept of alter ego arises. There are many circumstances, apart from the one given above, where separate existence of different companies, that are part of the same group, will be totally or partly ignored as a device or a conduit (in the pejorative sense).

68. The common law jurisdictions do invariably impose taxation against a corporation based on the legal principle that the corporation is "a person" that is separate from its members. It is the decision of the House of Lords in **Salomon v. Salomon (1897) A.C. 22** that opened the door

to the formation of a corporate group. If a "one man" corporation could be incorporated, then it would follow that one corporation could be a subsidiary of another. This legal principle is the basis of **Holding Structures**. It is a common practice in international law, which is the basis of international taxation, for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as Cayman Islands or Mauritius based company for both tax and business purposes. In doing so, foreign investors are able to avoid the lengthy approval and registration processes required for a direct transfer (i.e., without a foreign holding or operating company) of an equity interest in a foreign invested Indian company. However, taxation of such Holding Structures very often gives rise to issues such as double taxation, tax deferrals and tax avoidance. In this case, we are concerned with the concept of GAAR. In this case, we are not concerned with treaty-shopping but with the anti-avoidance rules. The concept of GAAR is not new to India since India already has a judicial anti-avoidance rule, like some other jurisdictions. Lack of clarity and absence of appropriate provisions in the statute and/or in the treaty regarding the circumstances in which judicial anti-avoidance rules would apply has generated litigation in India. Holding Structures are recognized in corporate as well as tax laws. Special Purpose Vehicles (SPVs) and Holding Companies have a place in legal structures in India, be it in company law, takeover code under SEBI or even under the income tax law. When it comes to taxation of a Holding Structure, at the threshold, the burden is on the Revenue to allege and establish abuse, in the sense of tax avoidance in the creation and/or use of such structure(s). In the application of a judicial anti-avoidance rule, the Revenue may invoke the "substance over form" principle or "piercing the corporate veil" test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant. To give an example, if a structure is used for circular trading or round tripping or to pay bribes then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity. Similarly, in a case where the Revenue finds that in a Holding Structure an entity which has no commercial/business substance has been interposed only to avoid tax then in such cases applying the test of fiscal nullity it would be open to the Revenue to discard such inter-positioning of that entity. However, this has to be done at the threshold. In this connection, we may reiterate the "**look at**" principle enunciated in **Ramsay** (supra) in which it was held that the Revenue or the Court must **look at** a document or a transaction in a context to which it properly belongs to. It is the task of the Revenue/Court to ascertain the legal nature of the transaction and while doing so it has to **look at** the entire transaction as a whole and not to adopt a dissecting approach. The Revenue cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but that it should apply the "**look at**" test to ascertain its true legal nature [See **Craven v. White** (supra) which further observed that genuine strategic tax planning has not been abandoned by any decision of the English Courts till date]. Applying the above tests, we are of the view that every strategic foreign direct investment coming to India, as an investment destination, should be seen in a holistic manner. While doing so, the Revenue/Courts should keep in mind the following factors: the concept of participation in investment, the duration of time during which the Holding Structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on such exit. In short, the onus will be on the Revenue to identify the scheme and its dominant purpose. The corporate business purpose of a transaction is evidence of the fact that the impugned transaction is not undertaken as a colourable or artificial device. The stronger the evidence of a device, the stronger the corporate business purpose must exist to overcome the evidence of a device.

Whether Section 9 is a "look through" provision as submitted on behalf of the Revenue?

69. According to the Revenue, if its primary argument (namely, that HTIL has, under the SPA, directly extinguished its property rights in HEL and its subsidiaries) fails, even then in any event, income from the sale of CGP share would nonetheless fall within Section 9 of the Income Tax Act, 1961 as that Section provides for a "**look through**". In this connection, it was submitted that the word "through"

in Section 9 *inter alia* means "in consequence of". It was, therefore, argued that if transfer of a capital asset situate in India happens "in consequence of" something which has taken place overseas (including transfer of a capital asset), then all income derived even **indirectly** from such transfer, even though abroad, becomes taxable in India. That, even if control over HEL were to get transferred in consequence of transfer of the CGP Share outside India, it would yet be covered by Section 9.

70. We find no merit in the above submission of the Revenue. At the outset, we quote hereinbelow the following Sections of the Income Tax Act, 1961:

> **Scope of total income.**
> **5. (2)** Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—
>
> > (*a*) is received or is deemed to be received in India in such year by or on behalf of such person ; or
> > (*b*) accrues or arises or is deemed to accrue or arise to him in India during such year.
>
> **Income deemed to accrue or arise in India.**
> **9. (1)** The following incomes shall be deemed to accrue or arise in India :—

> ***(i)*** all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

71. Section 9(1)(i) gathers in one place various types of income and directs that income falling under each of the sub-clauses shall be deemed to accrue or arise in India. Broadly there are four items of income. The income dealt with in each sub-clause is distinct and independent of the other and the requirements to bring income within each sub-clause, are separately noted. Hence, it is not necessary that income falling in one category under any one of the sub-clauses should also satisfy the requirements of the other sub-clauses to bring it within the expression "income deemed to accrue or arise in India" in Section 9(1)(i). In this case, we are concerned with the last sub-clause of Section 9(1)(i) which refers to income arising from "transfer of a capital asset situate in India". Thus, charge on capital gains arises on transfer of a capital asset situate in India during the previous year. The said sub-clause consists of

three elements, namely, transfer, existence of a capital asset, and situation of such asset in India. All three elements should exist in order to make the last sub-clause applicable. Therefore, if such a transfer does not exist in the previous year no charge is attracted. Further, Section 45 enacts that such income shall be deemed to be the income of the previous year in which transfer took place. Consequently, there is no room for doubt that such transfer should exist during the previous year in order to attract the said sub-clause. The fiction created by Section 9(1)(i) applies to the assessment of income of non-residents. In the case of a resident, it is immaterial whether the place of accrual of income is within India or outside India, since, in either event, he is liable to be charged to tax on such income. But, in the case of a non-resident, unless the place of accrual of income is within India, he cannot be subjected to tax. In other words, if any income accrues or arises to a non-resident, directly or indirectly, outside India is fictionally deemed to accrue or arise in India if such income accrues or arises as a sequel to the transfer of a capital asset situate in India. Once the factum of such transfer is established by the Department, then the income of the non-resident arising or accruing from such transfer is made liable to be taxed by reason of Section 5(2)(b) of the Act. This fiction comes into play only when the income is not charged to tax on the basis of receipt in India, as receipt of income in India by itself attracts tax whether the recipient is a resident or non-resident. This fiction is brought in by the legislature to avoid any possible argument on the part of the non-resident vendor that profit accrued or arose outside India by reason of the contract to sell having been executed outside India. Thus, income accruing or arising to a non-resident outside India on transfer of a capital asset situate in India is fictionally deemed to accrue or arise in India, which income is made liable to be taxed by reason of Section 5(2)(b) of the Act. This is the main purpose behind enactment of Section 9(1)(i) of the Act. We have to give effect to the language of the section when it is unambiguous and admits of no doubt regarding its interpretation, particularly when a legal fiction is embedded in that section. A legal fiction has a limited scope. A legal fiction cannot be expanded by giving purposive interpretation particularly if the result of such interpretation is to transform the concept of chargeability which is also there in Section 9(1)(i), particularly when one reads Section 9(1)(i) with Section 5(2)(b) of the Act. What is contended on behalf of the Revenue is that under Section 9(1)(i) it can "**look through**" the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that Section 9(1)(i) covers direct and **indirect transfers** of capital assets. For the above reasons, Section 9(1)(i) cannot by a process of interpretation be extended to cover **indirect transfers** of capital assets/property situate in India. To do so, would amount to changing the content and ambit of Section 9(1)(i). We cannot re-write Section 9(1)(i). The legislature has not used the words **indirect transfer** in Section 9(1)(i). If the word **indirect** is read into Section 9(1)(i), it would render the express statutory requirement of the 4th sub-clause in Section 9(1)(i) nugatory. This is because Section 9(1)(i) applies to transfers of a capital asset **situate in India.** This is one of the elements in the 4th sub-clause of Section 9(1)(i) and if indirect transfer of a capital asset is read into Section 9(1)(i) then the words **capital asset situate in India** would be rendered nugatory. Similarly, the words underlying asset do not find place in Section 9(1)(i). Further, "transfer" should be of an asset in respect of which it is possible to compute a capital gain in accordance with the provisions of the Act. Moreover, even Section 163(1)(c) is wide enough to cover the income whether received directly or indirectly. Thus, the words directly or indirectly in Section 9(1)(i) go with the income and not with the transfer of a capital asset (property). Lastly, it may be mentioned that the Direct Tax Code (DTC) Bill, 2010 proposes to tax income from transfer of shares of a foreign company by a non-resident, where at any time during 12 months preceding the transfer, the fair market value of the assets in India, owned directly or indirectly, by the company, represents at least 50% of the fair market value of all assets owned by the company. Thus, the DTC Bill, 2010 proposes taxation of offshore share transactions. This proposal indicates in a way that **indirect transfers** are not covered by the existing Section

