THE HIGH COURT OF JUDICATURE AT BOMBAY
O. O. C. J.

WRIT PETITION NO.1325 OF 2010

Vodafone International Holdings B.V. ...Petitioner.
Vs.
Union of India & Anr. ...Respondents.
....
Mr.Harish Salve, Sr.Advocate with Dr.Abhishek Singhvi, Sr.Advocate, Mr.Arvind Datar, Sr.Advocate, Ms.Anuradha Dutt, Ms.Fereshte Sethna, Mr.Kuber Dewan, Ms.Shweta Bindhuri, Mr.Gaurav Chauhan, Mr.Shardul Singh, Ms.Malvika Bakshi, Ms.Gayatri Goswami, Mr.Kamaldeep Dayal, Mr.Rahul Chugh, Mr.Jaiveer Shergill, Mr.Sameer Singh and Mr.Rook Ray i/b. Duttmenon Dunmorsett for the Petitioner.

Mr.Mohan Parasaran, Addl. Solicitor General, Sr.Advocate with Mr.G.C.Srivastava, Special Counsel, Mr.B.M.Chatterji, Sr.Standing Counsel, Mr.R.Parthawarathy, Mr.Girish Dave, Mr.Zoheb Hussain, Mr.D.L.Chaidananda, Mr.Suresh Kumar and Mr.P.S.Sahadevan for the Respondents.
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CORAM : DR.D.Y.CHANDRACHUD AND J.P.DEVADHAR, JJ.

September 8, 2010.

JUDGMENT (PER DR.D.Y.CHANDRACHUD, J.) :

1. **<u>The facts</u>**:

<u>Hutchison's business interest in India</u>:

Vodafone International Holdings B.V., Netherlands (VIH BV) is a company controlled by the Vodafone Group Plc. U.K. In 1992 the Hutchison Group of Hong Kong acquired interests in the

mobile telecommunications industry in India, through a joint venture vehicle, Hutchison Max Telecom Ltd. (renamed Hutchison Essar Ltd – HEL in August 2005). Between 1992 and 2006 Hutchison acquired interests in twenty three mobile telecommunication circles in India. HEL is an Indian company in which shares were acquired by the Hutchison Group of companies through a structural arrangement of holding and subsidiary companies. The moiety of shares of all the operational companies (Indian entities) which were under Hutchison control, direct or indirect, were held either by Mauritius based companies recognized as Overseas Corporate Bodies with tax residency certificates, or through other entities in which Hutchison interests (shareholding over which Hutchison exercised direct or indirect control) were held by a Mauritian company.

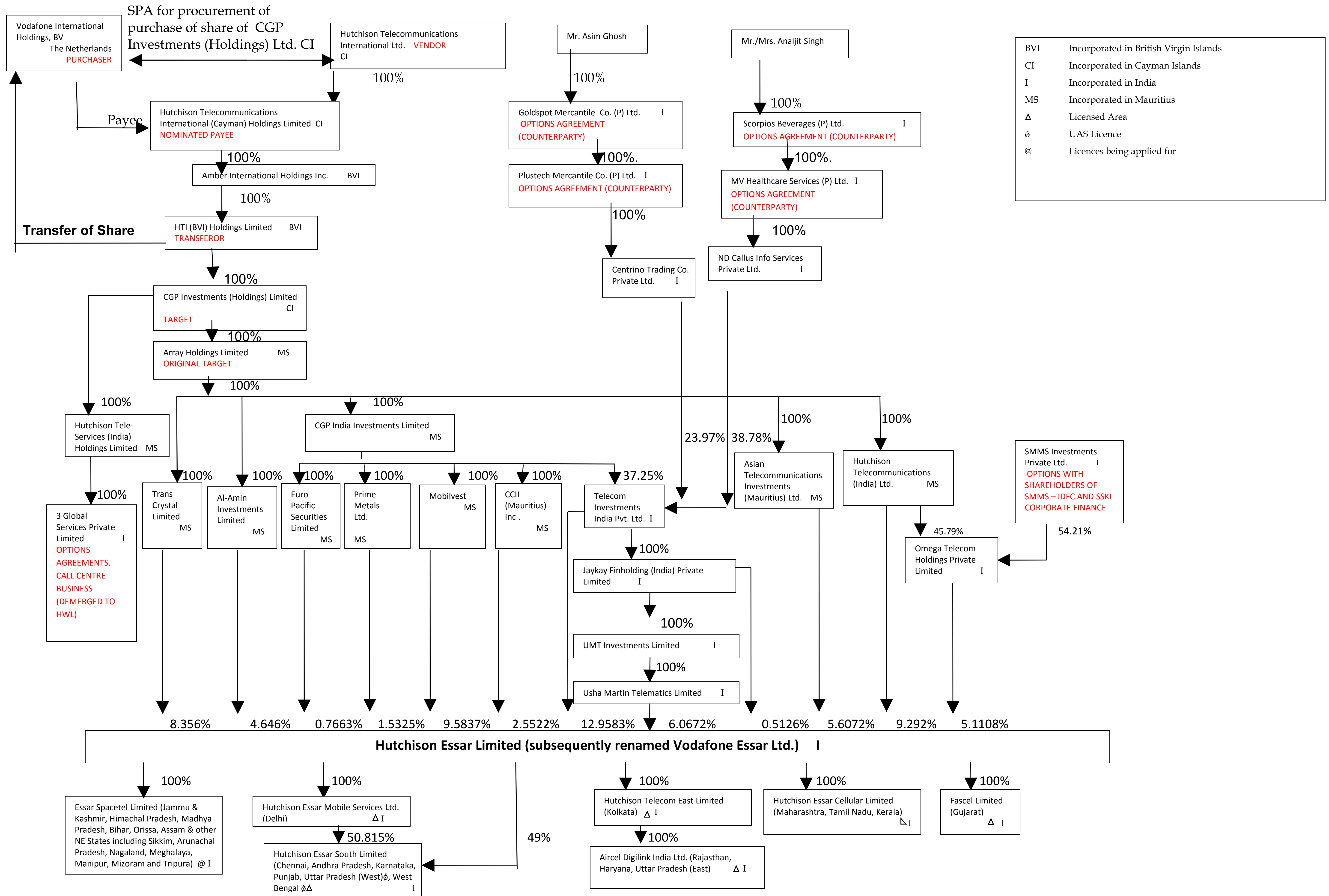
Ownership structure :

-2. In order to facilitate an understanding of the key issues in this case, we reproduce below an ownership structure chart:

EXHIBIT - C

OWNERSHIP STRUCTURE CHART

Ownership Structure Chart, as at 11 February 2007, of (a) Hutchison Telecommunications International Limited, Cayman Islands, (b) CGP (Investment) Holdings Ltd., Cayman Islands, and (c) Indian Investors, India



3. Hutchison held call options over companies controlled by Asim Ghosh and Analjit Singh as also over SMMS Investments Pvt. Ltd. aggregating to approximately 15% of the shareholding of HEL. The benefit of these options enured in favour of a corporate entity called 3 Global Services Private Ltd., a company registered under the Companies' Act, 1956.

