REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO…………. OF 2012
(Arising out of SLP (C)) No.26529 of 2010)

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

Vs.

Union of India and Anr. … Respondent(s)

J U D G M E N T

K.S. Radhakrishnan, J.

The question involved in this case is of considerable public importance, especially on Foreign Direct Investment (FDI), which is indispensable for a growing economy like India. Foreign investments in India are generally routed through Offshore Finance Centres (OFC) also through the countries with whom India has entered into treaties. Overseas investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues of global business in India. Potential users of off-shore finance are: international companies, individuals, investors and others and capital flows through

FDI, Portfolio Debt Investment and Foreign Portfolio Equity Investment and so on. Demand for off-shore facilities has considerably increased owing to high growth rates of cross-border investments and a number of rich global investors have come forward to use high technology and communication infrastructures. Removal of barriers to cross-border trade, the liberalisation of financial markets and new communication technologies have had positive effects on global economic growth and India has also been greatly benefited.

2. Several international organisations like UN, FATF, OECD, Council of Europe and the European Union offer finance, one way or the other, for setting up companies all over the world. Many countries have entered into treaties with several offshore companies for cross-border investments for mutual benefits. India has also entered into treaties with several countries for bilateral trade which has been statutorily recognised in this country. United Nations Conference on Trade and Development (UNCTAD) Report on World Investment prospects survey 2009-11 states that

India would continue to remain among the top five attractive destinations for foreign investors during the next two years.

3. Merger, Amalgamation, Acquisition, Joint Venture, Takeovers and Slump-sale of assets are few methods of cross-border re-organisations. Under the FDI Scheme, investment can be made by availing the benefit of treaties, or through tax havens by non-residents in the share/convertible debentures/preference shares of an Indian company but the question which looms large is whether our Company Law, Tax Laws and Regulatory Laws have been updated so that there can be greater scrutiny of non-resident enterprises, ranging from foreign contractors and service providers, to finance investors. Case in hand is an eye-opener of what we lack in our regulatory laws and what measures we have to take to meet the various unprecedented situations, that too without sacrificing national interest. Certainty in law in dealing with such cross-border investment issues is of prime importance, which has been felt by many countries around the world and some have taken adequate regulatory measures so that investors can arrange their affairs fruitfully and effectively.

Steps taken by various countries to meet such situations may also guide us, a brief reference of which is being made in the later part of this judgment.

4. We are, in the present case, concerned with a matter relating to cross-border investment and the legal issues emanate from that. Facts have been elaborately dealt with by the High Court in the impugned judgment and also in the leading judgment of Lord Chief Justice, but reference to few facts is necessary to address and answer the core issues raised. On all major issues, I fully concur with the views expressed by the Lord Chief Justice in his erudite and scholarly judgment.

5. Part-I of this judgment deals with the facts, Part-II deals with the general principles, Part-III deals with Indo-Mauritian Treaty, judgments in ***Union of India v. Azadi Bachao Andolan and Another*** (2004) 10 SCC 1 and ***McDowell and Company Limited v. Commercial Tax Officer*** (1985) 3 SCC 230, Part-IV deals with CGP Interposition, situs etc, Part-V deals with controlling interest

of HTIL/Vodafone and other rights and entitlements, Part-VI deals with the scope of Section 9, Part-VII deals with Section 195 and other allied provisions and Part-VIII is the conclusions.

Part – I

6. Hutchison Whampoa is a multi-sectional, multi-jurisdictional entity which consolidates on a group basis telecom operations in various countries. Hutchison Group of Companies (Hong Kong) had acquired interest in the Indian telecom business in the year 1992, when the group invested in Hutchison Max Telecom Limited (HTML) (later known a Hutchison Essar Limited (HEL), which acquired a cellular license in Mumbai circle in the year 1994 and commenced its operation in the year 1995. Hutchison Group, with the commercial purpose of consolidating its interest in various countries, incorporated CGP Investments Holding Limited (for short "CGP") in Cayman Islands as a WOS on 12.01.1998 as an Exempted Company for offshore investments. CGP held shares in two subsidiary companies, namely Array Holdings Limited (for short Array) and Hutchison Teleservices (India) Holding Ltd. [for short

HTIH(M)] both incorporated in Mauritius. CGP(India) Investment (for short CGPM) was incorporated in Mauritius in December 1997 for the purpose of investing in Telecom Investment (India) Pvt. Limited (for short TII), an Indian Company. CGPM acquired interests in four Mauritian Companies and entered into a Shareholders' Agreement (SHA) on 02.05.2000 with Essar Teleholdings Limited (ETH), CGPM, Mobilvest, CCII (Mauritius) Inc. and few others, to regulate shareholders' right *inter se*. Agreement highlighted the share holding pattern of each composition of Board of Directors, quorum, restriction on transfer of ownership of shares, Right of First Refusal (ROFR), Tag Along Rights (TARs) etc.

7. HTIL, a part of Hutchison Whampoa Group, incorporated in Cayman Islands in the year 2004 was listed in Hong Kong (HK) and New York (NY) Stock Exchanges. In the year 2005, as contemplated in the Term Sheet Agreement dated 05.07.2003, HTIL consolidated its Indian business operations through six companies in a single holding company HMTL, later renamed as Hutchison Essar

Ltd. (HEL). On 03.11.2005, Press Note 5 of 2005 series was issued by the Government of India enhancing the FDI ceiling from 49% to 74% in the Telecom Sector. On 28.10.2005, Vodafone International Holding BV (VIHBV) (Netherlands) had agreed to acquire 5.61% of shareholding in Bharati Tele Ventures Limited (Bharati Airtel Limited) and on the same day Vodafone Mauritius Limited (Subsidiary of VIHBV) had agreed to acquire 4.39% shareholding in Bharati Enterprises Pvt. Ltd. (renamed Bharati Infotel Ltd.), which indirectly held shares in Bharati Airtel Ltd.

8. HEL shareholding was then restructured through TII and an SHA was executed on 01.03.2006 between Centrino Trading Company Pvt. Ltd. (Centrino), an Asim Ghosh (Group) [for short (AG)], ND Callus Info Services Pvt. Ltd. (for short NDC), an Analjit Singh (Group) [for short (AS)], Telecom Investment India Pvt.Ltd. [for short (TII)], and CGP India (M). Further, two Framework Agreements (FWAs) were also entered into with respect to the restructuring. <u>Credit facilities were given to the companies controlled by AG and AS</u>. FWAs called, Centrino FWA and N.D. FWA were

executed on 01.03.2006. HTIL stood as a guarantor for Centrino, for an amount of ` 4,898 billion advanced by Rabo Bank. HTIL had also stood as a guarantor for ND Callus, for an award of ` 7.924 billion advanced by Rabo Bank.

9. Following the credit support given by HTIL to AG and AS so as to enable them to acquire shares in TII, parties entered into separate agreements with 3 Global Services Pvt. Ltd. (India) [for short 3GSPL], a WOS of HTIL. FWAs also contained **call option** in favour of 3GSPL, a right to purchase from Gold Spot (an AG company) and Scorpios (an AS company) their entire shareholding in TII held through Plustech (an AG company) and MVH (an AS company) respectively. **Subscription right** was also provided allowing 3GSPL a right to subscribe 97.5% and 97% of the equity share capital respectively at a pre-determined rate equal to the face value of the shares of Centrino and NDC respectively exercisable within a period of 10 years from the date of the agreements. Agreements also restricted AG

companies and AS companies from transferring any downstream interests leading to the shareholding in TII.

10. HEL shareholding again underwent change with Hinduja Group exiting and its shareholding being acquired by an Indian company called SMMS Investments Private Limited (SMMS). SMMS was also a joint venture company formed by India Development Fund (IDF) acting through IDFC Private Equity Company (IDFCPE), Infrastructure Development Finance Company Limited (IDFC) and SSKI Corporate Finance Pvt. Ltd. (SSKI) all the three companies were incorporated in India. Pursuant thereto, a FWA was entered into on 07.08.2006 between IDF (through IDFCPE), IDFC, SSKI, SMMS, HTIL (M), 3GSPL, Indus Ind Telecom Holding Pvt. Ltd. (ITNL) (later named as Omega Telecom Holding Pvt. Ltd. (Omega) and HTIL. 3GSPL, by that Agreement, had a **call option** and a right to purchase the entire equity shares of SMMS at a pre-determined price equal to ` 661,250,000 plus 15% compound interest. A SHA was also entered into on 17.08.2006 by SMMS, HTIL (M), HTIL(CI) and ITNL to regulate affairs of ITNL. Agreement

referred to the presence of at least one of the directors nominated by HTIL in the Board of Directors of Omega. HTIL was only a **confirming party** to this Agreement since it was the parent company.

11. HTIL issued a press release on 22.12.2006 in the HK and NY Stock Exchanges announcing that it had been approached by various potentially interested parties regarding a possible sale of "its equity interest" in HEL in the Telecom Sector in India. HTIL had adopted those measures after procuring all assignments of loans, facilitating FWAs, SHAs, transferring Hutch Branch, transferring Oracle License etc.

12. Vodafone Group Plc. came to know of the possible exit of Hutch from Indian telecom business and on behalf of Vodafone Group made a non-binding offer on 22.12.06, for a sum of US$ 11.055 million in cash for HTIL's shareholdings in HEL. The offer was valued at an "**enterprise value**" of US$ 16.5 billion. Vodafone then appointed on 02.01.2007 Ernst and Young LLP to conduct due diligence, and a Non-

Disclosure (Confidentiality) Agreement dated 02.01.2007 was entered into between HTIL and Vodafone. On 09.02.2007 Vodafone Group Plc. wrote a letter to HTIL making a "revised and binding offer" on behalf of a member of Vodafone Group (Vodafone) for HTIL's shareholdings in HEL together with interrelated company loans. Bharati Infotel Pvt. Limited on 09.02.2007 expressed its 'no objection' to the Chairman, Vodafone Mauritius Limited regarding proposed acquisition by Vodafone group of direct and / indirect interest in HEL from Hutchison or Essar group. Bharati Airtel also sent a similar letter to Vodafone.

13. Vodafone Group Plc. on 10.02.2007 made a final binding offer of US$ 11.076 billion "in cash over HTIL's interest", based on an **enterprise value** of US$ 18.800 billion of HEL. Ernst and Young LLP, U.K. on 11.02.2007 issued due diligence report in relation to operating companies in India namely HEL and subsidiaries and also the Mauritian and Cayman Island Companies. Report noticed that CGP(CI) <u>was not within the target group</u> and was later included at the instance of HTIL. On 11.02.2007, UBS Limited, U.K. issued

fairness opinion in relation to the transaction for acquisition by Vodafone from HTIL of a 67% effective interest in HEL through the acquisition of 100% interest in CGP and granting an option by Vodafone to Indian Continent Investment Ltd. over a 5.6% stake in Bharati Airtel Limited. Bharati Infotel and Bharati Airtel conveyed their no-objection to the Vodafone purchasing direct or indirect interest in HEL.

14. Vodafone and HTIL then entered into a Share and Purchase Agreement (SPA) on 11.02.2007 whereunder HTIL had agreed to procure the transfer of share capital of CGP by HTIBVI, free from all encumbrances and together with all rights attaching or accruing together with assignments of loan interest. HTIL on 11.02.2007 issued a side letter to Vodafone *inter alia* stating that, out of the purchase consideration, up to US$80 million could be paid to some of its Indian Partners. HTIL had also undertaken that Hutchison Telecommunication (India) Ltd. (HTM), Omega and 3GSPL, would enter into an agreed form "IDFC Transaction Agreement" as soon as practicable. On 11.02.2007, HTIL also sent a disclosure letter to Vodafone

in terms of Clause 9.4 of SPA – Vendor warranties relating to consents and approvals, wider group companies, material contracts, permits, litigation, arbitration and governmental proceedings to limit HTIL liability.

15. Vodafone on 12.02.2007 made a public announcement to the Securities and Exchange Commission, Washington (SEC), London Stock Exchange and HK Stock Exchange stating that it had agreed to acquire a Controlling Interest in HEL for a cash consideration of US$ 11.1 billion. HTIL Chairman sent a letter to the Vice-Chairman of Essar Group on 14.02.2007 along with a copy of Press announcement made by HTIL, setting out the principal terms of the intended sale of HTIL of its equity and loans in HEL, by way of sale of CGP share and loan assignment to VIHBV.

16. Vodafone on 20.02.2007 filed an application with Foreign Investment Promotion Board (FIPB) requesting it to take note of and grant approval under Press note no.1 to the indirect acquisition by Vodafone of 51.96% stake in HEL

through an overseas acquisition of the entire share capital of CGP from HTIL. HTIL made an announcement on HK Stock Exchange regarding the intended use of proceeds from sale of HTIL's interest in HEL viz., declaring a special dividend of HK$ 6.75 per share, HK$ 13.9 billion to reduce debt and the remainder to be invested in telecommunication business, both for expansion and towards working capital and general policies. Reference was also made to the sale share and sale loans as being the entire issued share capital of CGP and the loans owned by CGP/Array to an indirect WOS. AG on 02.03.2007 sent a letter to HEL confirming that he was the exclusive beneficial owner of his shares and was having full control over related voting rights. Further, it was also stated that AG had received credit support, but primary liability was with his Companies. AS also sent a letter on 05.03.2007 to FIPB confirming that he was the exclusive beneficial owner of his shares and also of the credit support received.

17. Essar had filed objections with the FIPB on 06.03.2007 to HTIL's proposed sale and on 14.03.2007, Essar withdrew its objections.

18. FIPB on 14.03.2007 sent a letter to HEL pointing out that in filing of HTIL before the U.S. SEC in Form 6K in the month of March 2006, it had been stated that HTIL Group would continue to hold an aggregate interest of 42.34% of HEL and an additional indirect interest through JV companies being non-wholly owned subsidiaries of HTIL which hold an aggregate of 19.54% of HEL and, hence, the combined holding of HTIL Group would then be 61.88%. Reference was also made to the communication dated 06.03.2007 sent to the FIPB wherein it was stated that the direct and indirect FDI by HTIL would be 51.96% and, hence, was asked to clarify that discrepancy. Similar letter dated 14.03.2007 was also received by Vodafone. On 14.03.2007, HEL wrote to FIPB stating that the discrepancy was because of the difference in U.S. GAAP and Indian GAAP declarations and that the combined holding for U.S. GAAP purposes was 61.88% and for Indian GAAP purposes

was 51.98%. It was pointed out that Indian GAAP number accurately reflected the true equity ownership and control position. On 14.03.2007 itself, HEL wrote to FIPB confirming that 7.577% stake in HEL was held legally and beneficially by AS and his wife and 4.78% stake in HEL was held legally and beneficially by AG. Further, it was also pointed out that 2.77% stake in HEL through Omega and S.M.M.S. was legally and beneficially owned by IDFC Limited, IDFC Private Equity Limited and SSKI Corporate Finance Limited. Further, it was also pointed out that Articles of Association of HEL did not give any person or entity any right to appoint directors, however, in practice six directors were from HTIL, four from Essar, two from TII and TII had appointed AG & AS. On credit support agreement, it was pointed out that no permission of any regulatory authority was required.

19. Vodafone also wrote to FIPB on 14.03.2007 confirming that VIHBV's effective shareholding in HEL would be 51.96% i.e. Vodafone would own 42% direct interest in HEL through its acquisition of 100% of CGP Investments (Holdings) Limited (CGPIL) and through CGPIL Vodafone

would also own 37% in TII which in turn owned 20% in HEL and 38% in Omega which in turn owned 5% in HEL. It was pointed out that both TII and Omega were Indian companies and those investments combined would give Vodafone a controlling interest of 52% in HEL. Further, it was pointed out that HTIL's Indian partners AG, AS, IDFC who between them held a 15% interest in HEL on aggregate had agreed to retain their shareholding with full control including voting rights and dividend rights.

20. HTIL, Essar Teleholding Limited (ETL), Essar Communication Limited (ECL), Essar Tele Investments Limited (ETIL), Essar Communications (India) Limited (ECIL) signed a settlement agreement on 15.03.2007 regarding Essar Group's support for completion of the proposed transaction and covenant not to sue any Hutchison Group Company etc., in lieu of payment by HTIL of US$ 373.5 million after completion and a further US$ 41.5 million after second anniversary of completion. In that agreement, HTIL had agreed to dispose of its direct and indirect equity, loan and other interests and rights in and related to HEL, to

Vodafone pursuant to the SPA. HTIL had also agreed to pay US$ 415 million to Essar in return of its acceptance of the SPA between HTIL and Vodafone. On 15.03.2007 a Deed of Waiver was entered into between Vodafone and HTIL, whereby Vodafone had waived some of the warranties set out in paragraphs 7.1(a) and 7.1(b) of Schedule 4 of the SPA and covenanted that till payment of HTIL under Clause 6.1(a) of the Settlement Agreement of 30.05.2007, Vodafone should not bring any claim or action. On 15.03.2007 a circular was issued by HTIL including the report of Somerley Limited on the Settlement Agreement between HTIL and Essar Group.

21. VIHBVI, Essar Tele Holdings Limited (ETH) and ECL entered into a Term Sheet Agreement on 15.03.2007 for regulating the affairs of HEL and the relationship of its shareholders including setting out VIHBVI's right as a shareholder of HEL to nominate eight persons out of twelve to the board of directors, requiring Vodafone to nominate director to constitute a quorum for board meetings and get ROFR over shares owned by Essar in HEL. Term Sheet also

stated that Essar had a TAR in respect of Essar's shareholding in HEL, should any Vodafone Group shareholding sell its share or part thereof in HEL to a person not in a Vodafone Group entity. VIHBV and Vodafone Group Plc.(as guarantor of VIHBV) had entered into a '**Put Option**' Agreement on 15.03.2007 with ETH, ECL (Mauritius), requiring VIHBV to purchase from Essar Group shareholders' all the option shares held by them.

22. The Joint Director of Income Tax (International Taxation), in the meanwhile, issued a notice dated 15.03.2007 under Section 133(6) of the Income Tax Act calling for certain information regarding sale of stake of Hutchison group HK in HEL, to Vodafone Group Plc.

23. HTIL, on 17.3.2007, wrote to AS confirming that HTIL <u>has no beneficial or legal or other rights in AS's TII interest or HEL interest</u>. Vodafone received a letter dated 19.3.2007 from FIPB seeking clarifications on the circumstances under which Vodafone had agreed to pay consideration of US$ 11.08 billion <u>for acquiring 67% of HEL when the actual</u>

acquisition was only 51.96% as per the application. Vodafone on 19.03.2007 wrote to FIPB stating that it had agreed to acquire from HTIL interest in HEL which included 52% equity shareholding for US$ 11.08 billion which price included control premium, use and rights to Hutch brand in India, a non-compete agreement with Hutch group, value of non-voting, non-convertible preference shares, various loans obligations and entitlement and to acquire further 15% indirect interest in HEL, subject to Indian foreign investment rules, which together equated to about 67% of the economic value of HEL.

24. VIHBVI and Indian continent Investors Limited (ICIL) had entered into an SHA on 21.03.2007 whereby VIHBVI had to sell 106.470.268 shares in Bharati Airtel to ICIL for a cash consideration of US$ 1,626,930.881 (which was later amended on 09.05.2007)

25. HEL on 22.3.2007 replied to the letter of 15.03.2007, issued by the Joint Director of Income Tax (International Taxation) furnishing requisite information relating to HEL

clarifying that it was neither a party to the transaction nor would there be any transfer of shares of HEL.