9(1)(i) of the Act. In fact, the DTC Bill, 2009 expressly stated that income accruing even from **indirect** transfer of a capital asset situate in India would be deemed to accrue in India. These proposals, therefore, show that in the existing Section 9(1)(i) the word **indirect** cannot be read on the basis of purposive construction. The question of providing "**look through"** in the statute or in the treaty is a matter of policy. It is to be expressly provided for in the statute or in the treaty. Similarly, **limitation of benefits** has to be expressly provided for in the treaty. Such clauses cannot be read into the Section by interpretation. For the foregoing reasons, we hold that Section 9(1)(i) is not a "look through" provision.

Transfer of HTIL's property rights by Extinguishment?

72. The primary argument advanced on behalf of the Revenue was that the SPA, commercially construed, evidences a transfer of HTIL's property rights by their extinguishment. That, HTIL had, under the SPA, directly extinguished its rights of control and management, which are property rights, over HEL and its subsidiaries and, consequent upon such extinguishment, there was a transfer

of capital asset situated in India. In support, the following features of the SPA were highlighted: (i) the right of HTIL to direct a downstream subsidiary as to the manner in which it should vote. According to the Revenue, this right was a property right and not a contractual right. It vested in HTIL as HTIL was a parent company, i.e., a 100% shareholder of the subsidiary; (ii) According to the Revenue, the 2006 Shareholders/ Framework Agreements had to be continued upon transfer of control of HEL to VIH so that VIH could step into the shoes of HTIL. According to the Revenue, such continuance was ensured by payment of money to AS and AG by VIH failing which AS and AG could have walked out of those agreements which would have jeopardized VIH's control over 15% of the shares of HEL and, consequently, the stake of HTIL in TII would have stood reduced to minority; (iii) Termination of IDFC Framework Agreement of 2006 and its substitution by a fresh Framework Agreement dated 5.06.2007, as warranted by SPA; (iv) Termination of Term Sheet Agreement dated 5.07.2003. According to the Revenue, that Term Sheet Agreement was given effect to by clause 5.2 of the SPA which gave Essar the right to Tag

Along with HTIL and exit from HEL. That, by a specific Settlement Agreement dated 15.03.2007 between HTIL and Essar, the said Term Sheet Agreement dated 5.07.2003 stood terminated. This, according to the Revenue, was necessary because the Term Sheet bound the parties; (v) the SPA ignores legal entities interposed between HTIL and HEL enabling HTIL to directly nominate the Directors on the Board of HEL; (vi) Qua management rights, even if the legal owners of HEL's shares (Mauritius entities) could have been directed to vote by HTIL in a particular manner or to nominate a person as a Director, such rights existed dehors the CGP share; (vii) Vide clause 6.2 of the SPA, HTIL was required to exercise voting rights in the specified situations on the diktat of VIH ignoring the legal owner of CGP share [HTIHL (BVI)]. Thus, according to the Revenue, HTIL ignored its subsidiaries and was exercising the voting rights qua the CGP and the HEL shares directly, ignoring all the intermediate subsidiaries which are 100% held and which are non-operational. According to the Revenue, extinguishment took place dehors the CGP share. It took place by virtue of various clauses of SPA as HTIL itself disregarded the corporate structure it had set up; (viii) As a holder of 100% shares of downstream subsidiaries, HTIL possessed **de facto control** over such subsidiaries. Such **de facto control** was the subject matter of the SPA.

73. At the outset, we need to reiterate that in this case we are concerned with the sale of shares and not with the sale of assets, item-wise. The facts of this case show sale of the entire investment made by HTIL, through a Top company, viz. CGP, in the Hutchison Structure. In this case we need to apply the "**look at**" test. In the impugned judgment, the High Court has rightly observed that the arguments advanced on behalf of the Department vacillated. The reason for such vacillation was adoption of "**dissecting approach**" by the Department in the course of its arguments. **Ramsay** (supra) enunciated the **look at** test. According to that test, the task of the Revenue is to ascertain the legal nature of the transaction and, while doing so, it has to **look at** the entire transaction holistically and not to adopt a dissecting approach. One more aspect needs to be reiterated. There is a conceptual difference between **preordained transaction** which is created for tax

avoidance purposes, on the one hand, and a transaction which evidences **investment to participate** in India. In order to find out whether a given transaction evidences a preordained transaction in the sense indicated above or **investment to participate**, one has to take into account the factors enumerated hereinabove, namely, duration of time during which the holding structure existed, the period of business operations in India, generation of taxable revenue in India during the period of business operations in India, the timing of the exit, the continuity of business on such exit, etc. Applying these tests to the facts of the present case, we find that the Hutchison structure has been in place since 1994. It operated during the period 1994 to 11.02.2007. It has paid income tax ranging from `3 crore to `250 crore per annum during the period 2002-03 to 2006-07. Even after 11.02.2007, taxes are being paid by VIH ranging from `394 crore to `962 crore per annum during the period 2007-08 to 2010-11 (these figures are apart from indirect taxes which also run in crores). Moreover, the SPA indicates "continuity" of the telecom business on the exit of its predecessor, namely, HTIL. Thus, it cannot be said that the structure was created or used as a sham or tax avoidant. It cannot be said that HTIL or VIH was a "fly by night" operator/ short time investor. If one applies the **look at** test discussed hereinabove, without invoking the dissecting approach, then, in our view, extinguishment took place because of the transfer of the CGP share and not by virtue of various clauses of SPA. In a case like the present one, where the structure has existed for a considerable length of time generating taxable revenues right from 1994 and where the court is satisfied that the transaction satisfies all the parameters of "participation in investment" then in such a case the court need not go into the questions such as de facto control vs. legal control, legal rights vs. practical rights, etc.