4. The licence for Mumbai Circle was awarded in November 1994 by the Department of Telecommunications (DoT) to Hutchison Max Telecom Ltd. (HMTL). 50% of the share capital in HMTL was held by an Indian company, Max Telecom Venture, 49% by Hutchison Telecommunications (India) Ltd. Mauritius (HTM) and 1% by another company. The parent company of HTM, at the material time, was Hutchison Telecommunications (India) Ltd. Cayman Islands (HTC). HTC, in turn, was a joint venture of the Hutchison Group (60%) and Distacom India Co.Ltd., BVI (40%). Distacom left the joint venture in 2004. Subsequently, a number of investments were made through other companies:

- In 1998, MTV sold a 40% stake in HMTL to Telecom

Investments India Ltd. (TII).

- In 2004, Essar (Mauritius) purchased the 40% stake of Distacom in HTC who then transferred the shares to HTI BVI Holdings Ltd. HTM transferred 19.6% of its holding in HMTL to the Essar Group.

- In 2006, Kotak Group sold its 51% stake in TII to ND Callus Info Services Pvt. Ltd., a company controlled by Analjit Singh. Simultaneously, Centrino Trading Co. Pvt. Ltd. subscribed to 23.97% stake in TII.

- In 2006, the Hinduja Group, which held a 5.11% stake in HEL, sold its stake to Hutchison Group.

5. On 12 January 1998 CGP Investments (Holdings) Ltd., (CGP) was incorporated in Cayman Islands by the Hutchison Group. HTL Hong Kong was the sole shareholder of CGP and in September 2004, it came to be transferred to/acquired by HTI BVI.

6. Hutchison entered into the Delhi Telecom Circle in December 1999, the Kolkata Circle in July 2000 and the Gujarat Circle in September 2000. Licences for these Circles had initially been awarded by DoT in 1994, 1997 and 1995 respectively.

7. In 2004, Hutchison Telecommunication International

Ltd., Cayman Islands (HTIL) was incorporated and listed on the Hong Kong and New York Stock Exchanges. HTIL and its downstream companies held interests in the mobile telecommunications business in several countries including India.

8. In 2005, HMTL (which later became HEL and is now VEL) completed a process of consolidation. Shares of several operating companies were transferred by diverse holding companies to HMTL, in consideration for which HMTL issued its own shares to these holding companies. Approval of the Foreign Investment Promotion Board of the Union Government (FIPB) was obtained in November 2004 and of the Reserve Bank in December 2004.

9. On 28 October 2005 VIH BV agreed to acquire 5.61% of the shareholding in Bharti Televentures Ltd. (now Bharti Airtel Ltd.).

Framework Agreements:

10. On 1 March 2006, Framework Agreements were entered

into by Asim Ghosh and Analjit Singh. One agreement was between Asim Gosh, Goldspot Mercantile Company Pvt. Ltd., Plustech Mercantile Co. Pvt. Ltd., 3 Global Services Pvt. Ltd. (3GSPL) and Centrino Trading Co.Pvt. Ltd. Centrino Trading acquired shares in TII. Plustech held 100% shares in Centrino. Goldspot held 100% shars in Plustech. Goldspot was controlled by Asim Ghosh. 3GSPL's holding company was Hutchison Tele-Services (India) Holdings Ltd., Mauritius, and in turn, CGPC was the holding company with a 100% shareholding of Hutchison Tele-Services (India) Holdings Ltd.

11. 3GSPL (a Hutchison Company) agreed to procure credit support in order to enable Centrino to subscribe to 23.97% shares in TII (which holds directly and indirectly 19.54% in HEL). In consideration for this, the Agreement conferred upon it a right:

- to subscribe to equity in Centrino.
- to purchase equity of Plustech

(3GSPL Call Option),

Goldspot had, in turn, an option to require 3GSPL to purchase equity shares of Plustech (Goldspot Put Option). The transfer

price/fair market value of the Plustech shares was to be determined in terms of a comprehensive mechanism agreed to between the parties, set out in Schedule 2.

12. There was a similar Framework Agreement between Analjit Singh, Scorpios Beverages Pvt. Ltd. (held 100% by Mr./Mrs.Analjit Singh), MV Healthcare Services Pvt.Ltd. (held 100% by Scorpios) and ND Callus Info Services Pvt. Ltd. (held 100% by MV Healthcare).

13. In consideration of 3GSPL procuring financial assistance for N.D. Callus to subscribe to 38.78% shares in TII (which holds directly and indirectly 19.54% in HEL), Scorpios granted 3GSPL.

- a right to subscribe to equity in ND Callus
- and/or purchase equity of MV. Healthcare.

3GSPL granted Scorpios Beverages an option to require 3GSPL to purchase equity shares of MV Healthcare. The transfer price/fair market value of the MV Healthcare shares was to be determined in terms of Schedule 2, which set out a mechanism somewhat at variance with the mechanism in the other Framework Agreement.

14. Similarly on 7 August 2006, a Framework Agreement was executed between IDFC Pvt. Equity Co. Ltd., Hutchison Telecommunications (India) Ltd., 3GSPL, Indusind Telecom Network Ltd., HTIL and other companies.

Hutchison exits :

15. In December 2006, HTIL issued a press statement, stating that it had been approached by various potentially interested parties regarding a possible sale of its equity interests in Hutchison Essar Limited (HEL), the company's mobile operations in India.