26. HEL received a letter dated 23.3.2007 from the Additional Director Income Tax (International Taxation) intimating that both Vodafone and Hutchison Telecom Group announcements/press releases/declarations had revealed that HTIL <u>had made substantive gains and consequently HEL was requested to impress</u> upon HTIL/Hutchison Telecom Group to discharge their liability on gains, before they ceased operations in India. HEL attention was also drawn to Sections 195, 195(2) and 197 of the Act and stated that under Section 195 obligations were both on the payer and the payee.

27. Vodafone, in the meanwhile, wrote to FIPB on 27.03.2007 confirming that in determining the bid price of US$ 11.09 billion it had taken into account various assets and liabilities of CGP including:

(a) its 51.96% direct and indirect equity ownership of Hutch Essar;

(b) Its ownership of redeemable preference shares in TII and JKF;

(c) Assumption of liabilities of various subsidiaries of CGP amounting to approximately US$630 million;

(d) subject to Indian Foreign Investment Rules, its rights and entitlements, including subscription rights at par value and call options to acquire in future a further 62.75% of TII and call options to acquire a further 54.21% of Omega Telecom Holdings Pvt. Ltd, which together would give Vodafone a further 15.03% proportionate indirect equity ownership of Hutch Essar, various intangible features such as control premium, use and rights of Hutch branch in India, non compete agreement with HTIL.

HEL on 5.4.2007 wrote to the Joint director of Income Tax stating that it has no liabilities accruing out of the transaction, also the department has no *locus standi* to invoke Section 195 in relation to non-resident entities regarding any purported tax obligations. On 09.04.2007 HTIL submitted FWAs, SHAs, Loan Agreement, Share-pledge Agreements, Guarantees, Hypothecations, Press Announcements, Regulatory filing etc., charts of TII and Omega Shareholding, note on terms of agreement relating to acquisition by AS, AG and IDFC, presentation by Goldman Sachs on fair market valuation and confirmation by

Vodafone, factors leading to acquisition by AG and AS and rationale for put/call options etc.

28. Vodafone on 09.04.2007 sent a letter to FIPB confirming that valuation of N.D. Callus, Centrino, would occur as per Goldman Sach's presentation in Schedule 5 to HTIL's letter of 09.04.2007 with a minimum value of US$ 266.25 million and US$164.51 million for the equity in N.D. Callus and Centrino respectively, which would form the basis of the future partnership with AS & AG. Vodafone also wrote a letter to FIPB setting out details of Vodafone Group's interest worldwide. On 30.04.07 a resolution was passed by the Board of Directors of CGP pertaining to loan agreement, resignation and appointment of directors, transfer of shares; all to take effect on completion of SPA. Resolution also accorded approval of entering into a Deed of Assignment in respect of loans owed to HTI(BVI) Finance Limited in the sums of US$ 132,092,447.14 and US$ 28,972,505.70. Further resolution also accorded approval to the resignations of certain persons as Directors of the Company, to take effect on completion of SPA. Further,

approval was also accorded to the appointment of Erik de Rjik as a sole director of CGP. Resolution also accorded approval to the transfer of CGP from HTI BVI to Vodafone. On 30.04.2007 a board of resolution was passed by the directors of Array for the assignment of loans and resignation of existing directors and appointment of new directors namely Erik de Rjik and two others. On 30.04.2007, the board of directors of HTI BVI approved the transfer documentation in relation to CGP share capital in pursuance of SPA and due execution thereof. On 04.05.2007 HTI BVI delivered the share transfer documentation to the lawyers in Caymen Islands to hold those along with a resolution passed by the board of directors of HTI BVI to facilitate delivery of instruments of transfer to Vodafone at closing of the transaction.

29. <u>Vodafone on 07.05.2007 received a letter from FIPB conveying its approval to the transaction subject to compliance of observation of applicable laws and regulations in India.</u> On 08.05.2007 a sum of US$10,854,229,859.05 was paid by Vodafone towards consideration for acquisition

of share capital of CGP. On 08.05.2007 Vodafone's name was entered in the register of members of CGP kept in Caymen Islands and the share certificate No.002 of HTI BVI relating to CGP share capital was cancelled. On the same day a Tax Deed of Covenant was entered into between HTIL and Vodafone in pursuance of SPA indemnifying Vodafone in respect of taxation or transfer pricing liabilities payable or suffered by wider group companies (as defined by SPA i.e., CGP, 3 GSPL, Mauritian holding and Indian Companies) on or before completion, including reasonable costs associated with any tax demand.

30. HTIL also sent a side letter to SPA on 08.05.2007 to Vodafone highlighting the termination of the brand licences and brand support service agreements between HTIL and 3GSPL and the Indian Operating Companies and stated that the net amount to be paid by Vodafone to HTIL would be US$ 10,854,229,859.05 and that Vodafone would retain US$ 351.8 million towards expenses incurred to operationalize the option agreements with AS and AG, out of the total consideration of US$11,076,000,000. On

08.05.2007 loan assignment between HTI BVI Finance Limited, Array and Vodafone of Array debt in a sum of US$ 231,111,427.41 was effected, whereby rights and benefits of HTI BVI Finance Limited to receive repayment was assigned in favour of Vodafone as part of the transaction contemplated vide SPA. On the same day loan assignment between HTI BVI Finance Limited, CGP and Vodafone, of CGP debt in the sum of US$ 28,972,505.70 was effected, whereby rights and benefits of HTI BVI Finance Limited to receive the repayment was assigned in favour of Vodafone as part of the transactions contemplated vide SPA. On 08.05.2007, business transfer agreement between 3GSPL and Hutchison Whampoa Properties (India) Limited, a WOS of HWP Investments Holdings (India) Limited, Mauritius, for the sale of business to 3GSPL of maintaining and operating a call centre as a going concern on slump-sale-basis for a composite price of ` 640 million. On 08.05.2007, as already stated, a Deed of Retention was executed between HTIL and Vodafone whereunder HTIL had agreed that out of the total consideration payable in terms of Clause 8.10(b) of the SPA, Vodafone would be entitled to retain US$ 351.8 million by way of HTIL's contribution towards acquisition cost of options i.e., stake of AS & AG. On 08.05.2007 Vodafone paid US$ 10,854,229,859.05 to HTIL.

31. Vodafone on 18.05.2007 sent a letter to FIPB confirming that VIHBV had no existing joint venture or technology transfer/trade mark agreement in the same field as HEL except with Bharati as disclosed and since 20.02.2007 a member of Bharati Group had exercised the option to acquire a further 5.6% interest from Vodafone such that Vodafone's direct and indirect stake in Bharati Airtel would be reduced to 4.39%.

32. An agreement (Omega Agreement) dated 05.06.2007 was entered into between IDF, IDFC, IDFC Private Equity Fund II (IDFCPE), SMMS, HT India, 3GSPL, Omega, SSKI and VIHBV. Due to that Agreement IDF, IDFC and SSKI would instead of exercising the '**Put option**' and '**cashless option**' under 2006 IDFC FWA could exercise the same in pursuance of the present Agreement. Further, 3GSPL had waived its right to exercise the '**call option**' pursuant to

2006 IDFC FWA. On 06.06.2007 a FWA was entered into between IDF, IDFC, IDFCPE, SMMS, HT India, 3GSPL, Omega and VIHBV. By that Agreement 3GSPL had a '**call option'** to purchase the equity shares of SMMS. On 07.06.2007 a SHA was entered into between SMMS, HTIL(M), Omega and VIHBV to regulate the affairs of Omega. On 07.06.2007 a Termination Agreement was entered into between IDF, IDFC, SMMS, HTIL, 3GSPL, Omega and HTL terminating the 2006 IDFC FWA and the SHA and waiving their respective rights and claims under those Agreements. On 27.06.2007 HTIL in their 2007 interim report declared a dividend of HK$ 6.75 per share on account of the gains made by the sale of its entire interest in HEL. On 04.07.2007 fresh certificates of incorporation was issued by the Registrar of Companies in relation to Indian operating companies whereby the word "Hutchison" was substituted with word "Vodafone".

33. On 05.07.2007, a FWA was entered into between AG, AG Mercantile Pvt. Limited, Plustech Mercantile Company Pvt.Ltd, 3GSPL, Nadal Trading Company Pvt. Ltd and

Vodafone as a confirming party. In consideration for the unconditional 'call option', 3GSPL agreed to pay AG an amount of US$ 6.3 million annually. On the same day a FWA was signed by AS and Neetu AS, Scorpio Beverages Pvt. Ltd.(SBP), M.V. Healthcare Services Pvt. Ltd, 3GSPL, N.D. Callus Info Services Pvt. Ltd and Vodafone, as a **confirming party**. In consideration for the 'call option' 3GSPL agreed to pay AS & Mrs. Neetu AS an amount of US$ 10.02 million annually. TII SHA was entered into on 05.07.2007 between Nadal, NDC, CGP (India), TII and VIHBV to regulate the affairs of TII. On 05.07.2007 Vodafone entered into a Consultancy Agreement with AS. Under that Agreement, AS was to be paid an amount of US$ 1,050,000 per annum and a one time payment of US$ 1,30,00,000 was made to AS.

34. Vodafone sent a letter to FIPB on 27.07.2007 enclosing undertakings of AS, AG and their companies as well as SMMS Group to the effect that they would not transfer the shares to any foreign entity without requisite approvals.

35. The Income Tax Department on 06.08.2007 issued a notice to VEL under Section 163 of the Income Tax Act to show cause why it should not be treated as a representative assessee of Vodafone. The notice was challenged by VEL in Writ Petition No.1942 of 2007 before the Bombay High Court. The Assistant Director of Income Tax (Intl.) Circle 2(2), Mumbai, issued a show cause notice to Vodafone under Section 201(1) and 201(1A) of the I.T. Act as to why Vodafone should not be treated a assessee-in-default for failure to withhold tax. Vodafone then filed a Writ Petition 2550/2007 before the Bombay High Court for setting aside the notice dated 19.09.2007. Vodafone had also challenged the constitutional validity of the retrospective amendment made in 2008 to Section 201 and 191 of the I.T. Act. On 03.12.2008 the High Court dismissed the Writ Petition No.2550 of 2007 against which Vodafone filed SLP No.464/2009 before this Court and this Court on 23.01.2009 disposed of the SLP directing the Income Tax Authorities to determine the jurisdictional challenge raised by Vodafone as a preliminary issue. On 30.10.2009 a 2nd show cause notice was issued to Vodafone under Section

201 and 201(1A) by the Income Tax authorities. Vodafone replied to the show cause notice on 29.01.2010. On 31.05.2010 the Income Tax Department passed an order under Section 201 and 201(1A) of the I.T. Act upholding the jurisdiction of the Department to tax the transaction. A show cause notice was also issued under Section 163(1) of the I.T. Act to Vodafone as to why it should not be treated as an agent / representative assessee of HTIL.

36. Vodafone then filed Writ Petition No.1325 of 2010 before the Bombay High Court on 07.06.2010 challenging the order dated 31.05.2010 issued by the Income Tax Department on various grounds including the jurisdiction of the Tax Department to impose capital gains tax to overseas transactions. The Assistant Director of Income Tax had issued a letter on 04.06.2010 granting an opportunity to Vodafone to address the Department on the question of quantification of liability under Section 201 and 201(1A) of the Income Tax Act. Notice was also challenged by Vodafone in the above writ petition by way of an amendment. The Bombay High Court dismissed the Writ

Petition on 08.09.2010 against which the present SLP has been filed.

37. The High Court upheld the jurisdiction of the Revenue to impose capital gains tax on Vodafone as a representative assessee after holding that the transaction between the parties attracted capital gains in India. Court came to the following conclusions:

(a) Transactions between HTIL and Vodafone were fulfilled not merely by transferring a single share of CGP in Cayman Islands, but the commercial and business understanding between the parties postulated that what was being transferred from HTIL to VIHBV was the "controlling interest" in HEL in India, which is an identifiable capital asset independent of CGP share.

(b) HTIL had put into place during the period when it was in the control of HEL a complex structure including the financing of Indian companies which in turn had holdings directly or indirectly in HEL and hence got controlling interest in HEL.

(c) Vodafone on purchase of CGP got indirect interest in HEL, controlling right in certain indirect holding companies in HEL, controlling rights through shareholder agreements which included the right to appoint directors in certain indirect holding companies in HEL, interest in the form of preference share capital in indirect holding companies of HEL, rights to use Hutch brand in India, non-compete agreement with Hutch brand in India etc., which all constitute capital asset as per Section 2(14) of the I.T. Act.

(d) The price paid by Vodafone to HTIL of US$ 11.08 billion factored in as part of the consideration of those diverse rights and entitlements and many of those entitlements are relatable to the transfer of CGP share and that the transactional documents are merely incidental or consequential to the transfer of CGP share but recognized independently the rights and entitlements of HTIL in relation to Indian business which are being transferred to VIHBV.

(e) High Court held that the transfer of CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIHBV and the rights and entitlements followed would amount to capital gains.

(f) The Court also held that where an asset or source of income is situated in India, the income of which accrues or arises directly or indirectly through or from it shall be treated as income which is deemed to accrue or arise in India, hence, chargeable under Section 9(1)(i) or 163 of the I.T. Act.

(g) Court directed the Assessing Officer to do apportionment of income between the income that has deemed to accrue or arise as a result of nexus with India and that which lies outside. High Court also concluded that the provisions of Section 195 can apply to a non-resident provided there is sufficient territorial connection or nexus between him and India.

(h) Vodafone, it was held, by virtue of its diverse agreements has nexus with Indian jurisdiction

> and, hence, the proceedings initiated under Section 201 for failure to withhold tax by Vodafone cannot be held to lack jurisdiction.

38. Shri Harish Salve, learned senior counsel appearing for Vodafone explained in detail how Hutchison Corporate Structure was built up and the purpose, object and relevance of such vertical Transnational Structures in the international context. Learned Senior counsel submitted that complex structures are designed not for avoiding tax but for good commercial reasons and Indian legal structure and foreign exchange laws recognize Overseas Corporate Bodies (OCB). Learned senior counsel also submitted that such Transnational Structures also contain exit option to the investors. Senior counsel also pointed out that where regulatory provisions mandate investment into corporate structure such structures cannot be disregarded for tax purposes by lifting the corporate veil especially when there is no motive to avoid tax. Shri Salve also submitted that Hutchison corporate structure was not designed to avoid tax and the transaction was not a colourable device to achieve that purpose. Senior counsel also submitted that source of

income lies where the transaction is effected and not where the underlying asset is situated or economic interest lies. Reference was made to judgment in ***Seth Pushalal Mansinghka (P) Ltd. v. CIT*** (1967) 66 ITR 159 (SC). Learned counsel also pointed out that without any express legislation, off-shore transaction cannot be taxed in India. Reference was made to two judgments of the Calcutta High Court ***Assam Consolidated Tea Estates v. Income Tax Officer "A" Ward*** (1971) 81 ITR 699 Cal. and ***C.I.T. West Bengal v. National and Grindlays Bank Ltd***. (1969) 72 ITR 121 Cal. Learned senior counsel also pointed out that when a transaction is between two foreign entities and not with an Indian entity, source of income cannot be traced back to India and nexus cannot be used to tax under Section 9. Further, it was also pointed out that language in Section 9 does not contain "look through provisions" and even the words "indirectly" or "through" appearing in Section 9 would not make a transaction of a non-resident taxable in India unless there is a transfer of capital asset situated in India. Learned Senior counsel also submitted that the Income Tax Department has committed an error in proceeding on a “moving theory of nexus” on the basis that economic interest and underlying asset are situated in India. It was pointed out that there cannot be transfer of controlling interest in a Company independent from transfer of shares and under the provisions of the Company Law. Acquisition of shares in a Company entitles the Board a right of “control” over the Company. Learned Senior Counsel also pointed out the right to vote, right to appoint Board of Directors, and other management rights are incidental to the ownership of shares and there is no change of control in the eye of law but only in commercial terms. Mr. Salve emphasized that, in absence of the specific legislation, such transactions should not be taxed. On the situs of shares, learned senior counsel pointed out that the situs is determined depending upon the place where the asset is situated. Learned senior counsel also pointed out that on transfer of CGP, Vodafone got control over HEL and merely because Vodafone has presence or chargeable income in India, it cannot be inferred that it can be taxed in some other transactions. Further, it was also pointed out that there was no transfer of any capital asset from HTIL to

Vodafone pursuant to Option Agreements, FWAs, executed by the various Indian subsidiaries. Learned Senior Counsel also pointed out that the definition of "transfer" under Section 2(47) which provides for "extinguishment" is attracted for a transfer of a legal right and not a contractual right and there was no extinguishment of right by HTIL which gave rise to capital gains tax in India. Reference was made to judgment ***CIT v. Grace Collis*** (2001) 3 SCC 430**.** Learned senior counsel also submitted that the acquisition of "controlling interest" is a commercial concept and tax is levied on transaction and not its effect. Learned senior counsel pointed out that to lift the corporate veil of a legally recognised corporate structure time and the stage of the transaction are very important and not the motive to save the tax. Reference was also made to several judgments of the English Courts viz, ***IRC v. Duke of Westminster*** (1936) AC 1 (HL)***, W. T. Ramsay v. IRC*** (1982) AC 300 (HL)***, Craven v. White*** (1988) 3 All ER 495***, Furniss v. Dawson*** (1984) 1 All ER 530 etc. Reference was also made to the judgment of this Court in ***McDowell, Azadi Bachao Andolan*** cases (supra) and few other judgments. Learned senior counsel point out that Azadi Bachao Andolan broadly reflects Indian jurisprudence and that generally Indian courts used to follow the principles laid down by English Courts on the issue of tax avoidance and tax evasion. Learned Senior counsel also submitted that Tax Residency Certificate (for short TRC) issued by the Mauritian authorities has to be respected and in the absence of any Limitation on Benefit (LOB Clause), the benefit of the Indo-Mauritian Treaty is available to third parties who invest in India through Mauritius route.

39. Mr. Salve also argued on the extra territorial applicability of Section 195 and submitted that the same cannot be enforced on a non-resident without a presence in India. Counsel also pointed out that the words "any person" in Section 195 should be construed to apply to payers who have a presence in India or else enforcement would be impossible and such a provision should be read down in case of payments not having any nexus with India. Senior counsel also submitted that the withholding tax provisions under Section 195 of the Indian Income Tax Act, do not

apply to offshore entities making off-shore payments and the said Section could be triggered only if it can be established that the payment under consideration is of a "sum chargeable" under the Income Tax Act (for short IT Act). Senior counsel therefore contended that the findings of the Tax Authorities that pursuant to the transaction the benefit of telecom licence stood transferred to Vodafone is misconceived and that under the telecom policy of India a telecom licence can be held only by an Indian Company and there is no transfer direct or indirect of any licence to Vodafone.

40. Mr. R.F. Nariman, Learned Solicitor General appearing for the Income Tax Department submitted that the sale of CGP share was nothing but an artificial avoidance scheme and CGP was fished out of the HTIL legal structure as an artificial tax avoidance contrivance. Shri Nariman pointed out that CGP share has been interposed at the last minute to artificially remove HTIL from the Indian telecom business. Reference was made to the Due Diligence Report of Ernst and Young which stated that target structure later included

CGP which was not there originally. Further, it was also pointed out that HTIL extinguished its rights in HEL and put Vodafone in its place and CGP was merely an interloper. Shri Nariman also pointed out that as per Settlement Agreement, HTIL sold direct and indirect equity holdings, loans, other interests and rights relating to HEL which clearly reveal something other than CGP share was sold and those transactions were exposed by the SPA. Learned Solicitor General also referred extensively the provisions of SPA and submitted that the legal owner of CGP is HTIBVI Holdings Ltd., a British Virgin Islands Company which was excluded from the Agreement with an oblique tax motive.