74. Be that as it may, did HTIL possess a legal right to appoint directors onto the board of HEL and as such had some "property right" in HEL? If not, the question of such a right getting "extinguished" will not arise. A legal right is an enforceable right. Enforceable by a legal process. The question is what is the nature of the "control" that a parent

company has over its subsidiary. It is not suggested that a parent company never has control over the subsidiary. For example, in a proper case of "lifting of corporate veil", it would be proper to say that the parent company and the subsidiary form one entity. But barring such cases, the legal position of any company incorporated abroad is that its powers, functions and responsibilities are governed by the law of its incorporation. No multinational company can operate in a foreign jurisdiction save by operating independently as a "good local citizen". A company is a separate legal persona and the fact that all its shares are owned by one person or by the parent company has nothing to do with its separate legal existence. If the owned company is wound up, the liquidator, and not its parent company, would get hold of the assets of the subsidiary. In none of the authorities have the assets of the subsidiary been held to be those of the parent unless it is acting as an agent. Thus, even though a subsidiary may normally comply with the request of a parent company it is not just a puppet of the parent company. The difference is between having power or having a persuasive position. Though it may be advantageous for parent and subsidiary companies to work as a group, each subsidiary will look to see whether there are separate commercial interests which should be guarded. When there is a parent company with subsidiaries, is it or is it not the law that the parent company has the "power" over the subsidiary. It depends on the facts of each case. For instance, take the case of a one-man company, where only one man is the shareholder perhaps holding 99% of the shares, his wife holding 1%. In those circumstances, his control over the company may be so complete that it is his alter ego. But, in case of multinationals it is important to realise that their subsidiaries have a great deal of autonomy in the country concerned except where subsidiaries are created or used as a sham. Of course, in many cases the courts do lift up a corner of the veil but that does not mean that they alter the legal position between the companies. The directors of the subsidiary under their Articles are the managers of the companies. If new directors are appointed even at the request of the parent company and even if such directors were removable by the parent company, such directors of the subsidiary will owe their duty to their companies (subsidiaries). They are not to be dictated by the parent company if it is not in the interests of those companies (subsidiaries). The fact that the parent company exercises shareholder's influence on its subsidiaries cannot obliterate the decision-making power or authority of its (subsidiary's) directors. They cannot be reduced to be puppets. The decisive criteria is whether the parent company's management has such steering interference with the subsidiary's core activities that subsidiary can no longer be regarded to perform those activities on the authority of its own executive directors.

75. Before dealing with the submissions advanced on behalf of the Revenue, we need to appreciate the reason for execution of the SPA. Exit is an important right of an investor in every strategic investment. The present case concerns transfer of investment in entirety. As stated above, exit coupled with continuity of business is one of the important tell-tale circumstance which indicates the commercial/business substance of the transaction. Thus, the need for SPA arose to re-adjust the outstanding loans

between the companies; to provide for standstill arrangements in the interregnum between the date of signing of the SPA on 11.02.2007 and its completion on 8.05.2007; to provide for a seamless transfer and to provide for fundamental terms of price, indemnities, warranties etc. As regards the right of HTIL to direct a downstream subsidiary as to the manner in which it should vote is concerned, the legal position is well settled, namely, that even though a subsidiary may normally comply with the request of a parent company, it is not just a puppet of the parent company. The difference is between having the **power** and having a **persuasive position**. A great deal depends on the facts of each case. Further, as stated above, a company is a separate legal persona, and the fact that all the shares are owned by one person or a company has nothing to do with the existence of a separate company. Therefore, though it may be advantageous for a parent and subsidiary companies to work as a group, each subsidiary has to protect its own separate commercial interests. In our view, on the facts and circumstances of this case, the right of HTIL, if at all it is a right, to direct a downstream subsidiary as to the manner in which it should vote would fall in the category of a persuasive position/influence rather than having a power over the subsidiary. In this connection the following facts are relevant.

76. Under the Hutchison structure, the business was carried on by the Indian companies under the control of their Board of Directors, though HTIL, as the Group holding company of a set of companies, which controlled 42% plus 10% (pro rata) shares, did influence or was in a position to persuade the working of such Board of Directors of the Indian companies. In this connection, we need to have a relook at the ownership structure. It is not in dispute that 15% out of 67% stakes in HEL was held by AS, AG and IDFC companies. That was one of the main reasons for entering into separate Shareholders and Framework Agreements in 2006, when Hutchison structure existed, with AS, AG and IDFC. HTIL was not a party to the agreements with AS and AG, though it was a party to the agreement with IDFC. That, the ownership structure of Hutchison clearly shows that AS, AG and SMMS (IDFC) group of companies, being Indian companies, possessed