16, On 22 December 2006, Vodafone Group Plc made a non-binding offer for a sum of US$11.055 billion, in cash, for HTIL's shareholdings in HEL. The letter stated that Hutch Essar was being valued at an enterprise value of US $ 16.5 billion. The offer to HTIL of US$ 11.055 billion was for its 67% interest in Hutch Essar.

17. On 9 February 2007, Vodafone Group Plc submitted a revised and binding offer to HTIL on behalf of Vodafone

International Holdings BV for HTIL's shareholdings in HEL together with inter related company loans. The offer was US $10.708 billion on the basis of an enterprise value of US $ 18.250 billion.

18. Bharti Infotel Pvt. Ltd. by a letter dated 9 February 2007 furnished its no objection to the proposed transaction.

19. On 10 February 2007, Vodafone Group Plc made a final binding offer of US $ 11.076 billion, based on an enterprise value of US $ 18.800 billion of HEL.

Sale Purchase Agreement :

20. On 11 February 2007, a Sale Purchase Agreement (SPA) was entered into between the Petitioner and HTIL under which HTIL agreed to procure and transfer to the Petitioner the entire issued share capital of CGP, by HTI BVI free from all encumbrances together with all rights attaching or accruing, and together with assignment of loan interests. This was followed by announcement by HTIL and Vodafone of 12 February 2007, the latter stating that

it had agreed to acquire a controlling interest in HEL via its subsidiary VIH BV.

21. On 20 February 2007, Vodafone Group Plc on behalf of VIH BV addressed a letter to Essar Teleholdings Ltd. for purchase of Essar's entire shareholding in HEL ('Tag along rights').

Application to FIPB :

22. On 20 February 2007, VIH BV, filed an application with the Foreign Investment Promotion Board (FIPB) of the Union Ministry of Finance stating thus:

> Vodafone Group acquired a direct and indirect investment in Bharti Airtel Ltd.
>
> - The Petitioner held 5.61% stake directly in Bharti Airtel.
> - Vodafone Mauritius held an indirect interest of 4.39% in Bharti Airtel through Bharti Infotel Pvt. Ltd. and Bharti Telecom Ltd.
> - The Petitioner intended to acquire the share capital of CGP indirectly from HTIL. CGP owns directly and indirectly through its subsidiaries an aggregate of 42.34% of the issued share capital of HEL.
> - This was an overseas transaction between two overseas companies, which requires noting, and does

not require approval of FIPB.

- The Petitioner will acquire an indirect controlling interest of 51.96% in HEL, a company competing in the same field with Bharti, attracting Press Note 1.
- The Consent of Bharti has been secured.

The Petitioner requested the FIPB to take note and grant approval under Press Note 1 to the indirect acquisition of a 51.96% stake in HEL through an overseas acquisition of the entire share capital of CGP from HTIL.

23. On 22 February 2007, HTIL made an announcement on the Hong Kong Stock Exchange stating that it intended to use the proceeds from the sale of its interest in HEL by declaring a special dividend of HK $ 6.75 per share, utilising HK $ 13.9 billion to reduce debt and the remainder for investment in telecommunications businesses.

24. On 28 February 2007, FIPB addressed a letter to HEL, seeking complete details from HEL regarding direct and indirect foreign holdings in HEL; details of Indian companies and beneficial ownership details of entities of Asim Ghosh and Analjit Singh and

the nature of arrangement of beneficial ownership.

25. On 2 March 2007, Asim Ghosh addressed a letter to HEL confirming that he -

- through his companies, owned 23.97% of Telecom Investments India Pvt.Ltd., which in turn owned 19.54% of HEL
- held indirect equity of 4.68%
- had full control over related voting rights,
- is his own beneficiary,
- has received credit support, but the primary liability is with his companies.

26. On 5 March 2007, Analjit Singh addressed a communication to FIPB confirming that -

- he is the founder and Chairman of Hutchison Max Telecom, now HEL.
- In 1998, Max divested 41% stake and balance 10% in 2005.
- In January 2006, an acquisition was made of 7.577% in HEL through Scorpios, etc. This is post-FDI norms altering the sectoral cap for foreign direct investment from 51% to 74%, when Hutch had to shed some equity.

- Voting rights legally and beneficially were owned by him.

- Structure was filed with FIPB in April 2006 and filed with DoT on 27.04.2006. FIPB confirmed the structure on 01.08.2006.

27. On 6 March 2007, Essar Teleholdings Ltd. filed an objection with FIPB in relation to the proposed transaction for purchase of a controlling interest by the Petitioner in HEL through purchase of overseas holding companies belonging to the Hutchison group, on the ground that HEL and Bharti Airtel are competing ventures in the same field and the proposed transaction would result in both companies having a common foreign partner, which could jeopardise the interests of HEL/Essar.

28. On 14 March 2007, FIPB addressed a letter to HEL seeking the following clarification:

> "In filing of HTIL before the US SEC in form 6K for the month of March 2006, it has been stated inter alia that the HTIL Group will continue to hold an aggregate interest of 42.34% of Hutchison Essar and an additional indirect interest through JV companies being non-wholly owned subsidiaries of HTIL which hold an aggregate of 19.54% of Hutchison Essar. Thus the combined holding of HTIL group would be 61.88%. However, in the

> communication dated 6 March 2007 sent to FIPB, the direct and indirect FDI by HTIL is stated to be 51.96%. This may kindly be clarified.”

29. A similar letter was addressed to the Petitioner. In reply HEL by its letter addressed to FIPB on 14 March 2007 clarified that

> “...In summary, it is because of this difference in the US GAAP and Indian GAAP declarations that the combined holding for US GAAP purposes was 61.88% and for Indian GAAP purposes is now 51.98%. The Indian GAAP number reflects accurately the true equity ownership and control position”.

30. The Petitioner by its clarification to FIPB dated 14 March 2007 stated that its effective shareholding in HEL will be 51.96% and consisted as follows:

- Vodafone will own a 42% direct interest in HEL through its acquisition of 100% of CGP Investments (Holdings) Limited.
- Through CGP Vodafone will also own 37% in Telecom Investments India Private Limited (‘TII’) which in turn owns 20% in HEL and 38% in Omega Telecom Holdings Private Limited (‘Omega’), which in turn owns 5% in HEL. Both TIL and Omega are Indian companies.
- These investments combined give Vodafone a controlling interest of 52% in HEL.