41. Mr. Nariman also submitted the situs of CGP can only be in India as the entire business purpose of holding that share was to assume control in Indian telecom operations, the same was managed through Board of Directors controlled by HTIL. The controlling interest expressed by HTIL would amount to property rights and hence taxable in India. Reference was made to judgments of the Calcutta High Court in ***CIT v. National Insurance Company*** (1978)

113 ITR 37(Cal.) and ***Laxmi Insurance Company Pvt. Ltd. v. CIT*** (1971) 80 ITR 575 (Delhi). Further, it was also pointed out the "call and put" options despite being a contingent right are capable of being transferred and they are property rights and not merely contractual rights and hence would be taxable. Referring to the SPA Shri Nariman submitted that the transaction can be viewed as extinguishment of HTILs property rights in India and CGP share was merely a mode to transfer capital assets in India. Further, it was also pointed out that the charging Section should be construed purposively and it contains a look through provision and that the definition of the transfer in Section 9(1)(i) is an inclusive definition meant to explain the scope of that Section and not to limit it. The resignation of HTIL Directors on the Board of HEL could be termed as extinguishment and the right to manage a Company through its Board of Directors is a right to property. Learned Solicitor General also extensively referred to Ramsay Doctrine and submitted that if business purpose as opposed to effect is to artificially avoid tax then that step should be ignored and the courts should adopt a purposive

<u>construction</u> on the SPA. Considerable reliance was placed on judgment of this Court in ***Mc.Dowell*** and submitted that the same be followed and not ***Azadi Bachao Andolan*** which has been incorrectly decided. Further, it was also pointed out that Circular No.789 as regards the conclusiveness of TRC would apply only to dividend clause and as regards capital gains, it would still have to satisfy the twin tests of Article 13(4) of the treaty namely the shares being "alienated and the gains being derived" by a Mauritian entity. Learned Solicitor General also submitted that the Department can make an enquiry into whether capital gains have been factually and legally assigned to a Mauritian entity or to third party and whether the Mauritian Company was a façade.

42. Learned counsels, on either side, in support of their respective contentions, referred to several judgments of this Court, foreign Courts, international expert opinions, authoritative articles written by eminent authors etc. Before examining the same, let us first examine the legal status of a corporate structure, its usefulness in cross-

border transactions and other legal and commercial principles in use in such transactions, which are germane to our case.

Part – II

CORPORATE STRUCTURE / GENERAL PRINCIPLES (National and International)

43. Corporate structure is primarily created for business and commercial purposes and multi-national companies who make offshore investments always aim at better returns to the shareholders and the progress of their companies. Corporation created for such purposes are legal entities distinct from its members and are capable of enjoying rights and of being subject to duties which are not the same as those enjoyed or borne by its members. Multi-national companies, for corporate governance, may develop corporate structures, affiliate subsidiaries, joint ventures for operational efficiency, tax avoidance, mitigate risks etc. On incorporation, the corporate property belongs to the company and members have no direct proprietary rights to it but merely to their “shares” in the undertaking and these shares constitute items of property which are freely

transferable in the absence of any express provision to the contrary.

44. Corporate structure created for genuine business purposes are those which are generally created or acquired: at the time when investment is being made; or further investments are being made; or the time when the Group is undergoing financial or other overall restructuring; or when operations, such as consolidation, are carried out, to clean-defused or over-diversified. Sound commercial reasons like hedging business risk, hedging political risk, mobility of investment, ability to raise loans from diverse investments, often underlie creation of such structures. In transnational investments, the use of a tax neutral and investor-friendly countries to establish SPV is motivated by the need to create a tax efficient structure to eliminate double taxation wherever possible and also plan their activities attracting no or lesser tax so as to give maximum benefit to the investors. Certain countries are exempted from capital gain, certain countries are partially exempted and, in certain countries,

there is nil tax on capital gains. Such factors may go in creating a corporate structure and also restructuring.

45. Corporate structure may also have an exit route, especially when investment is overseas. For purely commercial reasons, a foreign group may wind up its activities overseas for better returns, due to disputes between partners, unfavourable fiscal policies, uncertain political situations, strengthen fiscal loans and its application, threat to its investment, insecurity, weak and time consuming judicial system etc., all can be contributing factors that may drive its exit or restructuring. Clearly, there is a fundamental difference in transnational investment made overseas and domestic investment. Domestic investments are made in the home country and meant to stay as it were, but when the trans-national investment is made overseas away from the natural residence of the investing company, provisions are usually made for exit route to facilitate an exit as and when necessary for good business and commercial reasons, which is generally foreign to judicial review.

46. Revenue/Courts can always examine whether those corporate structures are genuine and set up legally for a sound and veritable commercial purpose. Burden is entirely on the Revenue to show that the incorporation, consolidation, restructuring etc. has been effected to achieve a fraudulent, dishonest purpose, so as to defeat the law.

CORPORATE GOVERNANCE

47. Corporate governance has been a subject of considerable interest in the corporate world. The Organisation for Economic cooperation and Development (OECD) defines corporate governance as follows :-

> "Corporate governance is a system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation and other stake holders and spells out rules and procedures for making decisions on corporate affairs. By doing this, it also provides a structure through which the company objectives are set and the means of attaining those objectives and monitoring performance."

The Ministry of Corporate Affairs to the Government of India, has issued several press notes for information of such global companies, which will indicate that Indian corporate Law has also accepted the corporate structure consisting of holding companies and several subsidiary companies. A holding company which owns enough voting stock in a subsidiary can control management and operation by influencing or electing its Board of Directors. The holding company can also maintain group accounts which is to give members of the holding company a picture of the financial position of the holding company and its subsidiaries. The form and content of holding company or subsidiary company's own balance sheet and profit and loss account are the same as if they were independent companies except that a holding company's accounts an aggregated value of shares it holds in its subsidiaries and in related companies and aggregated amount of loss made by it to its subsidiaries and to related companies and their other indebtedness to it must be shown separately from other assets etc.

48. Corporate governors can also misuse their office, using fraudulent means for unlawful gain, they may also manipulate their records, enter into dubious transactions for

tax evasion. Burden is always on the Revenue to expose and prove such transactions are fraudulent by applying look at principle.

OVERSEAS COMPANIES AND FDI

49. Overseas companies are companies incorporated outside India and neither the Companies Act nor the Income Tax Act enacted in India has any control over those companies established overseas and they are governed by the laws in the countries where they are established. From country to country laws governing incorporation, management, control, taxation etc. may change. Many developed and wealthy Nations may park their capital in such off-shore companies to carry on business operations in other countries in the world. Many countries give facilities for establishing companies in their jurisdiction with minimum control and maximum freedom. Competition is also there among various countries for setting up such offshore companies in their jurisdiction. Demand for offshore facilities has considerably increased, in recent times, owing

to high growth rates of cross-border investments and to the increased number of rich investors who are prepared to use high technology and communication infrastructures to go offshore. Removal of barriers to cross-border trade, the liberalization of financial markets and new communication technologies have had positive effects on the developing countries including India.

50. Investment under foreign Direct Investment Scheme (FDI scheme), investment by Foreign Institutional Investors (FIIs) under the Portfolio Investment Scheme, investment by NRIs/OBCs under the Portfolio Investment Scheme and sale of shares by NRIs/OBCs on non-repatriation basis; Purchase and sale of securities other than shares and convertible debentures of an Indian company by a non-resident are common. Press Notes are announced by the Ministry of Commerce and Industry and the Ministry issued Press Note no. 2, 2009 and Press Note 3, 2009, which deals with calculation of foreign investment in downstream entities and requirement of ownership or control in sectoral cap companies. Many of the offshore companies use the

facilities of Offshore Financial Centres situate in Mauritius, Cayman Islands etc. Many of these offshore holdings and arrangements are undertaken for sound commercial and legitimate tax planning reasons, without any intent to conceal income or assets from the home country tax jurisdiction and India has always encouraged such arrangements, unless it is fraudulent or fictitious.

51. Moving offshore or using an OFC does not necessarily lead to the conclusion that they involve in the activities of tax evasion or other criminal activities. The multi-national companies are attracted to offshore financial centres mainly due to the reason of providing attractive facilities for the investment. Many corporate conglomerates employ a large number of holding companies and often high-risk assets are parked in separate companies so as to avoid legal and technical risks to the main group. Instances are also there when individuals form offshore vehicles to engage in risky investments, through the use of derivatives trading etc. Many of such companies do, of course, involve in manipulation of the market, money laundering and also

indulge in corrupt activities like round tripping, parking black money or offering, accepting etc., directly or indirectly bribe or any other undue advantage or prospect thereof.

52. OECD (Organisation for Economic Co-operation and Development) in the year 1998 issued a report called "Harmful Tax Competition: An Emerging Global Issue". The report advocated doing away with tax havens and offshore financial canters, like the Cayman Islands, on the basis that their low-tax regimes provide them with an unfair advantage in the global marketplace and are thus harmful to the economics of more developed countries. OECD threatened to place the Cayman Islands and other tax havens on a "black list" and impose sanctions against them.

53. OECD's blacklist was avoided by Cayman Islands in May 2000 by committing itself to a string of reforms to improve transparency, remove discriminatory practices and began to exchange information with OECD. Often, complaints have been raised stating that these centres are utilized for manipulating market, to launder money, to evade tax, to finance terrorism, indulge in corruption etc. All the

same, it is stated that OFCs have an important role in the international economy, offering advantages for multi-national companies and individuals for investments and also for legitimate financial planning and risk management. It is often said that insufficient legislation in the countries where they operate gives opportunities for money laundering, tax evasion etc. and, hence, it is imperative that that Indian Parliament would address all these issues with utmost urgency.

Need for Legislation:

54. Tax avoidance is a problem faced by almost all countries following civil and common law systems and all share the common broad aim, that is to combat it. Many countries are taking various legislative measures to increase the scrutiny of transactions conducted by non-resident enterprises. Australia has both general and specific anti-avoidance rule (GAAR) in its Income Tax Legislations. In Australia, GAAR is in Part IVA of the Income Tax Assessment Act, 1936, which is intended to provide an effective measure against tax avoidance arrangements. South Africa has also

taken initiative in combating impermissible tax avoidance or tax shelters. Countries like China, Japan etc. have also taken remedial measures.

55. Direct Tax Code Bill (DTC) 2010, proposed in India, envisages creation of an economically efficient, effective direct tax system, proposing GAAR. GAAR intends to prevent tax avoidance, what is inequitable and undesirable. Clause 5(4)(g) provides that the income from transfer, outside India of a share in a foreign company shall be deemed to arise in if the FMV of assets India owned by the foreign company is at least 50% of its total assets. Necessity to take effective legislative measures has been felt in this country, but we always lag behind because our priorities are different. Lack of proper regulatory laws, leads to uncertainty and passing inconsistent orders by Courts, Tribunals and other forums, putting Revenue and tax payers at bay.

HOLDING COMPANY AND SUBSIDIARY COMPANY

56. Companies Act in India and all over the world have statutorily recognised subsidiary company as a separate legal

entity. Section 2(47) of the Indian Companies Act 1956 defines "subsidiary company" or "subsidiary", a subsidiary company within the meaning of Section 4 of the Act. For the purpose of Indian Companies Act, a company shall be subject to the provisions of sub-section 3 of Section 4, be deemed to be subsidiary of another, subject to certain conditions, which includes holding of share capital in excess of 50% controlling the composition of Board of Directors and gaining status of subsidiary with respect to third company by holding company's subsidization of third company. A holding company is one which owns sufficient shares in the subsidiary company to determine who shall be its directors and how its affairs shall be conducted. Position in India and elsewhere is that the holding company controls a number of subsidiaries and respective businesses of companies within the group and manage and integrate as whole as though they are merely departments of one large undertaking owned by the holding company. But, the business of a subsidiary is not the business of the holding company (See ***Gramophone & Typewriter Ltd. v. Stanley***, (1908-10) All ER Rep 833 at 837).

57. Subsidiary companies are, therefore, the integral part of corporate structure. Activities of the companies over the years have grown enormously of its incorporation and outside and their structures have become more complex. Multi National Companies having large volume of business nationally or internationally will have to depend upon their subsidiary companies in the national and international level for better returns for the investors and for the growth of the company. When a holding company owns all of the voting stock of another company, the company is said to be a WOS of the parent company. Holding companies and their subsidiaries can create pyramids, whereby subsidiary owns a controlling interest in another company, thus becoming its parent company.

58. Legal relationship between a holding company and WOS is that they are two distinct legal persons and the holding company does not own the assets of the subsidiary and, in law, the management of the business of the subsidiary also vests in its Board of Directors. In ***Bacha F. Guzdar v. CIT*** AIR 1955 SC 74, this Court held that shareholders' only

rights is to get dividend if and when the company declares it, to participate in the liquidation proceeds and to vote at the shareholders' meeting. Refer also to ***Carew and Company Ltd. v. Union of India*** (1975) 2 SCC 791 and ***Carrasco Investments Ltd. v. Special Director, Enforcement*** (1994) 79 Comp Case 631 (Delhi).

59. Holding company, of course, if the subsidiary is a WOS, may appoint or remove any director if it so desires by a resolution in the General Body Meeting of the subsidiary. Holding companies and subsidiaries can be considered as single economic entity and consolidated balance sheet is the accounting relationship between the holding company and subsidiary company, which shows the status of the entire business enterprises. Shares of stock in the subsidiary company are held as assets on the books of the parent company and can be issued as collateral for additional debt financing. Holding company and subsidiary company are, however, considered as separate legal entities, and subsidiary are allowed decentralized management. Each subsidiary can reform its own management personnel and

holding company may also provide expert, efficient and competent services for the benefit of the subsidiaries.

60. U.S. Supreme Court in ***United States v. Bestfoods*** 524 US 51 (1998) explained that it is a general principle of corporate law and legal systems that a parent corporation is not liable for the acts of its subsidiary, but the Court went on to explain that corporate veil can be pierced and the parent company can be held liable for the conduct of its subsidiary, if the corporal form is misused to accomplish certain wrongful purposes, when the parent company is directly a participant in the wrong complained of. Mere ownership, parental control, management etc. of a subsidiary is not sufficient to pierce the status of their relationship and, to hold parent company liable. In ***Adams v. Cape Industries Plc.*** (1991) 1 All ER 929, the Court of Appeal emphasized that it is appropriate to pierce the corporate veil where special circumstances exist indicating that it is mere façade concealing true facts.

61. <u>Courts, however, will not allow the separate corporate entities to be used as a means to carry out fraud or to evade tax. Parent company of a WOS, is not responsible, legally for the unlawful activities of the subsidiary save in exceptional circumstances, such as a company is a sham or the agent of the shareholder, the parent company is regarded as a shareholder.</u> Multi-National Companies, by setting up complex vertical pyramid like structures, would be able to distance themselves and separate the parent from operating companies, thereby protecting the multi-national companies from legal liabilities.

<u>SHAREHOLDERS' AGREEMENT</u>

62. hareholders' Agreement (for short SHA) is essentially a contract between some or all other shareholders in a company, the purpose of which is to confer rights and impose obligations over and above those provided by the Company Law. <u>SHA is a private contract between the shareholders compared to Articles of Association of the Company, which is a public document. Being a private document it binds</u>

parties thereof and not the other remaining shareholders in the company. Advantage of SHA is that it gives greater flexibility, unlike Articles of Association. It also makes provisions for resolution of any dispute between the shareholders and also how the future capital contributions have to be made. Provisions of the SHA may also go contrary to the provisions of the Articles of Association, in that event, naturally provisions of the Articles of Association would govern and not the provisions made in the SHA.

63. The nature of SHA was considered by a two Judges Bench of this Court in ***V. B. Rangaraj v. V. B. Gopalakrishnan and Ors.*** (1992) 1 SCC 160. In that case, an agreement was entered into between shareholders of a private company wherein a restriction was imposed on a living member of the company to transfer his shares only to a member of his own branch of the family, such restrictions were, however, not envisaged or provided for within the Articles of Association. This Court has taken the view that provisions of the Shareholders' Agreement imposing restrictions even when consistent with Company legislation,

are to be authorized only when they are incorporated in the Articles of Association, a view we do not subscribe. This Court in ***Gherulal Parekh v. Mahadeo Das Maiya*** (1959) SCR Supp (2) 406 held that freedom of contract can be restricted by law only in cases where it is for some good for the community. Companies Act 1956 or the FERA 1973, RBI Regulation or the I.T. Act do not explicitly or impliedly forbid shareholders of a company to enter into agreements as to how they should exercise voting rights attached to their shares.

64. <u>Shareholders can enter into any agreement in the best interest of the company, but the only thing is that the provisions in the SHA shall not go contrary to the Articles of Association. The essential purpose of the SHA is to make provisions for proper and effective internal management of the company</u>. It can visualize the best interest of the company on diverse issues and can also find different ways not only for the best interest of the shareholders, but also for the company as a whole. In ***S. P. Jain v. Kalinga Cables Ltd.*** (1965) 2 SCR 720, this Court held that agreements

between non-members and members of the Company will not bind the company, but there is nothing unlawful in entering into agreement for transferring of shares. Of course, the manner in which such agreements are to be enforced in the case of breach is given in the general law between the company and the shareholders. A breach of SHA which does not breach the Articles of Association is a valid corporate action but, as we have already indicated, the parties aggrieved can get remedies under the general law of the land for any breach of that agreement.

65. SHA also provides for matters such as restriction of transfer of shares i.e. Right of First Refusal (ROFR), Right of First Offer (ROFO), Drag-Along Rights (DARs) and Tag-Along Rights (TARs), Pre-emption Rights, Call option, Put option, Subscription option etc. SHA in a characteristic Joint Venture Enterprise may regulate its affairs on the basis of various provisions enumerated above, because Joint Venture enterprise may deal with matters regulating the ownership and voting rights of shares in the company, control and manage the affairs of the company, and also may make

provisions for resolution of disputes between the shareholders. Many of the above mentioned provisions find a place in SHAs, FWAs, Term Sheet Agreement etc. in the present case, hence, we may refer to some of those provisions.

(a) Right of First Refusal (ROFR): ROFR permits its holders to claim the transfer of the subject of the right with a unilateral declaration of intent which can either be contractual or legal. No statutory recognition has been given to that right either in the Indian Company Law or the Income Tax Laws. Some foreign jurisdictions have made provisions regulating those rights by statutes. Generally, ROFR is contractual and determined in an agreement. ROFR clauses have contractual restrictions that give the holders the option to enter into commercial transactions with the owner on the basis of some specific terms before the owner may enter into the transactions with a third party. Shareholders' right to transfer the shares is not totally prevented, yet a shareholder is obliged to offer the shares first to the existing shareholders. Consequently, the other shareholders will have the privilege over the third parties with regard to purchase of shares.