15% control in HEL. Similarly, the term sheet with Essar dated 5.07.2003 gave Essar the RoFR and Right to Tag Along with HTIL and exit from HEL. Thus, if one keeps in mind the Hutchison structure in its entirety, HTIL as a Group holding company could have only persuaded its downstream companies to vote in a given manner as HTIL had no power nor authority under the said structure to direct any of its downstream companies to vote in a manner as directed by it (HTIL). Facts of this case show that both the parent and the subsidiary companies worked as a group since 1994. That, as a practice, the subsidiaries did comply with the arrangement suggested by the Group holding company in the matter of voting, failing which the smooth working of HEL generating huge revenues was not possible. In this case, we are concerned with the expression "capital asset" in the income tax law. Applying the test of enforceability, influence/ persuasion cannot be construed as a right in the legal sense. One more aspect needs to be highlighted. The concept of "de facto" control, which existed in the Hutchison structure, conveys a state of being in control without any legal right to such state. This aspect is important while construing the words "capital asset" under the income tax law. As stated earlier, enforceability is an important aspect of a legal right. Applying these tests, on the facts of this case and that too in the light of the ownership structure of Hutchison, we hold that HTIL, as a Group holding company, had no legal right to direct its downstream companies in the matter of voting, nomination of directors and management rights. As regards continuance of the 2006 Shareholders/Framework Agreements by SPA is concerned, one needs to keep in mind two relevant concepts, viz., participative and protective rights. As stated, this is a case of HTIL exercising its exit right under the holding structure and continuance of the telecom business operations in India by VIH by acquisition of shares. In the Hutchison structure, exit was also provided for Essar, Centrino, NDC and SMMS through exercise of Put Option/TARs, subject to sectoral cap being relaxed in future. These exit rights in Essar, Centrino, NDC and SMMS (IDFC) indicate that these companies were independent companies. Essar was a partner in HEL whereas Centrino, NDC and SMMS controlled 15% of shares of HEL (minority). **A minority investor has what is called as a "participative" right, which is a subset of "protective rights"**. These participative rights, given to a minority shareholder, enable the minority to overcome the presumption of consolidation of operations or assets by the controlling shareholder. These participative rights in certain instances restrict the powers of the shareholder with majority voting interest to control the operations or assets of the investee. At the same time, even the minority is entitled to exit. This "exit right" comes under "protective rights". On examination of the Hutchison structure in its entirety, we find that both, participative and protective rights, were provided for in the Shareholders/ Framework Agreements of 2006 in favour of Centrino, NDC and SMMS which enabled them to participate, directly or indirectly, in the operations of HEL. Even without the execution of SPA, such rights existed in the above agreements. Therefore, it would not be correct to say that such rights flowed from the SPA. One more aspect needs to be mentioned. The Framework Agreements define "change of control with respect to a shareholder" inter alia as substitution of limited or unlimited liability company, whether directly or indirectly, to direct the policies/ management of the respective shareholders, viz., Centrino, NDC, Omega. Thus, even without the SPA, upon substitution of VIH in place of HTIL, on acquisition of CGP share, transition could have taken place. It is important to note that “transition” is a wide concept. It is impossible for the acquirer to visualize all events that may take place between the date of execution of the SPA and completion of acquisition. Therefore, we have a provision for standstill in the SPA and so also the provision for transition. But, from that, it does not follow that without SPA, transition could not ensue. Therefore, in the SPA, we find provisions concerning Vendor’s Obligations in relation to the conduct of business of HEL between the date of execution of SPA and the closing date, protection of investment during the said period, agreement not to amend, terminate, vary or waive any rights under the Framework/ Shareholders Agreements during the said period, provisions regarding running of business during the said period, assignment of loans, consequence of imposition of prohibition by way of injunction from any court, payment to be made by VIH to HTIL, giving of warranties by the Vendor, use of Hutch Brand, etc. The next point raised by the Revenue concerns termination of IDFC Framework Agreement of 2006 and its substitution by a fresh Framework Agreement dated 5.06.2007 in terms of the SPA. The submission of the Revenue before us was that the said Agreement dated 5.06.2007 (which is executed after the completion of acquisition by VIH on 8.05.2007) was necessary to assign the benefits of the earlier agreements of 2006 to VIH. This is not correct. The shareholders of ITNL (renamed as Omega) were Array through HTIL Mauritius and SMMS (an Indian company). The original investors through SMMS (IDFC), an infrastructure holding company, held 54.21% of the share capital of Omega; that, under the 2006 Framework Agreement, the original investors were given Put Option by GSPL [an Indian company under Hutchison Teleservices (India) Holdings Limited (Ms)] requiring GSPL to buy the equity share capital of SMMS; that on completion of acquisition on 8.05.2007 there was a change in control of HTIL Mauritius which held 45.79% in Omega and that changes also took place on 5.06.2007 within the group of original investors with the exit of IDFC and SSKI. In view of the said changes in the parties, a revised Framework Agreement was executed on 6.06.2007, which again had call and put option. Under the said Agreement dated 6.06.2007, the Investors once again agreed to grant call option to GSPL to buy the shares of SMMS and to enter into a Shareholders Agreement to regulate the affairs of Omega. It is important to note that even in the fresh agreement the call option remained with GSPL and that the said Agreement did not confer any rights on VIH. One more aspect needs to be mentioned. The conferment of call options on GSPL under the Framework Agreements of 2006 also had a linkage with intra-group loans. CGP was an Investment vehicle. It is through the acquisition of CGP that VIH had indirectly acquired the rights and obligations of GSPL in the Centrino and NDC Framework Agreements of 2006 [see the report of KPMG dated 18.10.2010] and not through execution of the SPA. Lastly, as stated above, apart from providing for "standstill", an SPA has to provide for transition and all possible future eventualities. In the present case, the change in the investors, after completion of acquisition on 8.05.2007, under which SSKI and IDFC exited leaving behind IDF alone was a situation which was required to be addressed by execution of a fresh Framework Agreement under which the call option remained with GSPL. Therefore, the June, 2007 Agreements relied upon by the Revenue merely reiterated the rights of GSPL which rights existed even in the Hutchison structure as it stood in 2006. It was next contended that the 2003 Term Sheet with Essar was given effect to by clause 5.2 of the SPA which gave Essar the Right to Tag Along with HTIL and exit from HEL. That, the Term Sheet of 5.07.2003 had legal effect because by a specific settlement dated 15.03.2007 between HTIL and Essar, the said Term Sheet stood terminated which was necessary because the Term Sheet bound the parties in the first place. We find no merit in the above arguments of the Revenue. The 2003 Term Sheet was between HTIL, Essar and UMTL. Disputes arose between Essar and HTIL. Essar asserted RoFR rights when bids were received by HTIL, which dispute ultimately came to be settled on 15.03.2007, that is after the SPA dated 11.02.2007. The SPA did not create any rights. The RoFR/TARs existed in the Hutchison structure. Thus, even without SPA, within the Hutchison structure these rights existed. Moreover, the very object of the SPA is to cover the situations which may arise during the transition and those which are capable of being anticipated and dealt with. Essar had 33% stakes in HEL. As stated, the Hutchison structure required the parent and the subsidiary to work together as a group. The said structure required the Indian partners to be kept in the loop. Disputes on existence of RoFR/ TARs had to be settled. They were settled on 15.03.2007. The rights and obligations created under the SPA had to be preserved. In any event, preservation of such rights with a view to continue business in India is not extinguishment.

77. For the above reasons, we hold that under the HTIL structure, as it existed in 1994, HTIL occupied only a persuasive position/influence over the downstream companies *qua* manner of voting, nomination of directors and management rights. That, the minority shareholders/investors had **participative and protective rights** (including RoFR/TARs, call and put options which provided for exit) which flowed from the CGP share. That,

the entire investment was sold to the VIH through the investment vehicle (CGP). Consequently, there was no extinguishment of rights as alleged by the Revenue.

Role of CGP in the transaction

78. The main contention of the Revenue was that CGP stood inserted at a late stage in the transaction in order to bring in a tax-free entity (or to create a transaction to avoid tax) and thereby avoid capital gains. That, in December, 2006, HTIL explored the possibility of the sale of shares of the Mauritius entities and found that such transaction would be taxable as HTIL under that proposal had to be the prime mover behind any agreement with VIH – prime mover in the sense of being both a seller of shares and the recipient of the sale proceeds therefrom. Consequently, HTIL moved upwards in the Hutchison structure and devised an artificial tax avoidance scheme of selling the CGP share when in fact what HTIL wanted was to sell its property rights in HEL. This, according to the Revenue, was the reason for the CGP share being interposed in the transaction. We find no merit in these arguments.

79. When a business gets big enough, it does two things. First, it reconfigures itself into a corporate group by dividing itself into a multitude of commonly owned subsidiaries. Second, it causes various entities in the said group to guarantee each other's debts. A typical large business corporation consists of sub-incorporates. Such division is legal. It is recognized by company law, laws of taxation, takeover codes etc. On top is a parent or a holding company. The parent is the public face of the business. The parent is the only group member that normally discloses financial results. Below the parent company are the subsidiaries which hold operational assets of the business and which often have their own subordinate entities that can extend layers. If large firms are not divided into subsidiaries, creditors would have to monitor the enterprise in its entirety. Subsidiaries reduce the amount of information that creditors need to gather. Subsidiaries also promote the benefits of specialization. Subsidiaries permit creditors to lend against only specified divisions of the firm. These are the efficiencies inbuilt in a holding structure. Subsidiaries are often created for tax or regulatory reasons.