- In addition, HTIL's existing Indian partners Asim Ghosh, Analjit Singh and IDFC who between them hold a 15% interest in HEL have agreed to retain their shareholdings with full control including voting rights and dividend rights.

31. On 15 March 2007, a settlement was arrived at between HTIL and a set of companies belonging to the Essar Group by which in lieu of the payment by HTIL of US $ 373.5 million immediately and a further US $ 41.5 million, subsequently, Essar indicated its support to the proposed transaction.

<u>Notice under Section 133(6)</u> :

32. On 15 March 2007, the Joint Director of Income Tax (International Taxation) issued a notice under Section 133(6) of the Income Tax Act, 1961 to HEL seeking information regarding the sale of the stake of the Hutchison group, Hong Kong in HEL to Vodafone Group Plc, including in relation to the Shareholders Agreements and details of the transaction for acquisition of the share capital of CGP.

33. On 19 March 2007, FIPB addressed a letter to the

Petitioner asking it to clarify under what circumstances Vodafone had agreed to pay a consideration of US $ 11.08 billion for acquiring 67% of HEL when the actual acquisition is only of 51.96%, according to the application.

34. On 19 March 2007, the Petitioner addressed a letter to FIPB stating that it had agreed to acquire from HTIL, interests in HEL which include a 52% equity shareholding, for US $ 11.08 billion and that the price included a control premium, use and rights to the Hutch brand in India, a non-compete agreement with the Hutch group, value of non-voting non-convertible preference shares, various loan obligations and an entitlement to acquire a further 15% indirect interest in HEL, subject to Indian foreign investment rules, which together equated to 67% of the economic value of HEL.

35. On 22 March 2007, HEL replied to the notice of 15 March 2007 of the Joint Director of Income Tax (International Taxation) and furnished information relating to HEL. As regards the transaction, HEL stated that it is not in a position to provide

any responses, since it is neither a party to the transaction nor will there be any transfer of shares of HEL.

36. On 22 March 2007, FIPB addressed a letter to the Petitioner seeking a break-up of the valuation attached to each of the items mentioned in the Petitioner's reply dated 19 March 2007, together with supporting documents and regulatory filings.

37. On 23 March 2007, the Additional Director of Income Tax (International Taxation) Range 2, Mumbai, issued a letter to HEL intimating that both Vodafone Group Plc and Hutchison Telecom group announcements evidenced that HTIL had made substantial gains. HEL was consequently requested to impress upon HTIL/Hutchison Telecom group to discharge tax liability on gains, before they cease operations in India. Additionally, the attention of HEL was drawn to Sections 195 and 197 of the Act. The letter seemed to proceed on the basis that the shares of HEL were being sold and that hence HEL would be in a position to get the requisite information.

38. On 27 March 2007, the Petitioner addressed a letter to FIPB confirming that it had taken into account :

i. The various assets and liabilities of CGPC including (i) (a) its 51.96% direct and indirect equity ownership of Hutch Essar; (b) its ownership of non-voting, non-convertible, redeemable preference shares in Telecom Investments India Private Limited (TII) and Jaykay Finholding (India) Private Limited; (c) assumption of liabilities in various subsidiaries of CGP amounting to approximately US $ 630 million; and (d) subject to Indian foreign investment rules, its rights and entitlements, including subscription rights at par value and call options to acquire in the future a further 62.75% of TII, and call options to acquire in the future a further 54.21% of Omega Telecom Holdings Private Limited (Omega) which together would give the Petitioner a further 15.03% proportionate indirect equity ownership of Hutch Essar; and

ii. Various other intangible factors such as control premium, use and rights to the Hutch brand in India and a Non-Compete Agreement with HTIL.

It also confirmed that in determining the bid price, there was no individual price placed on any of these items. The approach was to look at a total package, represented by the ownership of CGP and to assess the total value.

39. On 5 April 2007, HEL clarified to the Director of Income Tax (International Taxation) that HEL had no tax liabilities accruing out of the transaction and that it did not have a locus to

review the obligations under Section 195 in relation to non-resident entities regarding any purported tax obligations.

40. On 5 April 2007, FIPB in a letter to the Petitioner sought details of Vodafone Group's projects/joint ventures/subsidiaries/ branches/business interest collaborations in all countries.

41. On 9 April 2007, HTIL filed the agreements pertaining to its transactions with FIPB.

FIPB Approval :

42. On 7 May 2007, FIPB conveyed its approval of the transaction to the Petitioner subject to compliance with and observance of all the applicable laws and regulations in India. The approval was also subject to the condition of compliance with the sectoral cap on 74% of foreign direct investment in the Telecom Sector.

43. On 8 May 2007, the Petitioner paid a sum of US $ 10,854,229,859.05 as consideration for the transaction to HTI CHL

in terms of the instructions of HTIL dated 19 March 2007.

44. Following this, the share certificate of CGPC was delivered up in Cayman Islands and the name of the Petitioner was entered in the Register of Members of CGP.

45. On 8 May 2007, a Tax Deed of Covenant was entered into between HTIL and the Petitioner, in pursuance of the SPA indemnifying the Petitioner in respect of taxation or transfer pricing liabilities payable or suffered by the Wider Group Companies as defined by the SPA (i.e. CGP, 3GSPL, the Mauritian holding companies and the Indian operating companies) on or before completion, including any reasonable costs associated with any tax demand.

46. Separately Loan Assignments were entered into inter alia by the Petitioner and HTI (BVI) Finance Ltd., by which the rights of the latter to receive loan repayments was assigned to the Petitioner as part of the transactions contemplated under the SPA.

Notice under Sections 163, 201(1), 201(1A) :

47. On 6 August 2007, a notice to show cause was issued to VEL under Section 163 of the Income Tax Act, 1961 to explain why it should not be treated as a representative assessee of the Petitioner. The notice was challenged by VEL in a Writ Petition under Article 226 of the Constitution before this Court.

48. On 19 September 2007, the Assistant Director of Income Tax (International Taxation), issued a notice to the Petitioner under Sections 201(1) and 201(1A) to show cause as to why it should not be treated as an assessee-in-default for failure to withhold tax.