(b) **Tag Along Rights (TARs):** TARs, a facet of ROFR, often refer to the power of a minority shareholder to sell their shares to the prospective buyer at the same price as any other shareholder would propose to sell. In other words, if one shareholder wants to sell, he can do so only if the purchaser agrees to purchase the other shareholders, who wish to sell at the same price. TAR often finds a place in the SHA which protects the interest of the minority shareholders.

(c) **Subscription Option:** Subscription option gives the beneficiary a right to demand issuance of allotment of shares of the target company. It is for that reason that a subscription right is normally accompanied by ancillary provisions including an Exit clause where, if dilution crosses a particular level, the counter parties are given some kind of Exit option.

(d) **Call Option:** Call option is an arrangement often seen in Merger and Acquisition projects, especially when they aim at foreign investment. A Call option is given to a foreign buyer by agreement so that the foreign buyer is able to enjoy the permitted minimum equity interests of the target company. Call option is always granted as a right not an obligation, which can be exercised upon satisfaction of certain conditions and/or within certain period agreed by the grantor and grantee. The buyer of Call option pays for the right, without the obligation to buy some underlying instrument from the writer of the option contract at a set future date and at the strike price. Call option is where the beneficiary of the action has a right to compel a counter-party to transfer his shares at a pre-determined or price fixed in accordance with the pre-determined maxim or even fair market value which results in a simple transfer of shares.

(e) **<u>Put Option:</u>** A put option represents the right, but not the requirement to sell a set number of shares of stock, which one do not yet own, at a pre-determined strike price, before the option reaches the expiration date. A put option is purchased with the belief that the underlying stock price will drop well before the strike price, at which point one may choose to exercise the option.

(f) **Cash and Cashless Options:** Cash and Cashless options are related arrangement to call and put options creating a route by which the investors could carry out their investment, in the event of an appreciation in the value of shares.

66. SHA, therefore, regulate the ownership and voting rights of shares in the company including ROFR, TARs, DARs, Preemption Rights, Call Options, Put Options, Subscription Option etc. in relation to any shares issued by the company, restriction of transfer of shares or granting securities interest over shares, provision for minority protection, lock-down or for the interest of the shareholders and the company. Provisions referred to above, which find place in a SHA, may regulate the rights between the parties which are purely contractual and those rights will have efficacy only in the course of ownership of shares by the parties.

SHARES, VOTING RIGHTS AND CONTROLLING INTERESTS:

67. Shares of any member in a company is a moveable property and can be transferred in the manner provided by the Articles of Association of the company. Stocks and shares are specifically included in the definition of the Sale of Goods Act, 1930. A share represents a bundle of rights like right to (1) elect directors, (2) vote on resolution of the company, (3) enjoy the profits of the company if and when dividend is declared or distributed, (4) share in the surplus, if any, on liquidation.

68. Share is a right to a specified amount of the share capital of a company carrying out certain rights and liabilities, in other words, shares are bundles of intangible rights against the company. Shares are to be regarded as situate in the country in which it is incorporated and register is kept. Shares are transferable like any other moveable property under the Companies Act and the Transfer of Property Act. Restriction of Transfer of Shares is valid, if contained in the Articles of Association of the company.

Shares are, therefore, presumed to be freely transferable and restrictions on their transfer are to be construed strictly. Transfer of shares may result in a host of consequences.

Voting Rights:

69. Voting rights vest in persons who names appear in the Register of Members. Right to vote cannot be decoupled from the share and an agreement to exercise voting rights in a desired manner, does not take away the right of vote, in fact, it is the shareholders' right. Voting rights cannot be denied by a company by its articles or otherwise to holders of shares below a minimum number such as only shareholders holding five or more shares are entitled to vote and so on, subject to certain limitations.

70. Rights and obligations flowing from voting rights have been the subject matter of several decisions of this Court. In ***Chiranjit Lal Chowdhuri v. Union of India*** (1950) 1 SCR 869 at 909 : AIR 1951 SC 41, with regard to exercise of the right to vote, this Court held that the right to vote for the

election of directors, the right to pass resolutions and the right to present a petition for winding up are personal rights flowing from the ownership of the share and cannot be themselves and apart from the share be acquired or disposed of or taken possession of. In ***Dwarkadas Shrinivas of Bombay v. Sholapur Spinning & Weaving Company*** (1954) SCR 674 at 726 : AIR 1954 SC 119, this Court noticed the principle laid down in ***Chiranjit Lal Chowdhuri*** (supra).

71. Voting arrangements in SHAs or pooling agreements are not "property". Contracts that provide for voting in favour of or against a resolution or acting in support of another shareholder create only "contractual obligations". A contract that creates contractual rights thereby, the owner of the share (and the owner of the right to vote) agrees to vote in a particular manner does not decouple the right to vote from the share and assign it to another. A contract that is entered into to provide voting in favour of or against the resolution or acting in support of another shareholder, as we have already noted, creates contractual obligation. Entering into any such contract constitutes an assertion (and not an

assignment) of the right to vote for the reason that by entering into the contract: (a) the owner of the share asserts that he has a right to vote; (b) he agrees that he is free to vote as per his will; and (c) he contractually agrees that he will vote in a particular manner. Once the owner of a share agrees to vote in a particular manner, that itself would not determine as a property.

Controlling Interest:

72. Shares, we have already indicated, represent congeries of rights and controlling interest is an incident of holding majority shares. Control of a company vests in the voting powers of its shareholders. Shareholders holding a controlling interest can determine the nature of the business, its management, enter into contract, borrow money, buy, sell or merge the company. Shares in a company may be subject to premiums or discounts depending upon whether they represent controlling or minority interest. Control, of course, confers value but the question as to whether one will pay a premium for controlling interest depends upon whether the

potential buyer believes one can enhance the value of the company.

73. The House of Lords in ***IRC v. V.T. Bibby & Sons*** (1946) 14 ITR (Supp) 7 at 9-10, after examining the meaning of the expressions “control” and “interest”, held that controlling interest did not depend upon the extent to which they had the power of controlling votes. Principle that emerges is that where shares in large numbers are transferred, which result in shifting of “controlling interest”, it cannot be considered as two separate transactions namely transfer of shares and transfer of controlling interest. Controlling interest forms an inalienable part of the share itself and the same cannot be traded separately unless otherwise provided by the Statute. Of course, the Indian Company Law does not explicitly throw light on whether control or controlling interest is a part of or inextricably linked with a share of a company or otherwise, so also the Income Tax Act. In the impugned judgment, the High Court has

taken the stand that controlling interest and shares are distinct assets.

74. Control, in our view, is an interest arising from holding a particular number of shares and the same cannot be separately acquired or transferred. Each share represents a vote in the management of the company and such a vote can be utilized to control the company. <u>Controlling interest, therefore, is not an identifiable or distinct capital asset independent of holding of shares and the nature of the transaction has to be ascertained from the terms of the contract and the surrounding circumstances</u>. <u>Controlling interest is inherently contractual right and not property right and cannot be considered as transfer of property and hence a capital asset unless the Statute stipulates otherwise</u>. Acquisition of shares may carry the acquisition of controlling interest, which is purely a commercial concept and tax is levied on the transaction, not on its effect.

A. LIFTING THE VEIL – TAX LAWS

75. Lifting the corporate veil doctrine is readily applied in the cases coming within the Company Law , Law of Contract, Law of Taxation. Once the transaction is shown to be fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also for tax evasion, the Court can always lift the corporate veil and examine the substance of the transaction. This Court in ***Commissioner of Income Tax*** *v.* ***Sri Meenakshi Mills Ltd., Madurai,*** AIR 1967 SC 819 held that the Court is entitled to lift the veil of the corporate entity and pay regard to the economic realities behind the legal façade meaning that the court has the power to disregard the corporate entity if it is used for tax evasion. In ***Life Insurance Corporation of India*** *v.* ***Escorts Limited and Others*** (1986) 1 SCC 264, this Court held that the corporate veil may be lifted where a statute itself contemplates lifting of the veil or fraud or improper conduct intended to be prevented or a taxing statute or a beneficial statute is sought to be evaded or where associated companies are inextricably as to be, in reality part of one concern. Lifting the Corporate

Veil doctrine was also applied in ***Juggilal Kampalpat*** *v.* ***Commissioner of Income Tax, U.P.*** **,** AIR 1969 SC 932 : (1969) 1 SCR 988, wherein this Court noticed that the assessee firm sought to avoid tax on the amount of compensation received for the loss of office by claiming that it was capital gain and it was found that the termination of the contract of managing agency was a collusive transaction. Court held that it was a collusive device, practised by the managed company and the assessee firm for the purpose of evading income tax, both at the hands of the payer and the payee.

76. Lifting the corporate veil doctrine can, therefore, be applied in tax matters even in the absence of any statutory authorisation to that effect. Principle is also being applied in cases of holding company – subsidiary relationship- where in spite of being separate legal personalities, if the facts reveal that they indulge in dubious methods for tax evasion.

(B) **<u>Tax Avoidance and Tax Evasion:</u>**

Tax avoidance and tax evasion are two expressions which find no definition either in the Indian Companies Act, 1956 or the Income Tax Act, 1961. But the expressions are being used in different contexts by our Courts as well as the Courts in England and various other countries, when a subject is sought to be taxed. One of the earliest decisions which came up before the House of Lords in England demanding tax on a transaction by the Crown is ***Duke of Westminster*** (supra). In that case, Duke of Westminster had made an arrangement that he would pay his gardener an annuity, in which case, a tax deduction could be claimed. Wages of household services were not deductible expenses in computing the taxable income, therefore, Duke of Westminster was advised by the tax experts that if such an agreement was employed, Duke would get tax exemption. Under the Tax Legislation then in force, if it was shown as gardener's wages, then the wages paid would not be deductible. Inland Revenue contended that the form of the transaction was not acceptable to it and the Duke was taxed on the substance of the transaction, which was that payment of annuity was treated as a payment of salary or wages. Crown's claim of **substance doctrine** was, however, rejected by the House of Lords. Lord Tomlin's celebrated words are quoted below:

> "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."

Lord Atkin, however, dissented and stated that "the substance of the transaction was that what was being paid was remuneration."

The principles which have emerged from that judgment are as follows:

(1) A legislation is to receive a strict or literal interpretation;

(2) An arrangement is to be looked at not in by its economic or commercial substance but by its legal form; and

(3) An arrangement is effective for tax purposes even if it has no business purpose and has been entered into to avoid tax.

The House of Lords, during 1980's, it seems, began to attach a "**purposive interpretation approach**" and gradually began to give emphasis on "**economic substance doctrine**" as a question of statutory interpretation. In a most celebrated case in ***Ramsay*** (supra), the House of Lords considered this question again. That was a case whereby the taxpayer entered into a circular series of transactions designed to produce a loss for tax purposes, but which together produced no commercial result. Viewed that transaction as a whole, the series of transactions was self-canceling, the taxpayer was in precisely the same commercial position at the end as at the beginning of the series of transactions. House of Lords ruled that, notwithstanding the rule in ***Duke of Westminster's*** case, the series of transactions should be disregarded for tax purposes and the manufactured loss, therefore, was not available to the taxpayer. Lord Wilberforce opined as follows:

> "While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded; to do so in not to prefer form to substance, or substance to form. It is the task of

> the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions intended to operate as such, it is that series or combination which may be regarded."

(emphasis supplied)

House of Lords, therefore, made the following important remarks concerning what action the Court should consider in cases that involve tax avoidance:

> (1) A taxpayer was only to be taxed if the Legislation clearly indicated that this was the case;
>
> (2) A taxpayer was entitled to manage his or her affairs so as to reduce tax;
>
> (3) Even if the purpose or object of a transaction was to avoid tax this did not invalidate a transaction unless an anti-avoidance provision applied; and
>
> (4) If a document or transaction was genuine and not a sham in the traditional sense, the Court had to adhere to the form of the transaction following the Duke Westminster concept.

77. In ***Ramsay*** (supra) it may be noted, the taxpayer produced a profit that was liable to capital gains tax, but a readymade claim was set up to create an allowable loss that was purchased by the taxpayer with the intention of avoiding the capital gains tax. Basically, the House of Lords,

cautioned that the technique of tax avoidance might progress and technically improve and Courts are not obliged to be at a standstill. In other words, the view expressed was that that a subject could be taxed only if there was a clear intendment and the intendment has to be ascertained on clear principles and the Courts would not approach the issue on a mere literal interpretation. ***Ramsay*** was, therefore, seen as a new approach to **artificial tax avoidance scheme**.

78. ***Ramsay*** was followed by the House of Lords in another decision in ***IRC v. Burmah Oil Co Ltd.*** (1982) 54 TC 200. This case was also concerned with a self-cancelling series of transactions. Lord Diplock, in that case, confirmed the judicial view that a development of the jurisprudence was taking place, stating that ***Ramsay*** case marked a significant change in the approach adopted by the House of Lords to a **pre-ordained** series of transactions. ***Ramay*** and ***Burmah*** cases, it may be noted, were against self-cancelling artificial tax schemes which were widespread in England in 1970's. Rather than striking down the self-cancelling transactions, of course, few of the speeches of Law Lords gave the impression that the tax effectiveness of a scheme should be judged by reference to its commercial substance rather than its legal form. On this, of course, there was some conflict with the principle laid down in ***Duke of Westminster***. ***Duke of Westminster*** was concerned with the "single tax avoidance step". During 1970's, the Courts in England had to deal with several pre-planned avoidance schemes containing a number of steps. In fact, earlier in ***IRC v. Plummer*** (1979) 3 All ER 775, Lord Wilberforce commented about a scheme stating that the same was carried out with "almost military precision" which required the court to look at the scheme as a whole. The scheme in question was a "circular annuity" plan, in which a charity made a capital payment to the taxpayer in consideration of his covenant to make annual payments of income over five years. The House of Lords held that the scheme was valid. Basically, the ***Ramsay*** was dealing with "readymade schemes".

79. The House of Lords, however, had to deal with a non self-cancelling tax avoidance scheme in ***Dawson*** (supra). Dawsons, in that case, held shares in two operating

companies which agreed in principle in September 1971 to sell their entire shareholding to Wood Bastow Holdings Ltd. Acting on advice, to escape capital gains tax, Dawsons decided not to sell directly to Wood Bastow, rather arranged to exchange their shares for shares in an investment company to be incorporated in the Isle of Man. Greenjacket Investments Ltd. was then incorporated in the Isle of Man on 16.12.1971 and two arrangements were finalized (i) Greenjacket would purchase Dawsons shares in the operating company for £152,000 to be satisfied by the issue of shares of Greenjacket and (ii) an agreement for Greenjacket to sell the shares in the operating company to Wood Bastow for £152,000.

80. The High Court and the Court of Appeal ruled that ***Ramsay*** principle applied only where steps forming part of the scheme were **self-cancelling** and they considered that it did not allow share exchange and sale agreements to be distributed as steps in the scheme, because they had an enduring legal effect. The House of Lords, however, held that steps inserted in a **preordained** series of transactions with

no commercial purpose other than tax avoidance should be disregarded for tax purposes, notwithstanding that the inserted step (i.e. the introduction of Greenjacket) had a business effect. Lord Brightman stated that inserted step had no business purpose apart from the deferment of tax, although it had a business effect.

81. Even though in ***Dawson***, the House of Lords seems to strike down the transaction by the taxpayer for the purpose of tax avoidance, House of Lords in ***Craven*** (supra) clarified the position further. In that case, the taxpayers exchanged their shares in a trading company (Q Ltd) for shares in an Isle of Man holding company (M Ltd), in anticipation of a potential sale or merger of the business. Taxpayers, in the meanwhile, had abandoned negotiations with one interested party, and later concluded a sale of Q Ltd's shares with another. M Ltd subsequently loaned the entire sale proceeds to the taxpayers, who appealed against assessments to capital gains tax. The House of Lords held in favour of the taxpayers, dismissing the crown's appeal by a majority of three to two. House of Lords noticed that when the share

exchange took place, there was no certainty that the shares in Q Ltd would be sold. Lord Oliver, speaking for the majority, opined that ***Ramsay, Burmah and Dawson*** did not produce any legal principle that would nullify any transaction that has no intention besides tax avoidance and opined as follows:

> "My Lords, for my part I find myself unable to accept that Dawson either established or can properly be used to support a general proposition that any transaction which is effected for avoiding tax on a contemplated subsequent transaction and is therefore planned, is for that reason, necessarily to be treated as one with that subsequent transaction and as having no independent effect."

Craven made it clear that: (1) Strategic tax planning undertaken for months or possible years before the event (of-sale) in anticipation of which it was effected; (2) A series of transactions undertaken at the time of disposal/sale, including an intermediate transaction interposed into having no independent life, could under ***Ramsay*** principle be **looked at** and treated as a composite whole transaction to which the fiscal results of the single composite whole are to be applied, i.e. that an intermediate transfer which was, at the time when it was effected, so closely interconnected with the ultimate disposition, could properly be described as not, in itself, a real transaction at all, but merely an element in some different and larger whole without independent effect.

81. Later, House of Lords in ***Ensign Tankers (Leasing) Ltd. v. Stokes*** (1992) 1 AC 655 made a review of the various tax avoidance cases from ***Floor v. Davis*** (1978) 2 All ER 1079 : (1978) Ch 295 to ***Craven*** (supra). In ***Ensign Tankers***, a company became a partner of a limited partnership that had acquired the right to produce the film "Escape to Victory". 75% of the cost of making the film was financed by way of a non-recourse loan from the production company, the company claimed the benefit of depreciation allowances based upon the full amount of the production cost. The House of Lords disallowed the claim, but allowed depreciation calculated on 25% of the cost for which the limited partnership was at risk. House of Lords examined the transaction as a whole and concluded that the limited partnership had only 'incurred capital expenditure on the provision of machinery or plant' of 25% and no more.

83. Lord Goff explained the meaning of "unacceptable tax avoidance" in ***Ensign Tankers*** and held that unacceptable tax avoidance typically involves the creation of **complex artificial structures** by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed. This, of course, led to further debate as to what is "unacceptable tax avoidance" and "acceptable tax avoidance".

84. House of Lords, later in ***Inland Revenue Commissioner v. McGuckian*** (1997) BTC 346 said that the substance of a transaction may be considered if it is a tax avoidance scheme. Lord Steyn observed as follows:

> "While Lord Tomlin's observations in the *Duke of Westminster* case [1936] A.C. 1 still point to a material consideration, namely the general liberty of the citizen to arrange his financial affairs as he thinks fit, they have ceased to be canonical as to the consequence of a tax avoidance scheme."

McGuckian was associated with a tax avoidance scheme. The intention of the scheme was to convert the income from shares by way of dividend to a capital receipt. Schemes' intention was to make a capital receipt in addition to a tax dividend. ***Mc.Guckian*** had affirmed the **fiscal nullity** doctrine from the approach of United Kingdom towards tax penalties which emerged from tax avoidance schemes. The analysis of the transaction was under the principles laid down in ***Duke of Westminster***, since the entire transaction was not a tax avoidance scheme.

85. House of Lords in ***MacNiven*** *v.* ***Westmoreland Investments Limited*** (2003) 1 AC 311 examined the scope of Ramsay principle approach and held that it was one of purposive construction. In fact, Ramsay's case and case of ***Duke of Westminister*** were reconciled by Lord Hoffmann in ***MacNiven***. Lord Hoffmann clarified stating as follows

> 'if the legal position is that tax is imposed by reference to a legally designed concept, such as stamp duty payable on a document which constitute conveyance or sale, the court cannot tax a transaction which uses no such document on the ground that it achieves the same economic effect. On the other hand, the legal position is that the tax is imposed by reference to a commercial concept, then to have regard to the business "substance" of the matter is not to ignore the legal position but to give effect to it."