They at times come into existence from mergers and acquisitions. As group members, subsidiaries work together to make the same or complementary goods and services and hence they are subject to the same market supply and demand conditions. They are financially inter-linked. One such linkage is the intra-group loans and guarantees. Parent entities own equity stakes in their subsidiaries. Consequently, on many occasions, the parent suffers a loss whenever the rest of the group experiences a downturn. Such grouping is based on the principle of **internal correlation**. Courts have evolved doctrines like piercing the corporate veil, substance over form etc. enabling taxation of underlying assets in cases of fraud, sham, tax avoidant, etc. However, genuine strategic tax planning is not ruled out.

80. CGP was incorporated in 1998 in Cayman Islands. It was in the Hutchison structure from 1998. The transaction in the present case was of divestment and, therefore, the transaction of sale was structured at an appropriate tier, so that the buyer really acquired the same degree of control as was hitherto exercised by HTIL. VIH agreed to acquire companies and the companies it acquired controlled 67%

interest in HEL. CGP was an investment vehicle. As stated above, it is through the acquisition of CGP that VIH proposed to indirectly acquire the rights and obligations of GSPL in the Centrino and NDC Framework Agreements. The report of Ernst & Young dated 11.02.2007 inter alia states that when they were asked to conduct due diligence by VIH, it was in relation to Array and its subsidiaries. The said report evidences that at the negotiation stage, parties had in mind the transfer of an upstream company rather than the transfer of HEL directly. The transfer of Array had the advantage of transferring control over the entire shareholding held by downstream Mauritius companies (tier I companies), other than **GSPL**. On the other hand, the advantage of transferring the CGP share enabled VIH to indirectly acquire the rights and obligations of GSPL (Indian company) in the Centrino and NDC Framework agreements. This was the reason for VIH to go by the CGP route. One of the arguments of the Revenue before us was that the Mauritius route was not available to HTIL for the reason indicated above. In this connection, it was urged that the legal owner of HEL (Indian company) was not HTIL. Under the transaction, HTIL alone was the seller of the shares. VIH wanted to enter into an agreement only with HTIL so that if something goes wrong, VIH could look solely to HTIL being the group holding company (parent company). Further, funds were pumped into HEL by HTIL. These funds were to be received back in the shape of a capital gain which could then be used to declare a special dividend to the shareholders of HTIL. We find no merit in this argument. Firstly, the tier I (Mauritius companies) were the indirect subsidiaries of HTIL who could have influenced the former to sell the shares of Indian companies in which event the gains would have arisen to the Mauritius companies, who are not liable to pay capital gains tax under the Indo-Mauritius DTAA. That, nothing prevented the Mauritius companies from declaring dividend on gains made on the sale of shares. There is no tax on dividends in Mauritius. Thus, the Mauritius route was available but it was not opted for because that route would not have brought in the control over GSPL. Secondly, if the Mauritius companies had sold the shares of HEL, then the Mauritius companies would have continued to be the subsidiaries of HTIL, their accounts would have been consolidated in the hands of HTIL and HTIL would have accounted for the gains in exactly the same way as it has accounted for the gains in the hands of HTIHL (CI) which was the nominated payee. Thus, in our view, two routes were available, namely, the CGP route and the Mauritius route. It was open to the parties to opt for any one of the two routes. Thirdly, as stated above, in the present case, the SPA was entered into inter alia for a smooth transition of business on divestment by HTIL. As stated, transfer of the CGP share enabled VIH to indirectly acquire the rights and obligations of GSPL in the Centrino and NDC Framework Agreements. Apart from the said rights and obligations under the Framework Agreements, GSPL also had a call centre business. VIH intended to take over from HTIL the telecom business. It had no intention to acquire the business of call centre. Moreover, the FDI norms applicable to the telecom business in India were different and distinct from the FDI norms applicable to the call centre business. Consequently, in order to avoid legal and regulatory objections from Government of India, the call centre business stood hived off. In our view, this step was an integral part of transition of business under SPA.

81. On the role of CGP in the transaction, two documents are required to be referred to. One is the Report of the KPMG dated 18.10.2010 in which it is stated that through the acquisition of CGP, VIH had indirectly acquired the rights and obligations of GSPL in the Centrino and NDC Framework Agreements. That, the said two agreements were put in place with a view to provide AG and AS with downside protection while preserving upside value in the growth of HEL. The second document is the Annual Report 2007 of HTIL. Under the caption "Overview", the Report observes that on 11.02.2007, HTIL entered into an agreement to sell its entire interests in CGP, a company which held through various subsidiaries, the direct and indirect equity and loan interests in HEL (renamed VEL) and its subsidiaries to VIH for a cash consideration of HK $86.6 bn. As a result of the said Transaction, the net debt of the Group which stood at HK $37,369 mn as on 31.12.2006 became a net cash balance of HK $25,591 mn as on 31.12.2007. This supports the fact that the sole purpose of

CGP was not only to hold shares in subsidiary companies but also to enable a smooth transition of business, which is the basis of the SPA. Therefore, it cannot be said that the intervened entity (CGP) had no business or commercial purpose.

82. Before concluding, one more aspect needs to be addressed. It concerns situs of the CGP share. According to the Revenue, under the Companies Law of Cayman Islands, an exempted company was not entitled to conduct business in the Cayman Islands. CGP was an "exempted company". According to the Revenue, since CGP was a mere holding company and since it could not conduct business in Cayman Islands, the situs of the CGP share existed where the "underlying assets are situated", that is to say, India. That, since CGP as an exempted company conducts no business either in the Cayman Islands or elsewhere and since its sole purpose is to hold shares in a subsidiary company situated outside the Cayman Islands, the situs of the CGP share, in the present case, existed "where the underlying assets stood situated" (India). We find no merit in these arguments. At the outset, we do not

wish to pronounce authoritatively on the Companies Law of Cayman Islands. Be that as it may, under the Indian Companies Act, 1956, the situs of the shares would be where the company is incorporated and where its shares can be transferred. In the present case, it has been asserted by VIH that the transfer of the CGP share was recorded in the Cayman Islands, where the register of members of the CGP is maintained. This assertion has neither been rebutted in the impugned order of the Department dated 31.05.2010 nor traversed in the pleadings filed by the Revenue nor controverted before us. In the circumstances, we are not inclined to accept the arguments of the Revenue that the situs of the CGP share was situated in the place (India) where the underlying assets stood situated.

Did VIH acquire 67% controlling interest in HEL (and not 42%/ 52% as sought to be propounded)?