49. On 3 December 2008, a Division Bench of this Court dismissed the Petition, declining to exercise its jurisdiction under Article 226 in a challenge to the show cause notice.

Directions of the Supreme Court :

50. In a Special Leave Petition filed before the Supreme Court, by an order dated 23 January 2009, the Second Respondent

was directed to determine the jurisdictional challenge raised by the Petitioner. The order passed by the Supreme Court reserved the right of the Petitioner to challenge the decision of the Second Respondent on the preliminary issue, if determined against the Petitioner, before this Court leaving all questions of law open. Thereafter, a second notice to show cause was issued to the Petitioner under Section 201 on 30 October 2009 to which the Petitioner filed a reply dated 28 January 2010. On 31 May 2010 the impugned order was passed by the Second Respondent under Section 201 upholding jurisdiction.

51. On 31 May 2010, a notice to show cause was issued under Section 163 to the Petitioner to show cause as to why it should not be treated as an agent/representative assessee of HTIL.

CONTENTIONS:

A. The Petitioner :

52. Briefly stated, the case of the Petitioner is that if any of the shares held by the Mauritian Companies were sold in India, there would be no capital gains tax payable in India in view of the

Convention on avoidance of double taxation between Mauritius and India. Hence, on a transfer of shares of HEL which are admittedly an asset situated in India, there would have been no capital gain tax chargeable in India. However, as the transaction in the present case was that the share of an upstream overseas company which was in a position to exercise control over a Mauritian company was sold, the Revenue has sought to impose capital gains tax on the ground that the transfer resulted in consequential transfer of control over an Indian entity and thereby gave rise to capital gain which is taxable in India.

53. The Petitioner contends that CGP (the subsidiary whose share was transfered to it) through its downstream subsidiary, directly or indirectly controlled equity interest in HEL. The transfer of the share resulted in the Petitioner acquiring control over CGP and its downstream subsidiaries including, ultimately HEL and its downstream operating companies. On the passing of control of downstream companies, commercial arrangements common to such a transaction were put in place. The transaction represents a transfer of a capital asset viz., the share of CGP. Any

gain arising to the transferor or to any other person out of this transfer is not taxable in India because the asset is not situated in India. Hence, there was no sum chargeable to tax in India and the obligation to deduct tax under Section 195 did not, as a result, arise. The submissions can now be summarised.

(1) The case of the Department has vacillated: (i) The notice to show cause suggested that the transaction was sham and colourable. The impugned order proceeds on the basis that though holding companies are permissible and the transaction was not by itself a sham, the holding companies had no commercial operations. The transfer of the CGP share resulted in a transfer of 66.9848% interest in HEL. However, in the course of submissions the ASG, developed a new case that the transfer of the CGP share resulted only in a transfer of 42.34% interest in HEL and the balance must necessarily have been transferred through some device. The ASG had urged that the shares held by companies controlled by Analjit Singh and Asim Ghosh were beneficially held by HTIL. The Revenue cannot be permitted to challenge FIPB's acceptance to the contrary in collateral proceedings. The

Department, when it decides to challenge a quasi judicial order, cannot assign an entirely new set of reasons;

(2) The parties to the transaction understood the expression “equity interest” to be (i) The transfer of direct and indirect control of 42.34% of the equity capital of HEL; (ii) The transfer of pro-rata control over TII and SMMS which is mandated by the policy of the Government of India which provides a cap on foreign investments in telecommunications; and (iii) The availability of the ‘put’ options. The revised case of the Department is fallacious;

(3) Section 5(1) legislates with respect to nexus based on residence while Section 5(2) is based on nexus relatable to source. As regards nexus arising from source, tax can be imposed on income which (i) is received in India; (ii) which accrues and arises in India; and (iii) which is deemed to accrue or arise in India. For income to arise or accrue in India, there must be a right to receive income in India. In the present case, there is no income that accrues or arises in India since the right to receive the money was outside India under a contract entered into outside India and

payment was made outside India;

(4) In Section 9, Parliament has specifically limited gains arising out of transfers of capital assets to an asset situate in India. The share of CGP is situated outside India. A share is situated where it can be transferred. A share represents a bundle of rights and the transfer of a share results in a transfer of all the underlying rights. However, in law, what is transferred is a share and not individual rights. There is a distinction in law between shareholders and a company and a shareholder has no right in the assets of the company. Hence, the contention of the Revenue that the transfer of control over the business in India constitutes a transfer of an asset in India is without any foundation;

(5) By legislation several countries have made “look-through” provisions by which a tax is imposed on gains arising out of a transfer of shares outside the country if it results in the passing of control over a company which holds substantial immovable property in the country. This is an area of legislative intervention. In India, Parliament has amended the law by incorporating a full

Chapter on transfer pricing to deal with cross-border transactions. However, Section 9 has not been amended. A look-through provision cannot be introduced by judicial interpretation;

(6) The SPA represents an arms length commercial transaction which was entered into between the two large foreign corporations. It is not the case of the Revenue that the document is sham or colourable. If the shares of an Indian company which are held by companies resident in Mauritius were transferred to the Petitioner directly and without intervention of any intermediate company, there would be no liability to capital gains tax because it would be fully covered by the Indo-Mauritius Tax Treaty. The Department would not in law be permitted to go behind a corporation resident in Mauritius in view of the judgment of the Supreme Court in **Azadi Bachao**. The SPA dispels any notion that there was anything more than the transfer of the CGP share for consideration. The other clauses relate to consequential changes that would flow from the downstream effect of the transfer of the CGPC share;

(7) As regards the framework agreements, it has been submitted that (i) The framework agreements dated 1 March 2006 relating to Asim Ghosh and Analjit Singh Group companies confer rights upon 3GSPL. Neither of those agreements confers any right upon HTIL; (ii) The framework agreement of 7 August 2006 relating to TII confers options upon 3GSPL. Neither the shareholder's agreement dated 5 July 2003, nor of 1 August 2006 confers any right upon HTIL;