86. In other words, Lord Hoffmann reiterated that tax statutes must be interpreted "in a purposive manner to achieve the intention of the Legislature". ***Ramsay*** and ***Dawson*** are said to be examples of these fundamental principles.

87. Lord Hoffmann, therefore, stated that when Parliament intended to give a legal meaning to a statutory term or phrase, then Ramsay approach does not require or permit an examination of the commercial nature of the transaction, rather, it requires a consideration of the legal effect of what was done.

88. ***MacNiven*** approach has been reaffirmed by the House of Lord in ***Barclays Mercantile Business Finance Limited v. Mawson*** (2005) AC 685 (HL). In ***Mawson, BGE***, an Irish Company had applied for a pipeline and it sold the pipeline to (BMBF) taxpayer for ₤ 91.3 Million. BMBF later leased the pipeline back to BGE which granted a sub-lease onwards to its UK subsidiary. BGE immediately deposited the sale proceeds as Barclays had no access to it for 31

years. Parties had nothing to loose with the transaction designed to produce substantial tax deduction in UK and no other economic consequence of any significance. Revenue denied BMBF's deduction for depreciation because the series of transactions amounted to a single composite transaction that did not fall within Section 24(1) of the Capital Cost Allowance Act, 1990. House of Lords, in a unanimous decision held in favour of the tax payer and held as follows "driving principle in Ramsay's line of cases continues to involve a general rule of statutory interpretation and unblinked approach to the analysis of facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to a transaction, viewed realistically.

89. On the same day, House of Lords had an occasion to consider the Ramsay approach in ***Inland Revenue Commissioner*** v. ***Scottish Provident Institution*** (2004 [1] WLR 3172). The question involved in ***Scottish Provident Institution*** was whether there was "a debt contract for the purpose of Section 150A(1) of the Finance Act, 1994."

House of Lords upheld the Ramsay principle and considered the series of transaction as a composite transaction and held that the composite transaction created no entitlement to securities and that there was, thus, no qualifying contract. The line drawn by House of Lords between **Mawson** and **Scottish Provident Institution** in holding that in one case there was a composite transaction to which statute applied, while in the other there was not.

90. Lord Hoffmann later in an article "**Tax Avoidance"** reported in (2005) BTR 197 commented on the judgment in BMBF as follows:

> "the primacy of the construction of the particular taxing provision and the illegitimacy of the rules of general application has been reaffirmed by the recent decision of the House in "BMBF". Indeed, it may be said that this case has killed off Ramsay doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes".

Above discussion would indicate <u>that a clear-cut distinction between tax avoidance and tax evasion is still to emerge in England and in the absence of any legislative guidelines, there bound to be uncertainty, but to say that the principle</u>

of Duke of Westminster has been exorcised in England is too tall a statement and not seen accepted even in England. House of Lords in ***McGuckian*** and ***MacNiven***, it may be noted, has emphasised that the Ramsay approach as a principle of statutory interpretation rather than an over-arching anti avoidance doctrine imposed upon tax laws. Ramsay approach ultimately concerned with the statutory interpretation of a tax avoidance scheme and the principles laid down in ***Duke of Westminster***, it cannot be said, has been given a complete go by ***Ramsay, Dawson*** or other judgments of the House of Lords.

PART-III

INDO-MAURITIUS TREATY – AZADI BACHAO ANDOLAN

91. The Constitution Bench of this Court in ***McDowell*** (supra) examined at length the concept of tax evasion and tax avoidance in the light of the principles laid down by the House of Lords in several judgments like ***Duke of Westminster, Ramsay, Dawson*** etc. The scope of Indo-Mauritius Double Tax Avoidance Agreement (in short

DTAA)], Circular No. 682 dated 30.3.1994 and Circular No. 789 dated 13.4.2000 issued by CBDT, later came up for consideration before a two Judges Bench of this Court in ***Azadi Bachao Andolan***. Learned Judges made some observations with regard to the opinion expressed by Justice Chinnappa Reddy in a Constitution Bench judgment of this Court in ***McDowell***, which created some confusion with regard to the understanding of the Constitution Bench judgment, which needs clarification. Let us, however, first examine the scope of the India-Mauritius Treaty and its follow-up.

92. India-Mauritius Treaty was executed on 1.4.1983 and notified on 16.12.1983. Article 13 of the Treaty deals with the taxability of capital gains. Article 13(4) covers the taxability of capital gains arising from the sale/transfer of shares and stipulates that "Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs 1, 2 and 3 of that Article, shall be taxable only in that State". Article 10 of the Treaty deals with the taxability of Dividends. Article 10(1)

specifies that “Dividends paid by a company which is a resident of a Contracting State to a resident of other contracting State, may be taxed in that other State”. Article 10(2) stipulates that “such dividend may also be taxed in the Contracting State of which the company paying the dividends is a resident but if the recipient was the beneficial owner of the dividends, the tax should not exceed; (a) 5% of the gross amount of the dividends if the recipient of the dividends holds at least 10% of the capital of the company paying the dividends and (b) 15% of the gross amount of the dividends in all other cases.

93. CBDT issued Circular No. 682 dated 30.03.1994 clarifying that capital gains derived by a resident of Mauritius by alienation of shares of an Indian company shall be taxable only in Mauritius according to Mauritius Tax Law. In the year 2000, the Revenue authorities sought to deny the treaty benefits to some Mauritius resident companies pointing out that the **beneficial ownership** in those companies was outside Mauritius and thus the foremost purpose of investing in India via Mauritius was tax

avoidance. Tax authorities took the stand that Mauritius was merely being used as a conduit and thus sought to deny the treaty benefits despite the absence of a limitation of benefits (LOB) clause in the Treaty. CBDT then issued Circular No. 789 dated 13.04.2000 stating that the Mauritius Tax Residency Certificate (TRC) issued by the Mauritius Tax Office was a sufficient evidence of tax response of that company in Mauritius and that such companies were entitled to claim treaty benefits.

94. Writ Petitions in public interest were filed before the Delhi High Court challenging the constitutional validity of the above mentioned circulars. Delhi High Court quashed Circular No. 789 stating that inasmuch as the circular directs the Income Tax authorities to accept as a certificate of residence issued by the authorities of Mauritius as sufficient evidence as regards the status of resident and beneficial ownership, was *ultra vires* the powers of CBDT. The Court also held that the Income Tax Office was entitled to lift the corporate veil in India to see whether a company was a resident of Mauritius or not and whether the

company was paying income tax in Mauritius or not. The Court also held that the "Treaty Shopping" by which the resident of a third country takes advantage of the provisions of the agreement was illegal and necessarily to be forbidden. Union of India preferred appeal against the judgment of the Delhi High Court, before this Court. This Court in ***Azadi Bachao Andolan*** allowed the appeal and Circular No. 789 was declared valid.

Limitation of Benefit Clause (LOB)

95. India Mauritius Treaty does not contain any Limitation of Benefit (LOB) clause, similar to the Indo-US Treaty, wherein Article 24 stipulates that benefits will be available if 50% of the shares of a company are owned directly or indirectly by one or more individual residents of a controlling state. LOB clause also finds a place in India-Singapore DTA. Indo Mauritius Treaty does not restrict the benefit to companies whose shareholders are non-citizens/residents of Mauritius, or where the beneficial interest is owned by non-citizens/residents of Mauritius, in the event where there is no justification in prohibiting the

residents of a third nation from incorporating companies in Mauritius and deriving benefit under the treaty. No presumption can be drawn that the Union of India or the Tax Department is unaware that the quantum of both FDI and FII do not originate from Mauritius but from other global investors situate outside Mauritius. Maurtius, it is well known is incapable of bringing FDI worth millions of dollars into India. If the Union of India and Tax Department insist that the investment would directly come from Mauritius and Mauritius alone then the Indo-Mauritius treaty would be dead letter.

96. Mr. Aspi Chinoy, learned senior counsel contended that in the absence of LOB Clause in the India Mauritius Treaty, the scope of the treaty would be positive from Mauritius Special Purpose Vehicles (SPVs) created specifically to route investments into India, meets with our approval. We acknowledge that on a subsequent sale/transfer/disinvestment of shares by the Mauritian company, after a reasonable time, the sale proceeds would be received by the Mauritius Company as the registered

holder/owner of such shares, such benefits could be sent back to the Foreign Principal/100% shareholder of Mauritius company either by way of a declaration of special dividend by Mauritius company and/or by way of repayment of loans received by the Mauritius company from the Foreign Principal/shareholder for the purpose of making the investment. Mr. Chinoy is right in his contention that apart from DTAA, which provides for tax exemption in the case of capital gains received by a Mauritius company/shareholder at the time of disinvestment/exit and the fact that Mauritius does not levy tax on dividends declared and paid by a Mauritius company/subsidiary to its Foreign Shareholders/Principal, there is no other reason for this quantum of funds to be invested from/through Mauritius.

97. <u>We are, therefore, of the view that in the absence of LOB Clause and the presence of Circular No. 789 of 2000 and TRC certificate, on the residence and beneficial interest/ownership, tax department cannot at the time of sale/disinvestment/exit from such FDI, deny benefits to</u>

such Mauritius companies of the Treaty by stating that FDI was only routed through a Mauritius company, by a company/principal resident in a third country; or the Mauritius company had received all its funds from a foreign principal/company; or the Mauritius subsidiary is controlled/managed by the Foreign Principal; or the Mauritius company had no assets or business other than holding the investment/shares in the Indian company; or the Foreign Principal/100% shareholder of Mauritius company had played a dominant role in deciding the time and price of the disinvestment/sale/transfer; or the sale proceeds received by the Mauritius company had ultimately been paid over by it to the Foreign Principal/ its 100% shareholder either by way of Special Dividend or by way of repayment of loans received; or the real owner/beneficial owner of the shares was the foreign Principal Company. Setting up of a WOS Mauritius subsidiary/SPV by Principals/genuine substantial long term FDI in India from/through Mauritius, pursuant to the DTAA and Circular No. 789 can never be considered to be set up for tax evasion.

TRC whether conclusive

98. LOB and **look through** provisions cannot be read into a tax treaty but the question may arise as to whether the TRC is so conclusive that the Tax Department cannot pierce the veil and **look at the** substance of the transaction. DTAA and Circular No. 789 dated 13.4.2000, in our view, would not preclude the Income Tax Department from denying the tax treaty benefits, if it is established, on facts, that the Mauritius company has been interposed as the owner of the shares in India, at the time of disposal of the shares to a third party, solely with a view to avoid tax without any commercial substance. Tax Department, in such a situation, notwithstanding the fact that the Mauritian company is required to be treated as the beneficial owner of the shares under Circular No. 789 and the Treaty is entitled to look at the entire transaction of sale as a whole and if it is established that the Mauritian company has been interposed as a device, it is open to the Tax Department to discard the device and take into consideration the real transaction between the parties , and the transaction may be subjected to tax. In other words,

TRC does not prevent enquiry into a tax fraud, for example, where an OCB is used by an Indian resident for round-tripping or any other illegal activities, nothing prevents the Revenue from looking into special agreements, contracts or arrangements made or effected by Indian resident or the role of the OCB in the entire transaction.

99. No court will recognise sham transaction or a colourable device or adoption of a dubious method to evade tax, but to say that the Indo-Mauritian Treaty will recognise FDI and FII only if it originates from Mauritius, not the investors from third countries, incorporating company in Mauritius, is pitching it too high, especially when statistics reveals that for the last decade the FDI in India was US$ 178 billion and, of this, 42% i.e. US$ 74.56 billion was through Mauritian route. Presently, it is known, FII in India is Rs.450,000 crores, out of which Rs. 70,000 crores is from Mauritius. Facts, therefore, clearly show that almost the entire FDI and FII made in India from Mauritius under DTAA does not originate from that country, but has been made by Mauritius Companies / SPV, which are owned by

companies/individuals of third countries providing funds for making FDI by such companies/individuals not from Mauritius, but from third countries.

100. Mauritius, and India, it is known, has also signed a Memorandum of Understanding (MOU) laying down the rules for information, exchange between the two countries which provides for the two signatory authorities to assist each other in the detection of fraudulent market practices, including the insider dealing and market manipulation in the areas of securities transactions and derivative dealings. The object and purpose of the MOU is to track down transactions tainted by fraud and financial crime, not to target the bona fide legitimate transactions. Mauritius has also enacted stringent "Know Your Clients" (KYC) regulations and Anti-Money Laundering laws which seek to avoid abusive use of treaty.

101. Viewed in the above perspective, we also find no reason to import the "**abuse of rights doctrine**" (*abus de droit*) to India. The above doctrine was seen applied by the

Swiss Court in A Holding Aps. (8 ITRL), unlike Courts following Common Law. That was a case where a Danish company was interposed to hold all the shares in a Swiss Company and there was a clear finding of fact that it was interposed for the sole purpose of benefiting from the Swiss-Denmark DTA which had the effect of reducing a normal 35% withholding tax on dividend out of Switzerland down to 0%. Court in that case held that the only reason for the existence of the Danish company was to benefit from the zero withholding tax under the tax treaty. On facts also, the above case will not apply to the case in hand.

102. Cayman Islands, it was contended, was a **tax heaven** and CGP was a **shell company**, hence, they have to be looked at with suspicion. We may, therefore, briefly examine what those expressions mean and understood in the corporate world.

TAX HAVENS, TREATY SHOPPING AND SHELL COMPANIES

103. Tax Havens" is not seen defined or mentioned in the Tax Laws of this country Corporate world gives different meanings to that expression, so also the Tax Department. The term "tax havens" is sometime described as a State with

nil or moderate level of taxation and/or liberal tax incentives for undertaking specific activities such as exporting. The expression “tax haven” is also sometime used as a “secrecy jurisdiction. The term “Shell Companies” finds no definition in the tax laws and the term is used in its pejorative sense, namely as a company which exits only on paper, but in reality, they are investment companies. Meaning of the expression ‘Treaty Shopping’ was elaborately dealt with in **Azadi Bachao Andolan** and hence not repeated.

104. Tax Justice Network Project (U.K.), however, in its report published in September, 2005, stated as follows:

> “The role played by tax havens in encouraging and profiteering from tax avoidance, tax evasion and capital flight from developed and developing countries is a scandal of gigantic proportions”.

The project recorded that one per cent of the world’s population holds more than 57% of total global worth and that approximately US $ 255 billion annually was involved in using offshore havens to escape taxation, an amount which would more than plug the financing gap to achieve the Millennium Development Goal of reducing the world poverty by 50% by 2015. (“Tax Us If You Can” September

2005, 78 available at *http:/www.taxjustice.net*). Necessity of proper legislation for charging those types of transactions have already been emphasised by us.

Round Tripping

105. India is considered to be the most attractive investment destinations and, it is known, has received \$37.763 billion in FDI and \$29.048 billion in FII investment in the year to March 31, 2010. FDI inflows it is reported were of \$ 22.958 billion between April 2010 and January, 2011 and FII investment were \$ 31.031 billions. Reports are afloat that million of rupees go out of the country only to be returned as FDI or FII. Round Tripping can take many formats like under-invoicing and over-invoicing of exports and imports. Round Tripping involves getting the money out of India, say Mauritius, and then come to India like FDI or FII. Art. 4 of the Indo-Mauritius DTAA defines a 'resident' to mean any person, who under the laws of the contracting State is liable to taxation therein by reason of his domicile, residence, place of business or any other similar criteria. An Indian Company, with the idea of tax evasion can also

incorporate a company off-shore, say in a Tax Haven, and then create a WOS in Mauritius and after obtaining a TRC may invest in India. Large amounts, therefore, can be routed back to India using TRC as a defence, but once it is established that such an investment is black money or capital that is hidden, it is nothing but circular movement of capital known as Round Tripping; then TRC can be ignored, since the transaction is fraudulent and against national interest.

106. Facts stated above are food for thought to the legislature and adequate legislative measures have to be taken to plug the loopholes, all the same, a genuine corporate structure set up for purely commercial purpose and indulging in genuine investment be recognized. However, if the fraud is detected by the Court of Law, it can pierce the corporate structure since fraud unravels everything, even a statutory provision, if it is a stumbling block, because legislature never intents to guard fraud. Certainly, in our view, TRC certificate though can be accepted as a conclusive evidence for accepting status of residents as well as beneficial ownership for applying the

<u>tax treaty, it can be ignored if the treaty is abused for the fraudulent purpose of evasion of tax</u>.

<u>McDowell - WHETHER CALLS FOR RECONSDIERATION:</u>

107. ***McDowell*** has emphatically spoken on the principle of Tax Planning. Justice Ranganath Mishra, on his and on behalf of three other Judges, after referring to the observations of Justice S.C. Shah in ***CIT v. A. Raman and Co.*** (1968) 1 SCC 10, ***CIT v. B. M. Kharwar*** (1969) 1 SCR 651, the judgments in ***Bank of Chettinad Ltd. v. CIT*** (1940) 8 ITR 522 (PC), ***Jiyajeerao Cotton Mills Ltd.*** v. ***Commissioner of Income Tax and Excess Profits Tax, Bombay*** AIR 1959 SC 270; ***CIT v. Vadilal Lallubhai*** (1973) 3 SCC 17 and the views expressed by Viscount Simon in ***Latilla v. IRC***. 26 TC 107 : (1943) AC 377 stated as follows:

> "Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."

108. Justice Shah in ***Raman*** (supra) has stated that avoidance of tax liability by so arranging the commercial affairs that charge of tax is distributed is not prohibited and a tax payer may resort to a device to divert the income before it accrues or arises to him and the effectiveness of the device depends not upon considerations of morality, but on the operation of the Income Tax Act. Justice Shah made the same observation in ***B.N. Kharwar*** (supra) as well and after quoting a passage from the judgment of the Privy Council stated as follows :-

> "The Taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of the relationship. But the legal effect of a transaction cannot be displaced by probing into the "substance of the transaction".

In ***Jiyajeerao*** (supra) also, this Court made the following observation:

> "Every person is entitled so to arrange his affairs as to avoid taxation, but the arrangement must be real and genuine and not a sham or make-believe."

109. In ***Vadilal Lalubhai*** *(supra)* this Court re-affirmed the principle of strict interpretation of the charging provisions and also affirmed the decision of the Gujarat High Court in ***Sankarlal Balabhai v. ITO*** (1975) 100 ITR 97 (Guj.), which had drawn a distinction between the legitimate avoidance and tax evasion. ***Lalita's*** case (supra) dealing with a tax avoidance scheme, has also expressly affirmed the principle that genuine arrangements would be permissible and may result in an assessee escaping tax.

110. Justice Chinnappa Reddy starts his concurring judgment in McDowell as follows:

> "While I entirely agree with my brother Ranganath Mishra, J. in the judgment proposed to be delivered by me, I wish to add a few paragraphs, particularly to supplement what he has said on the "fashionable" topic of tax avoidance."
>
> (emphasis supplied)

Justice Reddy has, the above quoted portion shows, entirely **agreed** with Justice Mishra and has stated that he is only **supplementing** what Justice Mishra has spoken on tax avoidance. Justice Reddy, while agreeing with Justice

Mishra and the other three judges, has opined that in the very country of its birth, the principle of Westminster has been given a decent burial and in that country where the phrase "tax avoidance" originated the judicial attitude towards tax avoidance has changed and the Courts are now concerning themselves not merely with the genuineness of a transaction, but with the intended effect of it for fiscal purposes. Justice Reddy also opined that no one can get away with the tax avoidance project with the mere statement that there is nothing illegal about it. Justice Reddy has also opined that the ghost of Westminster (in the words of Lord Roskill) has been exorcised in England. In our view, what transpired in England is not the ratio of McDowell and cannot be and remains merely an opinion or view.

