Shell India wins multi-million dollar tax dispute

The Bombay High Court does not agree with the I-T department and quashed its order

The Bombay High Court, on Tuesday, ruled in favour of the Indian unit of Royal Dutch Shell Plc in a multi-million dollar tax dispute, the latest verdict against the tax department, which has been vigorously pursing claims against foreign firms in India.

Shell had challenged the largest ever claim in a tax case related to transfer pricing.

A rash of high-value tax claims on foreign firms, including IBM Corp and Nokia Oyj, in the past year has sparked criticism that overly zealous tax authorities could undermine foreign investment in India.

In the Shell case, the tax office alleged in February last year that the company's Indian unit under-priced shares transferred to the parent by about $2.5 billion, demanding tax on the interest the Anglo-Dutch oil company would have earned. It did not disclose the value of the claim. The tax sleuth had added Rs.15,000 crore and Rs.3,000 crore, respectively, to the taxable income of Shell India Markets Pvt. Ltd., the Indian subsidiary of Royal Dutch Shell Plc, for 2007-08 and 2008-09 in two transfer pricing cases. The judgment comes in the wake of two similar transfer pricing cases, which were ruled in favour of the Indian subsidiary of Vodafone Group Plc, in which the I-T department had sought adjustments of over Rs.4,500 crore last month.

The order in favour of Shell India was passed on Tuesday by a bench of justices M. S. Sanklecha and S. C. Gupte on a petition filed by Shell India Markets.

The transfer pricing tax orders of the I-T department against Shell and Vodafone pertain to alleged undervaluation of shares issued by their domestic subsidiaries to the parent companies abroad.

Transfer pricing refers to the practice of arm's length pricing for transactions between group companies based in different countries to ensure that a fair price — one that would have been charged to an unrelated party — is levied. Shell India had issued 870 million shares to Shell Gas BV in March, 2009, at Rs.10 a share. However, the I-T department contended that the shares were grossly undervalued, and it valued them at Rs.180 a share. The department then added the difference to the taxable income of Shell India.

In a separate development this year, the I-T department had issued a show-cause notice adding another Rs.3,100 crore to Shell India's income for 2008-09 in another transfer pricing case.

Being aggrieved, the company moved the Bombay High Court, challenging the tax notice.

Funding a subsidiary by issuing shares is a common practice among multinational companies, which view this as a capital transaction and out of the transfer pricing bracket.

However, the tax department argues that such a deal is a transfer pricing arrangement by which the shares issued are undervalued and hence the company is liable to pay tax on the income generated out of it.

The high court did not agree with the department and quashed its order and show-cause notice against Shell India.

Welcoming the high court judgment, Shell India termed it as a ‘positive outcome’.

“We welcome the High Court decision. Shell has always maintained that equity infusion by a foreign parent company into an Indian subsidiary cannot be taxed as income. This is a positive outcome, which should provide a further boost to the government initiatives to improve the investment climate,” a Shell India spokesman said in an e-mail statement.

Commenting on the Shell case verdict, Mukesh Butani, Managing Partner at law firm BMR Legal, which represented the British oil major in the case said, “The HC decision is a significant development, and it follows the earlier judgment in the Vodafone case wherein it was ruled that in so far as transfer pricing principles are concerned the issuance of shares by an Indian company to its foreign parent is not eligible to transfer pricing provisions as there is no income arising there from.

“The High Court has held that the legal principle laid down by the Bombay HC applies in the Shell case and rejected the I-T department’s argument that the facts of the Shell case were distinguishable from the Vodafone case,” he said, adding that the decision was a welcome relief not just for Shell India but for all MNCs which are facing the adjustment on share issuance.

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