(8) In any case, the theory that because there are some contracts which are related to the contract of sale, and since the former contracts have nexus with India, the sale outside India will have nexus with India is neither supportable in principle nor on authority. The tax relates to gains arising out of a transfer of a capital asset situated in India, not a capital asset, the transfer of which has some nexus with India. Parliament has deliberately used the word "situate in India" in relation to capital assets. Where the asset is situated outside India and the transfer of that capital asset takes place, the location of the asset does not notionally shift to India because the agreement pursuant to which it is transferred has

also led to certain related agreements which have nexus with India;

(9) The contention of the Department that the right to use the Hutch Brand during the transition period which was royalty free brings about the transfer of some capital assets in India to which the consideration paid for the shares relates, is misconceived. The Hutch Brand was to be withdrawn from India and all that the agreement permitted was, use during the limited period free of charge. Where a controlling interest in shares is sold, it is usual to incorporate transitory arrangements without specific consideration. The value of the transfer of the enterprise is captured in the sale price of the shares and the gain made by the seller is a capital gain, in the jurisdiction where the property is situated. Independent values are not assigned to these segments;

(10) The suggestion of the Revenue that the benefit of the Telecom licence stood transferred is misconceived. Under the Telecom policy, a Telecom licence can only be held by Indian Companies and there was no transfer direct or indirect of any licence. The Telecom policy, however, permits FDI in Telecom

companies which may be routed through investment and holding companies. Even the condition under the Telecom licence imposing restriction on the transfer of shares in companies holding licences was first amended in 2001 to reduce it to a lock-in period of five years from the date of the licence. In 2005, it was further amended and presently only a reporting requirement has been made;

(11) There is no legal requirement of obtaining permission of the FIPB for a transfer of shares. The shares in Telecom companies can be bought and sold and the only requirement is a reporting requirement. The Petitioner was required to obtain a formal permission under Press Note-1 as would any other buyer if he had a joint venture in the same field in India or held shares in any other companies in India. The need to obtain permission by the Petitioner, asserted by the Revenue, does not shift the situs of the share in India. The proceedings before the FIPB show that enquiries were held on whether HEL had permitted excessive FDI by virtue of the beneficial interest in the shares held by Analjit Singh and Asim Ghosh Group of companies in reality being held by

HTIL. After a thorough enquiry, this suggestion was negated and an undertaking secured that as and when they do transfer the shares, they would seek FIPB permission. This militated against the case of the Revenue that there was some transfer *in praesenti*;

(12) For the purpose of taxation, the corporate veil can be lifted only where a tax fraud is being perpetrated;

(13) Section 195 is inapplicable to off-shore entities making off-shore payments.

Section 195 has to be read consistent with the established principles of conflict of laws and harmonious with the proposition that Parliament does not enact law that has extra territorial operation, unless expressly so stated. The statutory duty under Section 195 cast on the payer is accompanied by a duty under Section 200 to pay the tax and is visited with penal consequences for breach. All these consequences which operate against a person who is not an assessee can arise only where the person concerned has some nexus with India. A person who has

no residential nexus whatsoever either temporary or permanent does not incur an obligation under Section 195. A foreign entity which has no presence in India, not even a branch office, cannot be subjected to the obligation to deduct and pay tax. It is the recipient who is a potential assessee because he has received a sum chargeable. This by itself does not create a nexus with the payer who has no income chargeable under the Act, nor has a presence of any kind in India. Moreover, Section 198 which deems tax deducted and paid to be income received by the payee and Section 199 which deems such a payment to be payment of tax on behalf of the person from whom such a tax is deducted, would not operate outside India in transactions such as the present. Payment of tax in India would not be a partial discharge of the obligation to pay consideration under the agreement outside India. Hence, even assuming that it is held that some part of the income may be taxable in India, considering the fact that -

(a) The Petitioner has no presence in India;

(b) The transaction was consummated outside India;

(c) The transaction related to transfer of a share

outside India, contracted to be delivered outside India and the transfer of which was registered outside India;

(d) The governing law of the contract pursuant to which it was transferred was English law;

(e) Payment was made from a bank account outside India to a bank account outside India,

there is no question of deduction of tax on such payments.

(14) In order that there should be an enforceable obligation under Section 195 against the payer, it must be established that the payment is of a sum chargeable under the Act. Section 195 uses the words "sum chargeable under the provisions of this Act". Hence, where a demand is made of tax against a person on the ground that there was a failure to deduct tax under Section 195, it is open to such a person to challenge the demand on the ground that the condition precedent – of there being a sum chargeable under the Act – is absent and the demand is without jurisdiction. Where there is a sum chargeable under the Act, then obviously two options would be to pay the tax on the gross amount or to seek and deduct tax under sub-sections (2) and (3) of Section 195. Where

nothing is chargeable, it is not mandatory for the payer to seek a determination under Section 195(2). In a case such as the present, where the payment has no element which could be made liable to tax in India and the payer does not withhold any tax and the Department thereafter makes a demand of tax which allegedly should have been withheld under Section 195, it is open to the payer to contend that his action was justified on the ground that there was no sum chargeable under the provisions of the Act. Such an issue if raised has to be decided and not only on a prima facie basis.

2) **SUBMISSIONS OF THE UNION OF INDIA**:

54. The core submission on behalf of the Union of India and the Respondents is that the SPA and other transaction documents establish that the subject matter of the transaction is not merely the transfer of one share of CGP situated in Cayman Islands as contended by the Petitioner. The transaction constitutes a transfer of the composite rights of HTIL in HEL as a result of the divestment of HTIL rights which paved the way for the Petitioner to step into the shoes of HTIL. The transaction in question, it is urged, has a

sufficient territorial nexus to India and is chargeable to tax under the Income Tax Act, 1961. Hence, the finding of the Assessing Officer that he has jurisdiction, is not perverse or arbitrary and would not warrant interference under Article 226 of the Constitution. The submissions may now be summarised:

(i) The decision of the Revenue is based on an interpretation of the agreements in question which would render the submission of the Petitioner on "form versus substance" irrelevant. The submission of the Department can be justified on the basis of the form of the transaction as reflected in the transaction documents;

(ii) There is a distinction between proceedings for the deduction of tax and regular assessment proceedings where larger issues have to be investigated. The jurisdictional issue is legitimately to be confined to the obligation of the Petitioner under Section 195 to deduct tax. In the absence of HTIL – the deductee – a full determination of facts which lie within its special knowledge would not be fair and proper. Nonetheless, the Revenue has placed its submissions before this Court in order to

assist the determination as to whether the transaction was chargeable to tax under Sections 4, 5 and 9;