111. Confusion arose (see Paragraph 46 of the judgment) when Justice Mishra has stated after referring to the concept of tax planning as follows:

> "On this aspect, one of us Chinnappa Reddy, J. has proposed a separate and detailed opinion with which we agree."

112. Justice Reddy, we have already indicated, himself has stated that he is entirely agreeing with Justice Mishra and has only supplemented what Justice Mishra has stated on Tax Avoidance, therefore, we have go by what Justice Mishra has spoken on tax avoidance.

113. Justice Reddy has depreciated the practice of setting up of Tax Avoidance Projects, in our view, rightly because the same is/was the situation in England and ***Ramsay*** and other judgments had depreciated the Tax Avoidance Schemes.

114. In our view, the ratio of the judgment is what is spoken by Justice Mishra for himself and on behalf of three other judges, on which Justice Reddy has agreed. Justice Reddy has clearly stated that he is only supplementing what Justice Mishra has said on Tax avoidance.

115. Justice Reddy has endorsed the view of Lord Roskill that the ghost of Westminster had been exorcised in England and that one should not allow its head rear over

India. If one scans through the various judgments of the House of Lords in England, which we have already done, one thing is clear that it has been a cornerstone of law, that a tax payer is enabled to arrange his affairs so as to reduce the liability of tax and the fact that the motive for a transaction is to avoid tax does not invalidate it unless a particular enactment so provides (Westminster Principle). Needless to say if the arrangement is to be effective, it is essential that the transaction has some economic or commercial substance. Lord Roskill's view is not seen as the correct view so also Justice Reddy's, for the reasons we have already explained in earlier part of this judgment.

116. A five Judges Bench judgment of this Court in ***Mathuram Agrawal v. State of Madhya Pradesh*** (1999) 8 SCC 667, after referring to the judgment in ***B.C. Kharwar*** (supra) as well as the opinion expressed by Lord Roskill on ***Duke of Westminster*** stated that the subject is not to be taxed by inference or analogy, but only by the plain words of a statute applicable to the facts and circumstances of each case.

117. Revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury.Revenue's stand that the ratio laid down in McDowell is contrary to what has been laid down in ***Azadi Bachao Andolan***, in our view, is unsustainable and, therefore, calls for no reconsideration by a larger branch.

PART-IV

CGP AND ITS INTERPOSITION

118. CGP's interposition in the HTIL Corporate structure and its disposition, by way of transfer, for exit, was for a commercial or business purpose or with an ulterior motive for evading tax, is the next question. Parties, it is trite, are free to choose whatever lawful arrangement which will suit their business and commercial purpose, but the true nature of the transaction can be ascertained only by looking into the legal arrangement actually entered into and carried out.

Indisputedly, that the contracts have to be read holistically to arrive at a conclusion as to the real nature of a transaction. Revenue's stand was that the CGP share was a mode or mechanism to achieve a transfer of control, so that the tax be imposed on the transfer of control not on transfer of the CGP share. Revenue's stand, relying upon ***Dawson*** test, was that CGP's interposition in the Hutchison structure was an arrangement to deceive the Revenue with the object of hiding or rejecting the tax liability which otherwise would incur.

119. Revenue contends that the entire corporate structure be looked at as on artificial tax avoidance scheme wherein CGP was introduced into the structure at the last moment, especially when another route was available for HTIL to transfer its controlling interest in HEL to Vodafone. Further it was pointed out that the original idea of the parties was to sell shares in HEL directly but at the last moment the parties changed their mind and adopted a different route since HTIL wanted to declare a special dividend out of US $

11 million for payment and the same would not have been possible if they had adopted Mauritian route.

120. Petitioner pointed out that if the motive of HTIL was only to save tax it had the option to sell the shares of Indian companies directly held Mauritius entities, especially when there is no LOB clause in India-Mauritius Treaty. Further, it was pointed out that if the Mauritius companies had sold the shares of HEL, then Mauritius companies would have continued to be the subsidiary of HTIL, their account could have been consolidated in the hands of HTIL and HTIL would have accounted for the accounts exactly the same way that it had accounted for the accounts in HTIL BVI/nominated payee. Had HTIL adopted the Mauritius route, then it would have been cumbersome to sell the shares of a host of Mauritian companies.

121. CGP was incorporated in the year 1998 and the same became part of the Hutchison Corporate structure in the year 2005. Facts would clearly indicate that the CGP held shares in Array and Hutchison Teleservices (India) Holdings Limited

(MS), both incorporated in Mauritius. HTIL, after acquiring the share of CGP (CI) in the year 1994 which constituted approximately 42% direct interest in HEL, had put in place various FWAs, SHAs for arranging its affairs so that it can also have interest in the functioning of HEL along with Indian partners.

122. Self centred operations in India were with 3GSPL an Indian company which held options through various FWAs entered into with Indian partners. <u>One of the tests to examine the genuineness of the structure is the "timing test" that is timing of the incorporation of the entities or transfer of shares etc. Structures created for genuine business reasons are those which are generally created or acquired at the time when investment is made, at the time where further investments are being made at the time of consolidation etc.</u>

123. HTIL preferred CGP route rather than adopting any other method (why ?) for which we have to examine whether HTIL has got any justification for adopting this route, for sound commercial reasons or purely for evasion of tax. In

international investments, corporate structures are designed to enable a smooth transition which can be by way of divestment or dilution. Once entry into the structure is honourable, exits from the structure can also be honourable.

124. HTIL structure was created over a period of time and this was consolidated in 2004 to provide a working model by which HTIL could make best use of its investments and exercise control over and strategically influence the affairs of HEL. HTIL in its commercial wisdom noticed the disadvantage of preferring Array, which would have created problems for HTIL. Hutchison Teleservices (India) Mauritius had a subsidiary, namely 3GSPL which carried on the call centre business in India and the transfer of CGP share would give control over 3GSPL, an indirect subsidiary which was incorporated in the year 1999. It would also obviate problems arising on account of call and put options arrangements and voting rights enjoyed by 3GSPL. If Array was transferred, the disadvantage was that HTIL had to deal with call and put options of 3GSPL. In the above circumstances, HTIL in their commercial wisdom thought of

transferring CGP share rather than going for any other alternatives. Further 3GSPL was also a party to various agreements between itself and the companies of AS, AG and IDFC Group. If Array had been transferred the disadvantage would be that the same would result in hiving off the call centre business from 3GSPL. Consolidation operations of HEL were evidently done in the year 2005 not for tax purposes but for commercial reasons and the contention that CGP was inserted at a very late stage in order to bring a pre tax entity or to create a transaction that would avoid tax, cannot be accepted.

125. The Revenue has no case that HTIL structure was a device or an artifice, but all along the contention was that CGP was interposed at the last moment and applying the ***Dawson*** test, it was contended that such an **artificially interposed device** be ignored, and applying ***Ramsay*** test of **purposive interpretation**, the transaction be taxed for gain. CGP, it may be noted, was already part of the HTIL's Corporate Structure and the decision taken to sell CGP (Share) so as to exit from the Indian Telecom Sector was not

the fall out of a tax exploitation scheme, but a genuine commercial decision taking into consideration the best interest of the investors and the corporate entity.

126. Principle of **Fiscal nullity** was applied by Vinelott, J. in favour of the assessee in ***Dawson***, where the judge rejected the contention of the Crown that the transaction was hit by the ***Ramsay*** principle, holding that a transaction cannot be disregarded and treated as **fiscal nullity** if it has enduring legal consequences. Principle was again explained by Lord Brightman stating that the ***Ramsay*** test would apply not only where the steps are **pre-contracted**, but also they are **pre-ordained,** if there is no contractual right and in all likelihood the steps would follow. On **Fiscal nullity**, Lord Brightman again explained that there should be a **pre-ordained** series of transactions and there should be steps inserted that have no commercial purpose and the inserted steps are to be disregarded for fiscal purpose and, in such situations, Court must then <u>**look at**</u> the end result, precisely how the end result will be taxed will depend on terms of the taxing statute sought to be applied. <u>Sale of CGP share, for exiting from the Indian Telecommunication Sector, in our</u>

view, cannot be considered as pre-ordained transaction, with no commercial purpose, other than tax avoidance. Sale of CGP share, in our view, was a genuine business transaction, not a fraudulent or dubious method to avoid capital gains tax.

SITUS OF CGP

127. Situs of CGP share stands where, is the next question. Law on situs of share has already been discussed by us in the earlier part of the judgment. Situs of shares situates at the place where the company is incorporated and/ or the place where the share can be dealt with by way of transfer. CGP share is registered in Cayman Island and materials placed before us would indicate that Cayman Island law, unlike other laws does not recognise the multiplicity of registers. Section 184 of the Cayman Island Act provides that the company may be exempt if it gives to the Registrar, a declaration that "operation of an exempted company will be conducted mainly outside the Island". Section 193 of the Cayman Island Act expressly recognises that even exempted

companies may, to a limited extent trade within the Islands. Section 193 permits activities by way of trading which are incidental of off shore operations also all rights to enter into the contract etc. The facts in this case as well as the provisions of the Caymen Island Act would clearly indicate that the CGP (CI) share situates in Caymen Island. The legal principle on which situs of an asset, such as share of the company is determined, is well settled. Reference may be made to the judgments in ***Brassard*** *v.* ***Smith*** [1925] AC 371, ***London and South American Investment Trust*** *v.* ***British Tobacco Co. (Australia)*** [1927] 1 Ch. 107. ***Erie Beach Co. v. Attorney-General for Ontario***, 1930 AC 161 PC 10, ***R.*** v. ***Williams*** [1942] AC 541. Situs of CGP share, therefore, situates in Cayman Islands and on transfer in Cayman Islands would not shift to India.

PART-V

128. Sale of CGP, on facts, we have found was not the fall out of an artificial tax avoidance scheme or an artificial device, pre-ordained, or pre-conceived with the sole object of tax avoidance, but was a genuine commercial decision to exit from the Indian Telecom Sector.

129. HTIL had the following controlling interest in HEL before its exit from the Indian Telecom Sector:-

1. HTIL held its direct equity interest in HEL amounting approximately to 42% through eight Mauritius companies.

2. HTIL indirect subsidiary CGP(M) held 37.25% of equity interest in TII, an Indian Company, which in turn held 12.96% equity interest in HEL. CGP(M), as a result of its 37.25% interest in TII had an interest in several downstream companies which held interest in HEL, as a result of which HTIL obtained indirect equity interest of 7.24% in HEL.

3. HTIL held in Indian Company Omega Holdings, an Indian Co., interest to the extent of 45.79% of share capital through HTIM which held shareholding of 5.11% in HEL, resulting in holding of 2.34% interest in the Indian Company HEL.

HTIL could, therefore, exercise its control over HEL, through the voting rights of its indirect subsidiary Array (Mauritius) which in turn controlled 42% shares through Mauritian Subsidiaries in HEL. Mauritian subsidiaries controlled 42% voting rights in HEL and HTIL could not however exercise voting rights as stated above, in HEL directly but only through indirect subsidiary CGP(M) which in turn held equity interest in TII, an Indian company which held equity interest in HEL.

HTIL likewise through an indirect subsidiary HTI(M), which held equity interest in Omega an Indian company which held equity interest in HEL, could exercise only indirect voting rights in HEL

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130. HTIL, by holding CGP share, got control over its WOS Hutchison Tele Services (India) Holdings Ltd (MS). HTSH(MS) was having control over its WOS 3GSPL, <u>an Indian company which exercised voting rights in HEL. HTIL, therefore, by holding CGP share, had 52% equity interest, direct 42% and approximately 10% (pro rata) indirect in HEL and not 67% as contended by the Revenue</u>.

131. HTIL had 15% interest in HEL by virtue of FWAs, SHAs Call and Put Option Agreements and Subscription Agreements and not controlling interest as such in HEL. HTIL, by virtue of those agreements, had the following interests:-

(i) Rights (and Options) by providing finance and guarantee to Asim Ghosh Group of companies to exercise control over TII and indirectly over HEL through TII Shareholders Agreement and the Centrino Framework Agreement dated 1.3.2006;

(ii) Rights (and Options) by providing finance and guarantee to Analjit Singh Group of companies to exercise control over TII and indirectly over HEL through various TII shareholders agreements and the N.D. Callus Framework Agreement dated 1.3.2006.

(iii) Controlling rights over TII through the TII Shareholder's Agreement in the form of rights to appoint two directors with veto power to promote its interest in HEL and thereby hold beneficial interest in 12.30% of the share capital of the in HEL.

(iv) Finance to SMMS to acquire shares in ITNL (formerly Omega) with right to acquire the share capital of Omega in future.

(v) Rights over ITNL through the ITNL Shareholder's Agreement, in the form of right to appoint two directors with veto power to promote its interests in HEL and thereby it held beneficial interest in 2.77% of the share capital of the Indian company HEL;

(vi) Interest in the form of loan of US$231 million to HTI (BVI) which was assigned to Array Holdings Ltd.;

(vii) Interest in the form of loan of US$ 952 million through HTI (BVI) utilized for purchasing shares in the Indian company HEL by the 8 Mauritius companies;

(viii) Interest in the form of Preference share capital in JKF and TII to the extent of US$ 167.5 million and USD 337 million respectively. These two companies hold 19.54% equity in HEL.

(ix) Right to do telecom business in India through joint venture;

(x) Right to avail of the telecom licenses in India and right to do business in India;

(xi) Right to use the Hutch brand in India;

(xii) Right to appoint/remove directors in the board of the Indian company HEL and its other Indian subsidiaries;

(xiii) Right to exercise control over the management and affairs of the business of the Indian company HEL (Management Rights);

(xiv) Right to take part in all the investment, management and financial decisions of the Indian company HEL;

(xv) Right to control premium;

(xvi) Right to consultancy support in the use of Oracle license for the Indian business;

Revenue's stand before us was that the SPA on a commercial construction brought about an **extinguishment** of HTIL's rights of **management and control** over HEL, resulting in transfer of capital asset in India. Further, it was pointed out that the assets, rights and entitlements are property rights pertaining to HTIL and its subsidiaries and the transfer of CGP share would have no effect on the Telecom operations in India, but for the transfer of the above assets, rights and entitlements. SPA and other agreements, if examined, as a whole, according to the Revenue, leads to the conclusion that the **substance** of the transaction was the transfer of various property rights of HTIL in HEL to Vodafone attracting capital gains tax in India. Further, it was pointed out that moment CGP share was transferred off-shore, HTIL's right of control over HEL and its subsidiaries **stood extinguished**, thus leading to **income indirectly earned**, outside India through the medium of sale of the CGP share. All these issues have to be examined without forgetting the fact that we are dealing with a taxing statute and the Revenue has to bring home all its contentions within the four corners of taxing statute and not on assumptions and presumptions.

132. Vodafone on acquisition of CGP share got controlling interest of 42% over HEL/VEL through voting rights through eight Mauritian subsidiaries, the same was the position of HTIL as well. On acquiring CGP share, CGP has become a direct subsidiary of Vodafone, but both are legally independent entities. Vodafone does not own any assets of CGP. Management and the business of CGP vests on the Board of Directors of CGP but of course, Vodafone could appoint or remove members of the Board of Directors of

CGP. On acquisition of CGP from HTIL , Array became an indirect subsidiary of Vodafone. Array is also a separate legal entity managed by its own Board of Directors. Share of CGP situates in Cayman Islands and that of Array in Mauritius. Mauritian entities which hold 42% shares in HEL became the direct and indirect subsidiaries of Array, on Vodafone purchasing the CGP share. <u>Voting rights, controlling rights, right to manage etc., of Mauritian Companies vested in those companies. HTIL has never sold nor Vodafone purchased any shares of either Array or the Mauritian subsidiaries, but only CGP, the share of which situates in Cayman Islands</u>. By purchasing the CGP share its situs will not shift either to Mauritius or to India, a legal issue, already explained by us. Array being a WOS of CGP, CGP may appoint or remove any of its directors, if it wishes by a resolution in the general body of the subsidiary, but CGP, Array and all Mauritian entities are separate legal entities and have de-centralised management and each of the Mauritian subsidiaries has its own management personnels.

133. Vodafone on purchase of CGP share got controlling interest in the Mauritian Companies and the incident of transfer of CGP share cannot be considered to be two distinct and separate transactions, one shifting of the share and another shifting of the controlling interest. Transfer of CGP share automatically results in host of consequences including transfer of controlling interest and that controlling interest as such cannot be dissected from CGP share without legislative intervention. Controlling interest of CGP over Array is an incident of holding majority shares and the control of Company vests in the voting power of its shareholders. Mauritian entities being a WOS of Array, Array as a holding Company can influence the shareholders of various Mauritian Companies. Holding Companies like CGP, Array, may exercise control over the subsidiaries, whether a WOS or otherwise by influencing the voting rights, nomination of members of the Board of Directors and so on. On transfer of shares of the holding Company, the controlling interest may also pass on to the purchaser along with the shares. Controlling interest might have percolated down the line to the operating companies but that

<u>controlling interest is inherently contractual and not a property right unless otherwise provided for in the statue.</u> Acquisition of shares, may carry the acquisition of controlling interest which is purely a commercial concept and the tax can be levied only on the <u>**transaction**</u> and not on its <u>**effect.**</u> Consequently, on transfer of CGP share to Vodafone, Vodafone got control over eight Mauritian Companies which owned shares in VEL totalling to 42% and that does not mean that the situs of CGP share has shifted to India for the purpose of charging capital gains tax.

134. Vodafone could exercise only indirect voting rights in VEL through its indirect subsidiary CGP(M) which held equity interests in TII, an Indian Company, which held equity interests in VEL. Similarly, Vodafone could exercise only indirect voting rights through HTI(M) which held equity interests in Omega, an Indian Company which in turn held equity interests in HEL. On transfer of CGP share, Vodafone gets controlling interest in its indirect subsidiaries which are situated in Mauritius which have equity interests in TII and Omega, Indian Companies which are independent

legal entities. Controlling interest, which stood transferred to Vodafone from HTIL accompany the CGP share and cannot be dissected so as to be treated as transfer of controlling interest of Mauritian entities and then that of Indian entities and ultimately that of HEL. Situs of CGP share, therefore, determines the transferability of the share and/or interest which flows out of that share including controlling interest. Ownership of shares, as already explained by us, carries other valuable rights like, right to receive dividend, right to transmit the shares, right to vote, right to act as per one's wish, or to vote in a particular manner etc; and on transfer of shares those rights also sail along with them.

135. Vodafone, on purchase of CGP share got all those rights, and the price paid by Vodafone is for all those rights, in other words, **control premium** paid, not over and above the CGP share, but is the integral part of the price of the share. On transfer of CGP share situated in Cayman Islands, the entire rights, which accompany stood transferred not in India, but offshore and the facts reveal

that the offshore holdings and arrangements made by HTIL and Vodafone were for sound commercial and legitimate tax planning, not with the motive of evading tax.

