



ANALYSIS OF SUPREME COURT JUDGMENT IN VODAFONE INTERNATIONAL

1

FACTS

Seller

Buyer

Hutchison
Telecommunications
Cayman Island Company

Vodafone
International BV
Dutch Company
(Assessee)



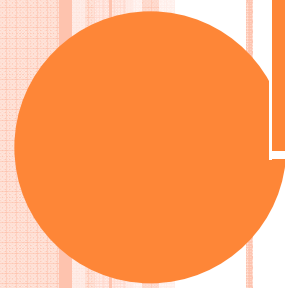
CGP Investments
Cayman Island Company

Transfer of shares



52%

Hutchison Essar Ltd
(HEL) Indian Company



2

CONTENTIONS



Transfer of a share of CGP not taxable in India as share is not situated in India



Transaction constitutes transfer of composite rights in Indian Co therefore has territorial nexus with India

IMPORTANT PRINCIPLES



- The Revenue may invoke the “substance over form” principle or “piercing the corporate veil” test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant.
- Where the Revenue finds that in a Holding Structure, an entity which has no commercial/business substance has been interposed only to avoid tax then in such cases applying the test of fiscal nullity, it would be open to the Revenue to discard such inter positioning of that entity.
- The Revenue or the Court must **look at a document** or a transaction in a context to which it properly belongs to. To ascertain the legal nature of the transaction, it has to **look at the entire** transaction as a whole and not to adopt a dissecting approach. Genuine strategic tax planning has not been abandoned.
- Every strategic foreign direct investment coming to India, as an investment destination, should be seen in a holistic manner.

IMPORTANT PRINCIPLES...

- The Revenue/Courts should keep in mind the following factors to assess the structuring:
 - the concept of participation in investment;
 - the duration of time during which the Holding Structure exists;
 - the period of business operations in India;
 - the generation of taxable revenues in India;
 - the timing of the exit;
 - the continuity of business on such exit.

APPLICABILITY OF SECTION 9 – INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

- Sec. 9 (1) (i) – “all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.”
- Three important elements : transfer, existence of a capital asset and situation of such asset in India.
- The word ‘indirect’ refers to income and not to transfer of capital asset.
- The word ‘underlying asset’ not covered.
- Section does not cover transfer of shares of foreign company holding shares in Indian company. This is not equivalent to transfer of shares of Indian company to be covered within section 9.

“LOOK AT” TEST



- Structure not a sham as :
 - It is in place since 1994
 - Continuity of business operations, not a “fly by night” operator
 - Payment of substantial amount of taxes in India
- CGP’s interposition in the corporate structure and its disposition, by way of transfer, for exit, was for a commercial or business purpose and not with the ulterior motive for evading tax.
- It cannot be considered to be an artificially interposed device and the principle of “fiscal nullity” will not apply. For the principle of “fiscal nullity” to apply, there should be a pre-ordained series of transactions and there should be steps inserted that have no commercial purpose. In that case, the inserted steps can be disregarded for fiscal purpose and one can look at the end result.
- The sale of the CGP shares was a genuine business transaction, not a fraudulent or dubious method to avoid capital gains tax.

TRANSFER OF OTHER RIGHTS AND ENTITLEMENTS

- It's a case of share sale and not an asset sale.
- Along with transfer of shares of CGP, it cannot be held that there was transfer of other rights and entitlements which constituted 'capital assets' as controlling interest flows from holding of shares.
- A controlling interest is not an identifiable or distinct capital asset independent of holding of shares.
- Shares, and the rights which emanate from them, flow together and cannot be dissected.
- Where a transaction involves transfer of shares lock, stock and barrel, such a transaction cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licenses and so on as shares constitute a bundle of rights.
- No separate value assigned to these rights in transfer agreement

APPLICABILITY OF SECTION 195



- Obligation on payer to deduct tax at source from payments to non-residents
- Payments must have an element of income embedded in it which is chargeable to tax in India
- Shareholding in companies incorporated outside India (CGP) is property located outside India. Where such shares become subject matter of offshore transfer between two non-residents, there is no liability for capital gains tax. In such a case, question of deduction of tax at source would not arise.
- Outright sale of capital asset situated outside India between two non-residents is not liable to capital gains tax. Therefore, section 195 does not apply in the absence of any income accruing in India.

SUMMARY



- Offshore transaction is a bonafide structured Foreign Direct Investment into India.
- Offshore transaction was between a Cayman Island company and a Dutch company and involved transfer of shares of Cayman Company. Therefore, it is outside India's territorial tax jurisdiction and hence not taxable.