(iii) The essential question is whether HTIL had a source of income traceable to India or a capital asset in India which it transferred. HTIL received income from the divestment of its rights and interests in HEL which cannot be disputed. The income has been appropriated by HTIL by declaring a "transaction special dividend" of H.K.$ 6.75 to its shareholders in Hong Kong which was paid out of the "profits from discontinued operations". This is evident from the interim and final annual reports of HTIL, for the year ending 2007 prepared in compliance with Hong Kong Financial Reporting Standard 5 (HKFRS5). HKFRS5 introduced the concept of a disposal group and a discontinued operation;

(iv) The subject matter of the transaction between HTIL and the Petitioner was a transfer of 67% in HEL. The acquisition of one CGP share is only one of means to achieve that object. The nexus of the transaction with India is evident from the nature of HTIL's rights in HEL which were :

-(i) A direct and indirect interest of 51.96% in the equity of HEL through its wholly owned subsidiaries;

-(ii) Indirect interest in the equity of HEL of 15.03% through Call Options in the companies held by Analjit Singh, Asim Ghosh and IDFC;

-(iii) Right to do business through telecom licence granted to the Special Purpose Vehicle promoted by HTIL and Essar as promoter and joint venture partner;

-(iv) Acquisition and devolution of Hutch brand;

-(v) Management rights over HEL flowing through Term Sheets and shareholder agreements; and

-(vi) Debt/loans through intermediaries for infusion as equity or debt in HEL.

(v) Besides procuring the sale of one share belonging to CGP, HTIL had necessarily to adopt several steps to consummate the transaction of transferring all its rights in HEL in India. These steps included (i) Procuring assignment of loans; (ii) Facilitating framework agreements; (iii) Transferring management rights in HEL; (iv) Transferring the Hutch Brand; and (v) Transferring

Oracle Licence etc. All these were independent of the transfer of the CGP share. The consideration paid by the Petitioner to HTIL was for a package of composite rights and not for a mere transfer of a CGP share.

(vi) The acquisition of the shareholding in CGP did not transfer in itself all the rights and interests which flow to the Petitioner from the transaction. The Petitioner obtained a compendium of rights including effective control and management of the joint venture in India as a result of which it stepped into the shoes of HTIL. This arose as a consequence of the Petitioner entering into distinct and independent contracts which have no co-relation with the acquisition of CGP equity. Though neither the Petitioner nor its predecessor-in-interest, HTIL are shareholders in HEL (now VEL), they are able to secure control over the Indian Corporate entity only by reason of their entering into contractual obligations as evidenced from the term sheet agreements between the joint venture partners. The first term sheet agreement of 5 July 2003 inter alia between Essar Teleholdings Ltd. and HTIL contemplated that the operating companies would be consolidated

by transferring their shares to an Indian holding company (Holdco). Holdco became HMTL and was renamed as HEL. As a result of such agreements, HTIL secured significant management rights so long as it continued to hold at least 40% of the issued share capital of HEL. All major decisions called “Reserved decisions” were to be at the absolute discretion of HTIL;

(vii) Accounting Standard 24 of the Institute of Chartered Accountants of India recognizes that control may be obtained directly or indirectly through a subsidiary from the ownership of more than half of the voting power of an enterprise or by control of the composition of the Board of Directors. Section 211(3A) of the Companies Act requires accounts to comply with Accounting Standards. A controlling interest in a company can be obtained by independent agreements *de hors* shareholding;

(viii) The right to take vital decisions with reference to the management of the joint venture was legally vested in the Petitioner as a result of stand alone contracts, independent of the acquisition of CGP share and was oriented towards the India

specific joint venture. These rights have enured independent of the CGP share as would be evident from the Restated Term Sheet dated 24 August 2007;

(ix) In order to appreciate the terms of and the impact of the SPA, the circumstances which transpired prior to and subsequent to its execution are relevant. The name which parties attribute to a transaction which is the source of receipt or the characterization of the receipt is not conclusive and the true nature and character has to be ascertained from the covenants of the contract in the light of surrounding circumstances;

(x) Several valueable rights which are property rights and capital assets stand relinquished in favour of the Petitioner by reason of the agreements which form part of the composite transaction and not merely by the simple transfer of one CGP share. These rights are property and constitute an asset of a capital nature which is situated in India. But for these agreements, HTIL would not have been able to effectively transfer to the Petitioner, controlling interest in the joint venture to the extent of 66.9828%

in HEL;

(xi) An Analysis of the SPA shows that clause 2 is expressly subject to the condition provided in clause 4.1. By clause 4.2(a), the purchaser had the responsibility to use all reasonable endeavours to obtain FIPB approval. The transaction is subject to the consent and approval of the Indian regulatory authority, FIPB. The fulfillment of the condition precedes the vesting of the rights and obligations of the parities under the contract and if FIPB approval is not obtained, HTIL was permitted to terminate the agreement. The approval of FIPB would not have been required if the transaction was only the transfer of one CGP share. HTIL entered into a settlement with the Essar Group on 15 March 2007, in order to obtain its support in the completion of SPA. By clause 5, HTIL was required to give notice to Essar and to purchase the *tag along* rights of Essar Teleholdings Ltd. as a minority shareholder of HEL. The Petitioner made an offer on 20 February 2007 for purchasing 33% of Essar interest in HEL for US $ 5.7687 billion. Vodafone and Essar Group entered into a term sheet agreement on 15 March 2007 to regulate the affairs of HEL and the

relationship between shareholders of HEL. The Petitioner would have operational control of HEL while Essar would have rights consistent with its shareholding, including a proportionate Board representation. The term sheet agreement was restated in August 2007 after the approval of FIPB was received. On 15 March 2007, Essar, HTIL and Vodafone entered into a Deed of Waiver by which Vodafone waived certain warranties given by the seller in the SPA. All this was unnecessary if the transaction related to only one share of CGP;