83. According to the Revenue, the entire case of VIH was that it had acquired only 42% (or, accounting for FIPB regulations, 52%) is belied by clause 5.2 of the Shareholders Agreement. In this connection, it was urged that 15% in HEL was held by AS/ AG/ IDFC because of the FDI cap of

74% and, consequently, vide clause 5.2 of the Shareholders Agreement between these entities and HTIL downstream subsidiaries, AS/AG/IDFC were all reigned in by having to vote only in accordance with HTIL's dictates as HTIL had funded the purchase by these gentlemen of the HEL shares through financing of loans. Further, in the Term Sheet dated 15.03.2007, that is, between VIH and Essar, VIH had a right to nominate 8 directors (i.e. 67% of 12) and Essar had a right to nominate 4 directors which, according to the Revenue, evidences that VIH had acquired 67% interest in HEL and not 42%/52%, as sought to be propounded by it. According to the Revenue, right from 22.12.2006 onwards when HTIL made its first public announcement, HTIL on innumerable occasions represented its direct and indirect "equity interest" in HEL to be 67% - the direct interest being 42.34% and indirect interest in the sense of shareholding belonging to Indian partners under its control, as 25%. Further, according to the Revenue, the purchase price paid by VIH was based on an enterprise value of 67% of the share capital of HEL; this would never have been so if VIH was to buy only 42.34% of the share capital of HEL and that nobody would pay US $2.5 bn extra without control over 25% in HEL. We find no merit in the above submissions. At the outset, it may be stated that **the expression "control" is a mixed question of law and fact**. The basic argument of the Revenue is based on the equation of "equity interest" with the word "control". On perusal of Hutchison structure, we find that HTIL had, through its 100% wholly owned subsidiaries, invested in 42.34% of HEL (i.e. direct interest). Similarly, HTIL had invested through its non-100% wholly owned subsidiaries in 9.62% of HEL (through the pro rata route). Thus, in the sense of shareholding, one can say that HTIL had an **effective shareholding** (direct and indirect interest) of 51.96% (approx. 52%) in HEL. On the basis of the shareholding test, HTIL could be said to have a 52% control over HEL. By the same test, it could be equally said that the balance 15% stakes in HEL remained with AS, AG and IDFC (Indian partners) who had through their respective group companies invested 15% in HEL through TII and Omega and, consequently, HTIL had no control over 15% stakes in HEL. At this stage, we may state that under the Hutchison structure shares of Plustech in the AG Group, shares of Scorpios in the AS Group and shares of SMMS came under the options held by GSPL. Pending exercise, options are not management rights. At the highest, options could be treated as potential shares and till exercised they cannot provide right to vote or management or control. In the present case, till date GSPL has not exercised its rights under the Framework Agreement 2006 because of the sectoral cap of 74% which in turn restricts the right to vote. Therefore, the transaction in the present case provides for a triggering event, viz. relaxation of the sectoral cap. Till such date, HTIL/VIH cannot be said to have a control over 15% stakes in HEL. It is for this reason that even FIPB gave its approval to the transaction by saying that VIH was acquiring or has acquired effective shareholding of 51.96% in HEL.

84. As regards the Term Sheet dated 15.03.2007, it may be stated that the said Term Sheet was entered into between VIH and Essar. It was executed after 11.02.2007 when SPA was executed. In the Term Sheet, it has been recited that the parties have agreed to enter into the Term Sheet in order to regulate the affairs of HEL and in order to regulate the

relationship of shareholders of HEL. It is also stated in the Term Sheet that VIH and Essar shall have to nominate directors on the Board of Directors of HEL in proportion to the aggregate beneficial shareholding held by members of the respective groups. That, initially VIH shall be entitled to nominate 8 directors and Essar shall be entitled to nominate 4 directors out of a total Board of Directors of HEL (numbering 12). We must understand the background of this Term Sheet. Firstly, as stated the Term Sheet was entered into in order to regulate the affairs of HEL and to regulate the relationship of the shareholders of HEL. It was necessary to enter into such an agreement for smooth running of the business post acquisition. Secondly, we find from the letter addressed by HEL to FIPB dated 14.03.2007 that Articles of Association of HEL did not grant any specific person or entity a right to appoint directors. The said directors were appointed by the shareholders of HEL in accordance with the provisions of the Indian Company Law. The letter further states that **in practice** the directors were appointed pro rata to their respective shareholdings which resulted in 4 directors being appointed from Essar group, 6 directors being appointed by HTIL and 2 directors were appointed by TII. One such director was AS, the other director was AG. This was the practice even before the Term Sheet. The Term Sheet continues this practice by guaranteeing or assuring Essar that 4 directors would be appointed from its Group. The above facts indicate that the object of the SPA was to continue the "practice" concerning nomination of directors on the Board of Directors of HEL which in law is different from a right or power to control and manage and which practice was given to keep the business going, post acquisition. Under the Company Law, the management control vests in the Board of Directors and not with the shareholders of the company. Therefore, neither from Clause 5.2 of the Shareholders Agreement nor from the Term Sheet dated 15.03.2007, one could say that VIH had acquired 67% controlling interest in HEL.

85. As regards the question as to why VIH should pay consideration to HTIL based on an enterprise value of 67% of the share capital of HEL is concerned, it is important to note that valuation cannot be the basis of taxation. The basis of taxation is profits or income or receipt. In this case,

we are not concerned with tax on income/ profit arising from business operations but with tax on transfer of rights (capital asset) and gains arising therefrom. In the latter case, we have to see the conditions on which the tax becomes payable under the Income Tax Act. Valuation may be a science, not law. In valuation, to arrive at the value one has to take into consideration the business realities, like the business model, the duration of its operations, concepts such as cash flow, the discounting factors, assets and liabilities, intangibles, etc. In the present case, VIH paid US $11.08 bn for 67% of the enterprise value of HEL plus its downstream companies having operational licences. It bought an upstream company with the intention that rights flowing from the CGP share would enable it to gain control over the cluster of Indian operations or operating companies which owned telecom licences, business assets, etc. VIH agreed to acquire companies which in turn controlled a 67% interest in HEL and its subsidiaries. Valuation is a matter of opinion. When the entire business or investment is sold, for valuation purposes, one may take into account the economic interest or realities. Risks as a discounting factor are also to be taken into consideration apart from loans, receivables, options, RoFR/ TAR, etc. In this case, Enterprise Value is made up of two parts, namely, the value of HEL, the value of CGP and the companies between CGP and HEL. In the present case, the Revenue cannot invoke Section 9 of the Income Tax Act on the value of the underlying asset or consequence of acquiring a share of CGP. In the present case, the Valuation done was on the basis of enterprise value. The price paid as a percentage of the enterprise value had to be 67% not because the figure of 67% was available *in praesenti* to VIH, but on account of the fact that the competing Indian bidders would have had *de facto* access to the entire 67%, as they were not subject to the limitation of sectoral cap, and, therefore, would have immediately encashed the call options. The question still remains as to from where did this figure/ expression of 67% of equity interest come? The expression “equity interest” came from US GAAP. In this connection, we have examined the Notes to the Accounts annexed to the Annual Report 2006 of HTIL. According to Note 1, the ordinary shares of HTIL stood listed on the Hong Kong Stock Exchange as well as on the New York Stock Exchange. In Note No. 36, a list of principal subsidiaries of HTIL as on 31.12.2006 has been attached. This list shows the names of HEL (India) and some of its subsidiaries. In the said Annual Report, there is an annexure to the said Notes to the Accounts under the caption "Information for US Investors". It refers to Variable Interest Entities (VIEs). According to the Annual Report, the Vodafone Group consisting of HTIL and its subsidiaries conducted its operations inter alia in India through entities in which HTIL did not have the voting control. Since HTIL was listed on New York Stock Exchange, it had to follow for accounting and disclosure the rules prescribed by US GAAP. Now, in the present case, HTIL as a listed company was required to make disclosures of potential risk involved in the investment under the Hutchison structure. HTIL had furnished Letters of Credit to Rabo Bank which in turn had funded AS and AG, who in turn had agreed to place the shares of Plustech and Scorpios under Options held by GSPL. Thus, giving of the Letters of Credit and placing the shares of Plustech and Scorpios under Options were required to be disclosed to the US investors under the US

GAAP, unlike Indian GAAP. Thus, the difference between the 52% figure (control) and 67% (equity interest) arose on account of the difference in computation under the Indian and US GAAP.