136. Vodafone, on purchase of CGP share also got control over its WOS, HTSH(M) which is having control over its WOS, 3GSPL, an Indian Company which exercised voting rights in HEL. 3GSPL, was incorporated on 16.03.99 and run call centre business in India. The advantage of transferring share of CGP rather than Array was that it would obviate the problems arising on account of the <u>call</u> and <u>put</u> agreements and <u>voting rights</u> enjoyed by 3GSPL. 3GSPL was also a party to various agreements between itself and Companies of AS, AG and IDFC Groups. AS , AG & IDFC have agreed to retain their shareholdings with full control including voting rights and dividend rights. In fact, on 02.03.2007 AG wrote to HEL confirming that his indirect equity or beneficial interest in HEL worked out to be as 4.68% and it was stated, <u>he was the beneficiary of full dividend rights attached to his shares and he had received credit support and primarily the liability for re-payment was</u>

<u>of his company</u>. Further, it was also pointed out that he was the exclusive beneficial owner of his shares in his companies, enjoying full and exclusive rights to vote and participate in any benefits accruing to those shares. On 05.03.2007 AS also wrote to the Government on the same lines.

137. Vodafone, on acquisition of CGP, is in a position to replace the directors of holding company of 3GSPL so as to get control over 3GSPL. 3GSPL has call option as well as the obligation of the put option. Rights and obligations which flow out of call and put options have already been explained by us in the earlier part of the judgment. **<u>Call</u>** and **<u>put options</u>** are contractual rights and do not sound in property and hence they cannot be, in the absence of a statutory stipulation, considered as capital assets. Even assuming so, they are in favour of 3GSPL and continue to be so even after entry of Vodafone.

138. We have extensively dealt with the terms of the various FWAs, SHAs and Term Sheets and in none of those

Agreements HTIL or Vodafone figure as parties. SHAs between Mauritian entities (which were shareholders of the Indian operating Companies) and other shareholders in some of the other operating companies in India held shares in HEL related to the management of the subsidiaries of AS, AG and IDFC and did not relate to the management of the affairs of HEL and HTIL was not a party to those agreements, and hence there was no question of assigning or relinquishing any right to Vodafone.

139. IDFC FWA of August 2006 also conferred upon 3 GSPL only call option rights and a right to nominate a buyer if investors decided to exit as long as the buyer paid a fair market value. June 2007 Agreement became necessary because the composition of Indian investors changed with some Indian investors going out and other Indian investors coming in. On June 2007, changes took place within the Group of Indian investors, in that SSKI and IDFC went out leaving IDF alone as the Indian investor. Parties decided to keep June 2007 transaction to effectuate their intention within the broad contours of June 2006 FWA. On

06.06.2007 FWA has also retained the rights and options in favour of 3GSPL but conferred no rights on Vodafone and Vodafone was only a confirming party to that Agreement. Call and put options, we have already mentioned, were the subject matter of three FWAs viz., Centrino, N.D. Callus, IDFC and in Centrino and N.D. Callus FWAs, neither HTIL was a party, nor was Vodafone. HTIL was only a confirming party in IDFC FWA, so also Vodafone. Since HTIL, and later Vodafone were not parties to those SHAs and FWAs, we fail to see how they are bound by the terms and conditions contained therein, so also the rights and obligations that flow out of them. HTIL and Vodafone have, of course, had the interest to see the SHAs and FWAs, be put in proper place but that interest cannot be termed as property rights, attracting capital gains tax.

140. We have dealt with the legal effect of exercising call option, put option, tag along rights, ROFR, subscription rights and so on and all those rights and obligations we have indicated fall within the realm of contract between various shareholders and interested parties and in any view,

are not binding on HTIL or Vodafone. Rights (and options) by providing finance and guarantee to AG Group of Companies to exercise control over TII and indirectly over HEL through TII SHA and Centrino FWA dated 01.03.2006 were only contractual rights, as also the revised SHAs and FWAs entered into on the basis of SPA. Rights (and options) by providing finance and guarantee to AS Group of Companies to exercise control over TII and indirectly over HEL through various TII SHAs and N.D. Callus FWA dated 01.03.2006 were also contractual rights, and continue to be so on entry of Vodafone.

141. Controlling right over TII through TII SHAs in the form of right to appoint two Directors with veto power to promote its interest in HEL and thereby held beneficial interest in 12.30% of share capital in the HEL are also contractual rights. Finance to SMMS to acquire shares in ITNL (ultimately Omega) with right to acquire share capital of Omega were also contractual rights between the parties. On transfer of CGP share to Vodafone corresponding

rearrangement were made in the SHAs and FWAs and Term Sheet Agreements in which Vodafone was not a party.

142. SPA, through the transfer of CGP, indirectly conferred the benefit of put option from the transferee of CGP share to be enjoyed in the same manner as they were enjoyed by the transferor and the revised set of 2007 agreements were exactly between the parties that is the beneficiary of the put options remained with the downstream company 3 GSPL and the counter-party of the put option remained with AG/AS Group Companies.

143. Fresh set of agreements of 2007 as already referred to were entered into between IDFC, AG, AS, 3 GSPL and Vodafone andin fact, those agreements were irrelevant for the transfer of CGP share. FWAs with AG and AS did not constitute transaction documents or give rise to a transfer of an asset, so also the IDFC FWA. All those FWAs contain some adjustments with regard to certain existing rights, however, the options, the extent of rights in relation to options, the price etc. all continue to remain in place as

they stood. Even if they had not been so entered into, all those agreements would have remained in place because they were in favour of 3GSPL, subsidiary of CGP.

144. The High Court has reiterated the common law principle that the controlling interest is an incident of the ownership of the share of the company, something which flows out of holding of shares and, therefore, not an identifiable or distinct capital asset independent of the holding of shares, but at the same time speaks of change in the controlling interest of VEL, without there being any transfer of shares of VEL. Further, the High Court failed to note on transfer of CGP share, there was only transfer of certain off-shore loan transactions which is unconnected with underlying controlling interest in the Indian Operating Companies. The other rights, interests and entitlements continue to remain with Indian Operating Companies and there is nothing to show they stood transferred <u>in law</u>.

145. The High Court has ignored the vital fact that as far as the put options are concerned there were pre-existing agreements between the beneficiaries and counter parties

and fresh agreements were also on similar lines. Further, the High Court has ignored the fact that Term Sheet Agreement with Essar had nothing to do with the transfer of CGP, which was a separate transaction which came about on account of independent settlement between Essar and Hutch Group, for a separate consideration, unrelated to the consideration of CGP share. The High Court committed an error in holding that there were some rights vested in HTIL under SHA dated 5.7.2003 which is also an agreement, conferring no right to any party and accordingly none could have been transferred. The High Court has also committed an error in holding that some rights vested with HTIL under the agreement dated 01.08.2006, in fact, that agreement conferred right on Hutichison Telecommunication (India) Ltd., which is a Mauritian Company and not HTIL, the vendor of SPA. The High court has also ignored the vital fact that FIPB had elaborately examined the nature of call and put option agreement rights and found no right in presenti has been transferred to Vodafone and that as and when rights are to be transferred by AG and AS Group Companies, it would specifically require Government permission since such a sale would attract capital gains, and may be independently taxable. We may now examine whether the following rights and entitlements would also amount to capital assets attracting capital gains tax on transfer of CGP share.

Debts/Loans through Intermediaries

146. SPA contained provisions for assignment of loans either at Mauritius or Cayman Islands and all loans were assigned at the face value. Clause 2.2 of the SPA stipulated that HTIL shall procure the assignment of and purchaser agrees to accept an assignment of loans free from encumbrances together with all rights attaching or accruing to them at completion. Loans were defined in the SPA to mean, all inter-company loans owing by CGP and Array to a vendor group company including accrued or unpaid interest, if any, on the completion date. HTIL warranted and undertook that, as on completion, loans set out in Part IV of Schedule 1 shall be the only indebtedness owing by the Wider group company to any member of the vendor group. Vendor was obliged to procure that the loans set out in Part

IV of Schedule 1 shall not be repaid on or before completion and further, that any loan in addition to those identified will be non-interest bearing. Clause 7.4 of the SPA stipulated that any loans in addition to those identified in Part IV of Schedule 1 of the SPA would be non-interest bearing and on terms equivalent to the terms of those loans identified in Part IV of Schedule 1 of the SPA. The sum of such indebtedness comprised of:

a) US$ 672,361,225 (Loan 1) – reflected in a Loan Agreement (effective date of loan: 31 December 2006; date of Loan Agreement: 28 April 2007);

b) HK$ 377,859,382.40 (Loan 2) – reflected in a Loan Agreement (effective date of Loan 31st December 2006; date of Loan Agreement: 28 April 2007) [(i) + (ii): US$ 1,050,220,607.40]

c) US$ 231,111,427.41 (Loan 3) – reflected in a Receivable Novation Agreement i.e. HTM owed HTI BVI Finance such sum, which Array undertook to repay in pursuance of an inter-group loan restructuring, which was captured in such Receivable Novation Agreement dated 28 April 2007.

HTI BVI Finance Limited, Array and Vodafone entered into a Deed of Assignment on 08.05.2007 pertaining to the Array indebtedness. On transfer of CGP shares, Array became a subsidiary of VIHBV. The price was calculated on a gross asset basis (enterprise value of underlying assets), the intra group loans would have to be assigned at face value, since nothing was payable by VIHBV for the loans as they had already paid for the gross assets.

147. CGP had acknowledged indebtedness of HTI BVI Finance Limited in the sum of US$161,064,952.84 as at the date of completion. The sum of such indebtedness was comprised of:

a) US$ 132,092,447.14, reflected in a Loan Agreement (effective date of loan: 31 December 2006; date of Loan Agreement: 28 April 2007)

b) US$ 28,972,505.70, reflected in a Loan Agreement (effective date of loan: 14 February 2007; date of Loan Agreement: 15 February 2007).

HTI BVI Finance Limited Limited, CGP and the Purchaser entered into the Deed of Assignment on 08.05.2007 pertaining to the CGP indebtedness.

148. In respect of Array Loan No. 3 i.e. US$ 231,111,427.41, the right that was being assigned was not the right under a Loan Agreement, but the right to receive payment from Array pursuant to the terms of a Receiveable Novation Agreement dated 28.04.2007 between Array, HTIL

and HTI BVI Finance Limited. Under the terms of the Receiveable Novation Agreement, HTIL's obligation to repay the loan was novated from HTI BVI Finance to Array, the consideration for this novation was US$ 231,111,427.41 payable by Array to HTI BVI Finance Limited. It was this right to receive the amount from Array that was assigned to VHI BV under the relevant Loan Assignment. It was envisaged that, between signing and completion of the agreement, there would be a further loan up to US$ 29.7 million between CGP (as borrower) from a Vendor Group Company (vide Clause 6.4 of the SPA) and the identity of the lender has not been identified in the SPA. The details of the loan were ultimately as follows:

Borrower	**Lender**	**Amount of Loan**	**Date of Agreement**	**Effective date of Agreement**
CGP	HTI (BVI) Finance Limited	US$28,972,505.70	15 February 2007	14 February 2007

Array and CGP stood outside of obligation to repay an aggregate US$ 1,442,396.987.61 to HTI BVI Finance Limited and VHIBV became the creditor of Array and CGP in the place and stepped off a HTI BVI Finance Limited on 8.5.2007 when VHIBV stepped into the shoes of HTI BVI Finance Limited.

149. Agreements referred to above including the provisions for assignments in the SPA, indicate that all loan agreements and assignments of loans took place outside India at face value and, hence, there is no question of transfer of any capital assets out of those transactions in India, attracting capital gains tax.

Preference Shares:

150. Vodafone while determining bid price had taken into consideration, *inter alia*, its ownership of redeemable preference shares in TII and JFK. Right to preference shares or rights thereto cannot be termed as transfer in terms of Section 2(47) of the Act. Any agreement with TII, Indian partners contemplated fresh investment, by subscribing to the preference shares were redeemable only by accumulated profit or by issue of fresh capital and hence any issue of fresh

capital cannot be equated to the continuation of old preference shares or transfer thereof.

NON COMPETE AGREEMENT

151. SPA contains a Non Compete Agreement which is a pure Contractual Agreement, a negative covenant, the purpose of which is only to see that the transferee does not immediately start a compete business. At times an agreement provides that a particular amount to be paid towards non-compete undertaking, in sale consideration, which may be assessable as business income under Section 28(va) of the IT Act, which has nothing to do with the transfer of controlling interest. However, a non-compete agreement as an adjunct to a share transfer, which is not for any consideration, cannot give rise to a taxable income. In our view, a non-compete agreement entered into outside India would not give rise to a taxable event in India. An agreement for a non-compete clause was executed offshore and, by no principle of law, can be termed as “property” so as

to come within the meaning of capital gains taxable in India in the absence of any legislation.

HUTCH BRAND

152. HTIL did not have any direct interest in the brand. The facts would indicate that brand/Intellectual Property Right were held by Hutchison Group Company based in Luxemburg. SPA only assured Vodafone that they would not have to overnight cease the use of the Hutch brand name, which might have resulted in a disruption of operations in India. The bare license to use a brand free of charge, is not itself a “property” and, in any view, if the right to property is created for the first time and that too free of charge, it cannot give rise to a chargeable income. Under the SPA, a limited window of license was given and it was expressly made free of charge and, therefore, the assurance given by HTIL to Vodafone that the brand name would not cease overnight, cannot be described as “property” rights so as to consider it as a capital asset chargeable to tax in India.

ORACLE LICENSE:

153. Oracle License was an accounting license, the benefit of which was extended till such time VEL replaced it with its own accounting package. There is nothing to show that this accounting package, which is a software, was transferred to Vodafone. In any view, this license cannot be termed as a capital asset since it has never been transferred to the petitioner.

154. We, therefore, conclude that on transfer of CGP share, HTIL had transferred only 42% equity interest it had in HEL and approximately 10% (pro-rata) to Vodafone, the transfer was off-shore, money was paid off-shore, parties were no-residents and hence there was no transfer of a capital asset situated in India. Loan agreements extended by virtue of transfer of CGP share were also off-shore and hence cannot be termed to be a transfer of asset situated in India. Rights and entitlements referred to also, in our view, cannot be termed as capital assets, attracting capital gains tax and even after transfer of CGP share, all those rights and

entitlements remained as such, by virtue of various FWAs, SHAs, in which neither HTIL nor Vodafone was a party.

155. Revenue, however, wanted to bring in all those rights and entitlements within the ambit of Section 9(1)(i) on a liberal construction of that Section applying the principle of purposive interpretation and hence we may examine the scope of Section 9.

PART VI

SECTION 9 AND ITS APPLICATION

156. Shri Nariman, submitted that this Court should give a purposive construction to Section 9(1) of the Income Tax Act when read along with Section 5(2) of the Act. Referring extensively to the various provisions of the Income Tax Act, 1922, and also Section 9(1)(i), Shri Nariman contended that the expression “transfer” in Section 2(47) read with Section 9 has to be understood as an inclusive definition comprising of both direct and indirect transfers so as to expand the scope of Section 9 of the Act. Shri Nariman also submitted

that the object of Section 9 would be defeated if one gives undue weightage to the term "situate in India", which is intended to tax a non-resident who has a source in India. Shri Nariman contended that the effect of SPA is not only to effect the transfer of a solitary share, but transfer of rights and entitlements which falls within the expression "capital asset" defined in Section 2(14) meaning property of any kind held by the assessee. Further, it was stated that the word "property" is also an expression of widest amplitude and would include anything capable of being raised including beneficial interest. Further, it was also pointed out that the SPA extinguishes all the rights of HTIL in HEL and such extinguishment would fall under Section 2(47) of the Income Tax Act and hence, a capital asset.

157. Shri Harish Salve, learned senior counsel appearing for the petitioner, submitted that Section 9(1)(i) of the Income Tax Act deals with taxation on income "deemed to accrue or arise" in India through the transfer of a capital asset situated in India and stressed that the source of income lies where the transaction is effected and not where

the economic interest lies and pointed out that there is a distinction between a legal right and a contractual right. Referring to the definition of "transfer" in Section 2(47) of the Income Tax Act which provides for extinguishment, it was submitted, that the same is attracted for transfer of a legal right. Placing reliance on the judgment of this Court in ***Commissioner of Income Tax*** *v.* ***Grace Collins and Others,*** 248 ITR 323, learned senior counsel submitted that SPA has not relinquished any right of HTIL giving rise to capital gains tax in India.

158. Mr. S.P. Chenoy, senior counsel, on our request, argued at length, on the scope and object of Section 9 of the Income Tax Act. Learned senior counsel submitted that the first four clauses/parts of Section 9(1)(i) deal with taxability of revenue receipts, income arising through or from holding an asset in India, income arising from the transfer of an asset situated in India. Mr. Chenoy submitted that only the last limb of Section 9(1)(i) deals with the transfer of a capital asset situated in India and can be taxed as a capital receipt. Learned senior counsel submitted to apply Section 9(1)(i) the capital asset must situate in India and cannot by

a process of interpretation or construction extend the meaning of that section to cover indirect transfers of capital assets/properties situated in India. Learned senior counsel pointed out that there are cases, where the assets/shares situate in India are not transferred, but where the shares of foreign company holding/owning such shares are transferred.

159. Shri Mohan Parasaran, Additional Solicitor General, submitted that on a close analysis of the language employed in Section 9 and the various expressions used therein, would self-evidently demonstrate that Section 9 seeks to capture income arising directly or indirectly from direct or indirect transfer. Shri Parasaran submitted, if a holding company incorporated offshore through a maze of subsidiaries, which are investment companies incorporated in various jurisdictions indirectly contacts a company in India and seeks to divest its interest, by the sale of shares or stocks, which are held by one of its upstream subsidiaries located in a foreign country to another foreign company and the foreign company step into the shoes of the

holding company, then Section 9 would get attracted. Learned counsel submitted that it would be a case of indirect transfer and a case of income accruing indirectly in India and consequent to the sale of a share outside India, there would be a transfer or divestment or extinguishment of holding company's rights and interests, resulting in transfer of capital asset situated in India.

160. Section 9 of the Income Tax Act deals with the incomes which shall be deemed to accrue or arise in India. Under the general theory of nexus relevant for examining the territorial operation of the legislation, two principles that are generally accepted for imposition of tax are: (a) Source and (b) Residence. Section 5 of the Income Tax Act specifies the principle on which tax can be levied. Section 5(1) prescribes "residence" as a primary basis for imposition of tax and makes the global income of the resident liable to tax. Section 5(2) is the source based rule in relation to residents and is confined to: income that has been received in India; and income that has accrued or arisen in India or income that is deemed to accrue or arise in India. In the case of Resident in

India, the total income, according to the residential status is as under:

> (a) Any income which is received or deemed to be received in India in the relevant previous year by or on behalf of such person;
>
> (b) Any income which accrues or arises or is deemed to accrue or arise in India during the relevant previous year; and
>
> (c) Any income which accrues or arises outside India during the relevant previous year.

In the case of Resident but not Ordinarily Resident in India, the principle is as follows:

> (a) Any income which is received or deemed to be received in India in the relevant previous year by or on behalf of such person;
>
> (b) Any income which accrues or arises or is deemed to accrue or arise in India to him during the relevant previous year; and
>
> (c) Any income which accrues or arises to him outside India during the relevant previous year, if it is derived from a business controlled in or a profession set up in India.