Approach of the High Court (acquisition of CGP share with "other rights and entitlements")

86. Applying the "nature and character of the transaction" test, the High Court came to the conclusion that the transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH. That, intrinsic to the transaction was a transfer of other **"rights and entitlements**" which rights and entitlements constituted in themselves "capital assets" within the meaning of Section 2(14) of the Income Tax Act, 1961. According to the High Court, VIH acquired the CGP share with other rights and entitlements whereas, according to the appellant, whatever VIH obtained was through the CGP share (**for short "High Court Approach"**).

87. At the outset, it needs to be mentioned that the Revenue has adopted the abovementioned **High Court Approach** as an alternative contention.

88. We have to view the subject matter of the transaction, in this case, from a commercial and realistic perspective. The present case concerns an offshore transaction involving a structured investment. This case concerns **"a share sale" and not an asset sale**. It concerns sale of an entire investment. A "sale" may take various forms. Accordingly, tax consequences will vary. The tax consequences of a **share sale** would be different from the tax consequences of an **asset sale**. A slump sale would involve tax consequences which could be different from the tax consequences of sale of assets on itemized basis. "Control" is a mixed question of law and fact. Ownership of shares may, in certain situations, result in the assumption of an interest which has the character of a **controlling interest** in the management of the company. A controlling interest is an incident of ownership of shares in a company, something which flows out of the holding of shares. A controlling interest is, therefore, not an identifiable or distinct capital asset independent of the holding of shares. The control of a company resides in the voting power of its shareholders and shares represent an interest of a shareholder which is made

up of various rights contained in the contract embedded in the Articles of Association. The right of a shareholder may assume the character of a controlling interest where the extent of the shareholding enables the shareholder to control the management. Shares, and the rights which emanate from them, flow together and cannot be dissected. In the felicitous phrase of Lord MacMillan in **IRC** v. **Crossman** [1936] 1 All ER 762, shares in a company consist of a "congeries of rights and liabilities" which are a creature of the Companies Acts and the Memorandum and Articles of Association of the company. Thus, control and management is a facet of the holding of shares. Applying the above principles governing shares and the rights of the shareholders to the facts of this case, we find that this case concerns a straightforward **share sale**. VIH acquired Upstream shares with the intention that the congeries of rights, flowing from the CGP share, would give VIH an indirect control over the three genres of companies. If one looks at the chart indicating the Ownership Structure, one finds that the acquisition of the CGP share gave VIH an indirect control over the tier I Mauritius companies which owned shares in HEL totalling to 42.34%; CGP India (Ms), which in turn held shares in TII and Omega and which on a pro rata basis (the FDI principle), totalled up to 9.62% in HEL and an indirect control over Hutchison Tele-Services (India) Holdings Ltd. (Ms), which in turn owned shares in GSPL, which held call and put options. Although the High Court has analysed the transactional documents in detail, it has missed out this aspect of the case. It has failed to notice that till date options have remained **un-encashed** with GSPL. Therefore, even if it be assumed that the options under the Framework Agreements 2006 could be considered to be property rights, there has been no transfer or assignment of options by GSPL till today. Even if it be assumed that the High Court was right in holding that the options constituted capital assets even then Section 9(1)(i) was not applicable as these options have not been transferred till date. Call and put options were not transferred vide SPA dated 11.02.2007 or under any other document whatsoever. Moreover, if, on principle, the High Court accepts that the transfer of the CGP share did not lead to the transfer of a capital asset in India, even if it resulted in a transfer of indirect control over 42.34% (52%) of shares in HEL, then surely the transfer of indirect control over GSPL which held options (contractual rights), would not make the transfer of the CGP share taxable in India. Acquisition of the CGP share which gave VIH an indirect control over three genres of companies evidences a straightforward **share sale** and not an **asset sale**. There is another fallacy in the impugned judgment. On examination of the impugned judgment, we find a serious error committed by the High Court in appreciating the case of VIH before FIPB. On 19.03.2007, FIPB sought a clarification from VIH of the circumstances in which VIH agreed to pay US$ 11.08 bn for acquiring 67% of HEL when actual acquisition was of 51.96%. In its response dated 19.03.2007, VIH stated that it had agreed to acquire from HTIL for US$ 11.08 bn, interest in HEL which included a 52% equity shareholding. According to VIH, the price also included a control premium, use of Hutch brand in India, a non-compete agreement, loan obligations and an entitlement to acquire, subject to the Indian FDI rules, a further 15% indirect interest in HEL. According to the said letter, the above elements together equated to 67% of the economic value of HEL. This sentence has been misconstrued by the High Court to say that the above elements equated to 67% of the equity capital (See para 124). 67% of the economic value of HEL is not 67% of the equity capital. If VIH would have acquired 67% of the equity capital, as held by the High Court, the entire investment would have had breached the FDI norms which had imposed a sectoral cap of 74%. In this connection, it may further be stated that Essar had 33% stakes in HEL out of which 22% was held by Essar Mauritius. Thus, VIH did not acquire 67% of the equity capital of HEL, as held by the High Court. This problem has arisen also because of the reason that this case deals with **share sale** and not **asset sale**. This case does not involve sale of assets on itemized basis. The High Court ought to have applied the **look at** test in which the entire Hutchison structure, as it existed, ought to have been looked at holistically. This case concerns investment into India by a holding company (parent company), HTIL through a maze of subsidiaries. When one applies the "nature and character of the transaction test", confusion arises if a dissecting approach of examining each individual asset is adopted. As stated, CGP was treated in the Hutchison structure as an investment vehicle. As a general rule, in a case where a transaction involves transfer of shares lock, stock and barrel, such a transaction cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licences and so on as shares constitute a bundle of rights. [See **Charanjit Lal v. Union of India** AIR 1951 SC 41, **Venkatesh (minor) v. CIT** 243 ITR 367 (Mad) and **Smt. Maharani Ushadevi v. CIT** 131 ITR 445 (MP)] Further, the High Court has failed to examine the nature of the following items, namely, non-compete agreement, control premium, call and put options, consultancy support, customer base, brand licences etc. On facts, we are of the view that the High Court, in the present case, ought to have examined the entire transaction holistically. VIH has rightly contended that the transaction in question should be looked at as an entire package. The items mentioned hereinabove, like, control premium, non-compete agreement, consultancy support, customer base, brand licences, operating licences etc. were all an integral part of the Holding Subsidiary Structure which existed for almost 13 years, generating huge revenues, as indicated above. Merely because at the time of exit capital gains tax becomes not payable or exigible to tax would not make the entire **"share sale" (investment)** a sham or a tax avoidant. The High Court has failed to appreciate that the payment of US$ 11.08 bn was for purchase of the entire investment made by HTIL in India. The payment was for the entire package. The parties to the transaction have not agreed upon a separate price for the CGP share and for what the High Court calls as "other rights and entitlements" (including options, right to non-compete, control premium, customer base etc.). Thus, it was not open to the Revenue to split the payment and consider a part of such payments for each of the above items. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or on the basis that the payment is related to a contingency ('options', in this case), particularly when the transaction does not contemplate such a split up. Where the parties have agreed for a lump sum consideration without placing separate values for each of the above items which go to make up the entire **investment in participation**, merely because certain values are indicated in the correspondence with FIPB which had raised the query, would not mean that the parties had agreed for the price payable for each of the above items. The transaction remained a contract of outright sale of the entire investment for a lump sum consideration [see: Commentary on Model Tax Convention on Income and Capital dated 28.01.2003 as also the judgment of this Court in the case of **CIT (Central), Calcutta** v. **Mugneeram Bangur and Company (Land Deptt.)**, (1965) 57 ITR 299 (SC)]. Thus, we need to **"look at"** the entire Ownership Structure set up by Hutchison as a **single consolidated bargain** and interpret the transactional documents, while examining the Offshore Transaction of the nature involved in this case, in that light.