In the case of Non-Resident, income from whatsoever source derived forms part of the total income. It is as follows:

(a) Any income which is received or is deemed to be received in India during the relevant previous year by or on behalf of such person; and

(b) Any income which accrues or arises or is deemed to accrue or arise to him in India during the relevant previous year.

161. Section 9 of the Income Tax Act extends its provisions to certain incomes which are deemed to accrue or arise in India. Four kinds of income which otherwise may not fall in Section 9, would be deemed to accrue or arise in India, which are (a) a business connection in India; (b) a property in India; (c) an establishment or source in India; and (d) transfer of a capital asset in India.

Income deemed to accrue or arise in India
Section 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 orfrom any asset or source of income in India, or through the transfer of a capital asset situate in India.

[*Explanation 1] – For the purposes of this clause –*

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

(b) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;

(c) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India;]

(a) in the case of a non-resident, being –

(1) an individual who is not a citizen of India; or
(2) a firm which does not have any partner who is a citizen of India who is resident in India; or
(3) a company which does not have any shareholder who is a citizen of India or who is resident in India."

162. The meaning that we have to give to the expressions "either directly or indirectly", "transfer", "capital asset" and "situated in India" is of prime importance so as to get a proper insight on the scope and ambit of Section 9(1)(i) of the Income Tax Act. The word "transfer" has been defined in

Section 2(47) of the Income Tax Act. The relevant portion of the same is as under:

> "**2(47)** "Transfer", in relation to a capital asset, includes.-
>
> (i) the sale, exchange or relinquishment of the asset; or
>
> (ii) the extinguishment of any rights therein; or
>
> (iii) the compulsory acquisition thereof under any law; or
>
> (iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or
>
> xxx xxx xxx
> xxx xxx xxx"

The term "capital asset" is also defined under Section 2(14) of the Income Tax Act, the relevant portion of which reads as follows:

> "**2(14)** "Capital asset" means property of any kind held by an assessee, whether or not connected with the business or profession, but does not include-
>
> (i) any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession;
>
> xxx xxx xxx
> xxx xxx xxx"

163. The meaning of the words "either directly or indirectly", when read textually and contextually, would indicate that they govern the words those precede them, namely the words "all income accruing or arising". The section provides that all income accruing or arising, whether directly or indirectly, would fall within the category of income that is deemed to accrue or arise in India. Resultantly, it is only where factually it is established that there is either a business connection in India, or a property in India, or an asset or source in India or a capital asset in India, the transfer of which has taken place, the further question arises whether there is any income deeming to accrue in India from those situations. In relation to the expression "through or from a business connection in India", it must be established in the first instance that (a) there is a non-resident; (b) who has a business connection in India; and (c) income arises from this business connection.

164. Same is the situation in the case of income that "arises through or from a property in India", i.e. (a) there

must be, in the first instance, a property situated in India; and (b) income must arise from such property. Similarly, in the case of "transfer of a capital asset in India", the following test has to be applied: (a) there must be a capital asset situated in India, (b) the capital asset has to be transferred, and (c) the transfer of this asset must yield a gain. The word 'situate', means to set, place, locate. The words "situate in India" were added in Section 9(1)(i) of the Income Tax Act pursuant to the recommendations of the 12th Law Commission dated 26.9.1958.

165. Section 9 on a plain reading would show, it refers to a property that yields an income and that property should have the situs in India and it is the income that arises through or from that property which is taxable. <u>Section 9, therefore, covers only income arising from a transfer of a capital asset situated in India and it does not purport to cover income arising from the indirect transfer of capital asset in India</u>.

SOURCE

166. Revenue placed reliance on “Source Test” to contend that the transaction had a deep connection with India, i.e. ultimately to transfer control over HEL and hence the source of the gain to HTIL was India.

167. Source in relation to an income has been construed to be where the transaction of sale takes place and not where the item of value, which was the subject of the transaction, was acquired or derived from. HTIL and Vodafone are off-shore companies and since the sale took place outside India, applying the source test, the source is also outside India, unless legislation ropes in such transactions.

168. Substantial territorial nexus between the income and the territory which seeks to tax that income, is of prime importance to levy tax. Expression used in Section 9(1)(i) is “source of income in India” which implies that income arises from that source and there is no question of **income arising indirectly** from a source in India. Expression used is

"source of income in India" and not "from a source in India". Section 9 contains a "deeming provision" and in interpreting a provision creating a legal fiction, the Court is to ascertain for what purpose the fiction is created, but in construing the fiction it is not to be extended beyond the purpose for which it is created, or beyond the language of section by which it is created. [See ***C.I.T. Bombay City II v. Shakuntala*** (1962) 2 SCR 871, ***Mancheri Puthusseri Ahmed v. Kuthiravattam Estate Receiver*** (1996) 6 SCC 185].

169. Power to impose tax is essentially a legislative function which finds in its expression Article 265 of the Constitution of India. Article 265 states that no tax shall be levied except by authority of law. Further, it is also well settled that the subject is not to be taxed without clear words for that purpose; and also that every Act of Parliament must be read according to the natural construction of its words. Viscount Simon quoted with approval a passage from Rowlatt, J. expressing the principle in the following words:

> "In a taxing Act one has to look merely at what is clearly said. There is no room for any

> intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used. *[Cape Brandy Syndicate v. IRC* (1921) 1 KB 64, P. 71 (Rowlatt,J.)]"

170. In ***Ransom (Inspector of Tax) v. Higgs*** 1974 3 All ER 949 (HL), Lord Simon stated that it may seem hard that a cunningly advised tax-payer should be able to avoid what appears to be his equitable share of the general fiscal burden and cast it on the shoulders of his fellow citizens. But for the Courts to try to stretch the law to meet hard cases (whether the hardship appears to bear on the individual tax-payer or on the general body of tax-payers as represented by the Inland Revenue) is not merely to make bad law but to run the risk of subverting the rule of law itself. The proper course in construing revenue Acts is to give a fair and reasonable construction to their language without leaning to one side or the other but keeping in mind that no tax can be imposed without words clearly showing an intention to lay the burden and that equitable construction of the words is not permissible [***Ormond Investment Co. v. Betts*** (1928) All ER Rep 709 (HL)], a principle entrenched in our jurisprudence as

well. In ***Mathuram Aggarwal*** (supra), this Court relied on the judgment in ***Duke of Westminster*** and opined that the charging section has to be strictly construed. An invitation to purposively construe Section 9 applying look through provision without legislative sanction, would be contrary to the ratio of ***Mathuram Aggarwal.***

171. Section 9(1)(i) covers only income arising or accruing directly or indirectly or through the transfer of a capital asset situated in India. Section 9(1)(i) cannot by a process of "interpretation" or "construction" be extended to cover "indirect transfers" of capital assets/property situate in India.

172. On transfer of shares of a foreign company to a non-resident off-shore, there is no transfer of shares of the Indian Company, though held by the foreign company, in such a case it cannot be contended that the transfer of shares of the foreign holding company, results in an extinguishment of the foreign company control of the Indian company and it also does not constitute an extinguishment

and transfer of an asset situate in India. Transfer of the foreign holding company's share off-shore, cannot result in an extinguishment of the holding company right of control of the Indian company nor can it be stated that the same constitutes extinguishment and transfer of an asset/ management and control of property situated in India.

173. The Legislature wherever wanted to tax income which arises indirectly from the assets, the same has been specifically provided so. For example, reference may be made to Section 64 of the Indian Income Tax Act, which says that in computing the total income of an individual, there shall be included all such income as arises directly or indirectly: to the son's wife, of such individual, from assets transferred directly or indirectly on and after 1.6.73 to the son's wife by such individual otherwise than for adequate consideration. The same was noticed by this Court in ***CIT*** *v.* ***Kothari (CM)***, (1964) 2 SCR 531. Similar expression like "from asset transfered directly or indirectly", we find in Sections 64(7) and (8) as well. On a comparison of Section 64 and Section 9(1)(i) what is discernible is that the Legislature has not

chosen to extend Section 9(1)(i) to "**indirect transfers**". Wherever "indirect transfers" are intended to be covered, the Legislature has expressly provided so. The words "either directly or indirectly", textually or contextually, cannot be construed to govern the words that follow, but must govern the words that precede them, namely the words "all income accruing or arising". The words "directly or indirectly" occurring in Section 9, therefore, relate to the relationship and connection between a non-resident assessee and the income and these words cannot and do not govern the relationship between the transaction that gave rise to income and the territory that seeks to tax the income. In other words, when an assessee is sought to be taxed in relation to an income, it must be on the basis that it arises to that assessee directly or it may arise to the assessee indirectly. In other words, for imposing tax, it must be shown that there is specific nexus between earning of the income and the territory which seeks to lay tax on that income. Reference may also be made to the judgment of this Court in ***Ishikawajma-Harima Heavy Industries Ltd. v. Director of***

Income Tax, Mumbai (2007) 3 SCC 481 and ***CIT v. R.D. Aggarwal*** (1965) 1 SCR 660.

174. Section 9 has no "look through provision" and such a provision cannot be brought through construction or interpretation of a word 'through' in Section 9. In any view, "look through provision" will not shift the situs of an asset from one country to another. Shifting of situs can be done only by express legislation. ***Federal Commission of Taxation v. Lamesa Holdings BV (LN) – (1998) 157 A.L.R. 290*** gives an insight as to how "look through" provisions are enacted. Section 9, in our view, has no inbuilt "look through mechanism".

175. Capital gains are chargeable under Section 45 and their computation is to be in accordance with the provisions that follow Section 45 and there is no notion of indirect transfer in Section 45.

176. Section 9(1)(i), therefore, in our considered opinion, will not apply to the transaction in question or on the rights

and entitlements, stated to have transferred, as a fall out of the sale of CGP share, since the Revenue has failed to establish both the tests, Resident Test as well the Source Test.

177. Vodafone, whether, could be proceeded against under Section 195(1) for not deducting tax at source and, alternatively, under Section 163 of the Income Tax Act as a representative assessee, is the next issue.

SECTION 195 AND OFFSHORE TRANSACTIONS

178. Section 195 provides that any person responsible for making any payment to a non-resident which is chargeable to tax must deduct from such payment, the income tax at source. Revenue contended that if a non-resident enters into a transaction giving rise to income chargeable to tax in India, the necessary nexus of such non-resident with India is established and the machinary provisions governing the collection of taxes in respect of such chargeable income will spring into operation. Further, it is also the stand of the Revenue that the person, who is a non-resident, and not

having a physical presence can be said to have a presence in India for the purpose of Section 195, if he owns or holds assets in India or is liable to pay income tax in India. Further, it is also the stand of the Revenue that once chargeability is established, no further requirements of nexus needs to be satisfied for attracting Section 195.

179. Vodafone had "presence" in India, according to the Revenue at the time of the transaction because it was a Joint Venture (JV) Partner and held 10% equity interest in Bharti Airtel Limited, a listed company in India. Further, out of that 10%, 5.61% shares were held directly by Vodafone itself. Vodafone had also a right to vote as a shareholder of Bharati Airtel Limited and the right to appoint two directors on the Board of Directors of Bharti Airtel Limited. Consequently, it was stated that Vodafone had a **presence** by reason of being a JV Partner in HEL on completion of HEL's acquisition. Vodafone had also entered into Term Sheet Agreement with Essar Group on 15.03.2007 to regulate the affairs of VEL which was restated by a fresh Term Sheet Agreement dated 24.08.2007, entered into with Essar Group and formed a JV

Partnership in India. Further, Vodafone itself applied for IFPB approval and was granted such approval on 07.05.2007. On perusal of the approval, according to the Revenue, it would be clear that Vodafone had a **presence** in India on the date on which it made the payment because of the approval to the transaction accorded by FIPB. Further, it was also pointed out that, in fact, Vodafone had presence in India, since by mid 1990, it had entered into a JV arrangement with RPG Group in the year 1994-95 providing cellular services in Madras, Madhya Pradesh circles. After parting with its stake in RPG Group, in the year 2003, Vodafone in October, 2005 became a 10% JV Partner in HEL. Further, it was pointed out that, in any view, Vodafone could be treated as a **representative assessee** of HTIL and hence, notice under Section 163 was validly issued to Vodafone.

180. Vodafone has taken up a specific stand that "tax presence" has to be viewed in the context of the transaction that is subject to tax and not with reference to an entirely unrelated matter. Investment made by Vodafone group in Bharti Airtel would not make all entities of Vodafone group of

companies subject to the Indian Law and jurisdiction of the Taxing Authorities. "Presence", it was pointed out, be considered in the context of the transaction and not in a manner that brings a non-resident assessee under jurisdiction of Indian Tax Authorities. Further, it was stated that a "tax presence" might arise where a foreign company, on account of its business in India, becomes a resident in India through a permanent establishment or the transaction relates to the permanent establishment.

181. Vodafone group of companies was a JV Partner in Bharti Airtel Limited which has absolutely no connection whatsoever with the present transaction. The mere fact that the Vodafone group of companies had entered into some transactions with another company cannot be treated as its presence in a totally unconnected transaction.

182. To examine the rival stand taken up by Vodafone and the Revenue, on the interpretation of Section 195(1) it is necessary to examine the scope and ambit of Section 195(1) of the Income Tax Act and other related provisions. For easy

reference, we may extract Section 195(1) which reads as follows:

> **"Section 195. OTHER SUMS.-** (1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries" shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force :
>
> Provided that in the case of interest payable by the Government or a public sector bank within the meaning of clause (23D) of section 10 or a public financial institution within the meaning of that clause, deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode:
>
> Provided further that no such deduction shall be made in respect of any dividends referred to in section 115-O.
>
> Explanation: For the purposes of this section, where any interest or other sum as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to

> the account of the payee and the provisions of this section shall apply accordingly."

Section 195 finds a place in Chapter XVII of the Income Tax Act which deals with collection and recovery of tax. Requirement to deduct tax is not limited to deduction and payment of tax. It requires compliance with a host of statutory requirements like Section 203 which casts an obligation on the assessee to issue a certificate for the tax deducted, obligation to file return under Section 200(3), obligation to obtain "tax deduction and collection number" under Section 203A etc. Tax deduction provisions enables the Revenue to collect taxes in advance before the final assessment, which is essentially meant to make tax collection easier. The Income Tax Act also provides penalties for failure to deduct tax at source. If a person fails to deduct tax, then under Section 201 of the Act, he can be treated as an assessee in default. Section 271C stipulates a penalty on the amount of tax which has not been deducted. Penalty of jail sentence can also be imposed under Section 276B. Therefore, failure to deduct tax at source under Section 195 may attract various penal provisions.

183. Article 246 of the Constitution gives Parliament the authority to make laws which are extra-territorial in application. Article 245(2) says that no law made by the Parliament shall be deemed to be invalid on the ground that it would have extra territorial operation. Now the question is whether Section 195 has got extra territorial operations. It is trite that laws made by a country are intended to be applicable to its own territory, but that presumption is not universal unless it is shown that the intention was to make the law applicable extra territorially. We have to examine whether the presumption of territoriality holds good so far as Section 195 of the Income Tax Act is concerned and is there any reason to depart from that presumption.

184. A literal construction of the words "any person responsible for paying" as including non-residents would lead to absurd consequences. A reading of Sections 191A, 194B, 194C, 194D, 194E, 194I, 194J read with Sections 115BBA, 194I, 194J would show that the intention of the Parliament was first to apply Section 195 only to the residents who have a tax presence in India. It is all the more so, since the person

responsible has to comply with various statutory requirements such as compliance of Sections 200(3), 203 and 203A.

185. The expression "any person", in our view, looking at the context in which Section 195 has been placed, would mean any person who is a resident in India. This view is also supported, if we look at similar situations in other countries, when tax was sought to be imposed on non-residents. One of the earliest rulings which paved the way for many, was the decision in ***Ex Parte Blain; In re Sawers*** _ (1879) LR 12 ChD 522 at 526, wherein the Court stated that "if a foreigner remain abroad, if he has never come into this country at all, it seems impossible to imagine that the English Legislature could ever have intended to make such a person subject to particular English Legislation." In ***Clark (Inspector of Taxes) v. Oceanic Contractors Inc.*** (1983) 1 ALL ER 133, the House of Lords had to consider the question whether chargeability has *ipso facto* sufficient nexus to attract TDS provisions. A TDS provision for payment made outside England was not given extra territorial application based on

the principle of statutory interpretation. Lord Scarman, Lord Wilberforce and Lord Roskill held so on behalf of the majority and Lord Edmond Davies and Lord Lowry in dissent. Lord Scarman said :

> "unless the contrary is expressly enacted or so plainly implied as to make it the duty of an English court to give effect to it, United Kingdom Legislation is applicable only to British subjects or to foreigners who by coming into this country, whether for a long or short time, have made themselves during that time subject to English jurisdiction."

The above principle was followed in ***Agassi v. Robinson*** [2006] 1 WLR 2126.

186. This Court in ***CIT v. Eli Lilly and Company (India) P. Ltd.*** (2009) 15 SCC 1 had occasion to consider the scope of Sections 192, 195 etc. That was a case where Eli Lilly Netherlands seconded expatriates to work in India for an India-incorporated joint venture (JV) between Eli Lilly Netherlands and another Indian Company. The expatriates rendered services only to the JV and received a portion of their salary from the JV. The JV withheld taxes on the salary actually paid in India. However, the salary costs paid by Eli Lilly Netherlands were not borne by the JV and that

portion of the income was not subject to withholding tax by Eli Lilly or the overseas entity. In that case, this Court held that the chargeability under Section 9 would constitute sufficient nexus on the basis of which any payment made to non-residents as salaries would come under the scanner of Section 192. But the Court had no occasion to consider a situation where salaries were paid by non-residents to another non-resident. Eli Lilly was a part of the JV and services were rendered in India for the JV. In our view, the ruling in that case is of no assistance to the facts of the present case since, here, both parties were non-residents and payment was also made offshore, unlike the facts in Eli Lilly where the services were rendered in India and received a portion of their salary from JV situated in India.

187. In the instant case, indisputedly, CGP share was transferred offshore. Both the companies were incorporated not in India but offshore. Both the companies have no income or fiscal assets in India, leave aside the question of transferring, those fiscal assets in India. Tax presence has to be viewed in the context of transaction in question and not

with reference to an entirely unrelated transaction. Section 195, in our view, would apply only if payments made from a resident to another non-resident and not between two non-residents situated outside India. In the present case, the transaction was between two non-resident entities through a contract executed outside India. Consideration was also passed outside India. That transaction has no nexus with the underlying assets in India. In order to establish a nexus, the legal nature of the transaction has to be examined and not the indirect transfer of rights and entitlements in India. Consequently, Vodafone is not legally obliged to respond to Section 163 notice which relates to the treatment of a purchaser of an asset as a representative assessee.

PART-VIII

CONCLUSION:

188. I, therefore, find it difficult to agree with the conclusions arrived at by the High Court that the sale of CGP share by HTIL to Vodafone would amount to transfer of a capital asset within the meaning of Section 2(14) of the Indian Income Tax Act and the rights and entitlements flow from FWAs, SHAs, Term Sheet, loan assignments, brand

license etc. form integral part of CGP share attracting capital gains tax. Consequently, the demand of nearly Rs.12,000 crores by way of capital gains tax, in my view, would amount to imposing capital punishment for capital investment since it lacks authority of law and, therefore, stands quashed and I also concur with all the other directions given in the judgment delivered by the Lord Chief Justice.

..............................J.
(K.S. Radhakrishnan)

New Delhi
January 20, 2012