Scope and applicability of Sections 195 and 163 of IT Act

89. Section 195 casts an obligation on the payer to deduct tax at source ("TAS" for short) from payments made to non-residents which payments are chargeable to tax. Such payment(s) must have an element of income embedded in it which is chargeable to tax in India. If the sum paid or credited by the payer is not chargeable to tax then no obligation to deduct the tax would arise. Shareholding in companies incorporated outside India (CGP) is property located outside India. Where such shares become subject matter of offshore transfer between two non-residents, there is no liability for capital gains tax. In such a case, question of deduction of TAS would not arise. If in law the responsibility for payment is on a non-resident, the fact that the payment was made, under the instructions of the non-resident, to its Agent/Nominee in India or its PE/Branch Office will not absolve the payer of his liability under Section 195 to deduct TAS. Section 195(1) casts a duty upon the payer of any income specified therein to a non-resident to deduct therefrom the TAS unless such payer is himself liable to pay income-tax thereon as an Agent of the payee.

Section 201 says that if such person fails to so deduct TAS he shall be deemed to be an assessee-in-default in respect of the deductible amount of tax (Section 201). Liability to deduct tax is different from "assessment" under the Act. Thus, the person on whom the obligation to deduct TAS is cast is not the person who has earned the income. Assessment has to be done after liability to deduct TAS has arisen. The object of Section 195 is to ensure that tax due from non-resident persons is secured at the earliest point of time so that there is no difficulty in collection of tax subsequently at the time of regular assessment. The present case concerns the transaction of "outright sale" between two non-residents of a capital asset (share) outside India. Further, the said transaction was entered into on principal to principal basis. Therefore, no liability to deduct TAS arose. Further, in the case of transfer of the Structure in its entirety, one has to look at it holistically as one **Single Consolidated Bargain** which took place between two foreign companies outside India for which a lump sum price was paid of US$ 11.08 bn. Under the transaction, there was no split up of payment of US$ 11.08 bn. It is the Revenue which has split the consolidated payment and it is the Revenue which wants to assign a value to the rights to control premium, right to non-compete, right to consultancy support etc. For FDI purposes, the FIPB had asked VIH for the basis of fixing the price of US$ 11.08 bn. But here also, there was no split up of lump sum payment, asset-wise as claimed by the Revenue. There was no assignment of price for each right, considered by the Revenue to be a "capital asset" in the transaction. In the absence of PE, profits were not attributable to Indian operations. Moreover, **tax presence** has to be viewed in the context of the transaction that is subjected to tax and not with reference to an entirely unrelated matter. The investment made by Vodafone Group companies in Bharti did not make all entities of that Group subject to the Indian Income Tax Act, 1961 and the jurisdiction of the tax authorities. **Tax presence** must be construed in the context, and in a manner that brings the non-resident assessee under the jurisdiction of the Indian tax authorities. Lastly, in the present case, the Revenue has failed to establish any connection with Section 9(1)(i). Under the circumstances, Section 195 is not applicable.

Alternatively, the Revenue contended before us that VIH can be proceeded against as **"representative assessee"** under Section 163 of the Act. Section 163 does not relate to deduction of tax. It relates to treatment of a purchaser of an asset as a **representative assessee**. A conjoint reading of Section 160(1)(i), Section 161(1) and Section 163 of the Act shows that, under given circumstances, certain persons can be treated as **"representative assessee"** on behalf of non-resident specified in Section 9(1). This would include an **agent** of non-resident and also who is treated as an **agent** under Section 163 of the Act which in turn deals with special cases where a person can be regarded as an agent. Once a person comes within any of the clauses of Section 163(1), such a person would be the "**Agent**" of the non-resident for the purposes of the Act. However, merely because a person is an agent or is to be treated as an agent, would not lead to an automatic conclusion that he becomes liable to pay taxes on behalf of the non-resident. It would only mean that he is to be treated as a **"representative assessee"**. Section 161 of the Act makes a **"representative assessee"** liable only "as regards the income in respect of which he is a representative assessee" (See: Section 161). Section 161 of the Act makes a representative assessee liable only if the eventualities stipulated in Section 161 are satisfied. This is the scope of Sections 9(1)(i), 160(1), 161(1) read with Sections 163(1) (a) to (d). In the present case, the Department has invoked Section 163(1)(c). Both Sections 163(1)(c) and Section 9(1)(i) state that income should be deemed to accrue or arise in India. Both these Sections have to be read together. On facts of this case, we hold that Section 163(1)(c) is not attracted as there is no transfer of a capital asset situated in India. Thus, Section 163(1)(c) is not attracted. Consequently, VIH cannot be proceeded against even under Section 163 of the Act as a representative assessee. For the reasons given above, there is no necessity of examining the written submissions advanced on behalf of VIH by Dr. Abhishek Manu Singhvi on Sections 191 and 201.

Summary of Findings

90. Applying the **look at** test in order to ascertain the true nature and character of the transaction, we hold, that the Offshore Transaction herein is a bonafide structured FDI

investment into India which fell outside India's territorial tax jurisdiction, hence not taxable. The said Offshore Transaction evidences **participative investment** and not a sham or tax avoidant preordained transaction. The said Offshore Transaction was between HTIL (a Cayman Islands company) and VIH (a company incorporated in Netherlands). The subject matter of the Transaction was the transfer of the CGP (a company incorporated in Cayman Islands). Consequently, the Indian Tax Authority had no territorial tax jurisdiction to tax the said Offshore Transaction.

Conclusion

91. FDI flows towards location with a strong governance infrastructure which includes enactment of laws and how well the legal system works. Certainty is integral to rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner. Legal doctrines like **"Limitation of Benefits"** and **"look**

through" are matters of policy. It is for the Government of the day to have them incorporated in the Treaties and in the laws so as to avoid conflicting views. Investors should know where they stand. It also helps the tax administration in enforcing the provisions of the taxing laws. As stated above, the Hutchison structure has existed since 1994. According to the details submitted on behalf of the appellant, we find that from 2002-03 to 2010-11 the Group has contributed an amount of `20,242 crores towards direct and indirect taxes on its business operations in India.

Order

92. For the above reasons, we set aside the impugned judgment of the Bombay High Court dated 8.09.2010 in Writ Petition No. 1325 of 2010. Accordingly, the Civil Appeal stands allowed with no order as to costs. The Department is hereby directed to return the sum of `2,500 crores, which came to be deposited by the appellant in terms of our interim order, with interest at the rate of 4% per annum within two months from today. The interest shall be calculated from the date of withdrawal by the

Department from the Registry of the Supreme Court up to the date of payment. The Registry is directed to return the Bank Guarantee given by the appellant within four weeks.

....CJI
(S. H. Kapadia)

....J.
(Swatanter Kumar)

New Delhi;
January 20, 2012