(xii) Vodafone and Vodafone Group Plc as guarantor of Vodafone, entered into a Put Option agreement on 15 March 2007 with Essar Teleholdings Ltd., India and Essar Mauritius Company requiring Vodafone to purchase from Essar Group all of the option shares held by them at a price payable at the first put option shares of US $ 5 billion. For the second put option Vodafone Group acquired from Essar Group, an irrevocable right to purchase such number of shares as the Essar Group may determine, subject to a minimum aggregate fair market value of US $ 1 billion and upto a maximum of US $ 5 billion. This shows that the transaction under

the SPA involved a succession by Vodafone of HTIL's joint venture interest in India and not merely a transfer of one share of CGP;

(xiii) In clause 8 of the SPA, HTIL assumed the responsibility to ensure execution of the terms of the transaction documents by the Indian entities and persons. Clause 9.5 of the SPA contemplated that in the event of breach, the agreement would be treated as requiring HTIL to procure the delivery of 66.9848% of the issued share capital of HEL to Vodafone and HTIL will be deemed to have transferred that proportion of the share capital of HEL. Clause 10.4 requires the replacement of the Oracle licence in favour of HEL and so that the consulting agreement is not terminated as a result of the SPA. Clause 14.1 embodied a non-compete clause restraining the vendor from carrying on any competing business in India. The extent of this restriction was co-terminus with the rights conferred on HTIL under its non-compete agreement with Hutchison Whampoa Ltd. in 2004 at the time of restructuring of the Hutchison Group;

(xiv) The transaction between HTIL and VIH BV took into

consideration the following:

(i) The interest held in HEL through eight Mauritius companies characterized as a direct interest aggregating to 42.34%;

(ii) Interest held in the Indian Company TII (to the extent of 37.25% of share capital through CGPM) which held shareholding of 19.54% in HEL, resulting in holding of 7.24% interest in the Indian company HEL;

(iii) Interest held in the Indian company Omega Holdings (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;

(iv) 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;

(v) 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 1-3-2006;

(vi) Controlling rights over TII through the TII Shareholder's Agreement, in the form of right to appoint two directors with veto power to promote its interests in HEL and thereby hold beneficial interest in 12.30% of the share capital of the Indian company HEL;

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

(viii) Controlling rights over ITNL through the ITNL Shareholders 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;

(ix) Interest in the form of loan of USD 231 million to

HTI (BVI) which was assigned to Array Holdings Ltd.;

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

(xi) Interest in the form of Preference share capital in JKF and TII to the extent of USD 167.5 million and USD 337 million respectively. These two companies hold 19.54% equity of HEL. Right to do telecom business in India through joint venture;

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

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

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

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

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

(xvii) Right to control premium;

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

The rights enumerated above are subject matter of transfer between HTIL and Vodafone and are enumerated in clauses 6.1(ix), 6.2(b), 6.4, 8.8, 8.9, 10.1, 10.4, 10.5 and 14.1 of the SPA. The price paid by Vodafone was for the acquisition of all the above enumerated composite rights which it held in HEL. It is not for the mere transfer of a CPG share.

(xv). HTIL's interest in HEL arose by way of indirect equity shareholding, option agreements, finance agreements, shareholders' agreements etc., the aggregate of which confers a controlling interest of 66.9848% in HEL. All these varied interests did not emerge only from one share of CGP and could not have been conveyed by the transfer of only one equity share. HTIL held

its direct equity interest in HEL amounting to 42.34% through eight Mauritian companies. HTIL exercised management control on account of the collective shareholdings of diverse entities and on account of shareholders' agreements, term sheet agreements and other arrangements negotiated with the joint venture partners. HTIL's indirect subsidiary, CGPM held 37.25% equity interest in TII, an Indian company which in turn, held a 12.96% equity interest in HEL. CGPM, as a result of its 37.25% interest in TII had an interest in several downstream companies which in turn, held interests in HEL, as a result of which HTIL obtained an indirect equity interest of 7.24% in HEL. HTIL had a further 15% interest in HEL by virtue of option agreements, framework agreements and shareholders agreements of Asim Ghosh, Analjit Singh and IDFC and credit arrangement with their companies. All these rights essentially did not go with one share of CGP. The significance of the framework agreements with the Analjit Singh Group companies, Asim Ghosh Group companies and IDFC Group companies was that Global Services Private Limited (GSPL), an indirect subsidiary of HTIL held certain subscription rights and call options to subscribe to and to acquire the shares of Indian

companies, controlled by Asim Ghosh, Analjit Singh and IDFC, which held investments in TII which in turn held shares in HEL. These rights arose under the -

1. ND Callus Framework Agreement dated 1 March 2006.
2. Centrino Framework Agreement dated 1 March 2006.
3. IDFC Framework Agreement dated 7 August 2006.
4. TII Shareholders' agreement dated 1 March 2006.
5. ITNL (Omega) Shareholders' agreement dated 7 August 2006.

- The subscription rights and call options were granted to 3-Global Services Private Limited (3GSPL) in consideration of 3GSPL procuring credit support to finance the acquisition of investment in TII and ITNL by the said Indian companies.
- Through these agreements, HTIL had indirect control and substantial influence over HEL which was characterized as 15% economic interest over HEL.

(xvi) These subscription rights and option rights were acquired under the framework agreements and could be exercised subject to their terms and conditions. These were rights which arose or accrued under independent agreements. One of the terms and conditions was that the agreement could be terminated on the occurrence of an event of default. A change of control was defined

as an event of default. Hence, a transfer of the CGP share to Vodafone would not enable Vodafone to exercise rights under these agreements unless it acquired those rights by entering into separate agreements with the Indian companies. Vodafone entered into similar agreements with the Indian companies to assure rights in its favour.

(xvii) Under Section 9(1), the deeming fiction is of a wide amplitude and all kinds of income derived by a non-resident from whatever source are brought within the ambit of the provision. Clause (i) of Section 9(1) provides that income is deemed to accrue or arise in India whether directly or indirectly inter alia through or from (a) a business connection in India; (b) property in India; (c) any asset in India; (d) any source of income in India; or (e) through the transfer of a capital asset situated in India. The common thread is that the income should have sufficient territorial or economic nexus with India. Unlike the OECD Group of countries, India has a wide net of source based taxation to preserve its tax base. It is for this reason that Section 9 is of a wide amplitude and a comparison with the OECD system of taxation will

not be appropriate.

(xviii) HEL is situated in India and its business of telecommunications was carried out entirely in India with relevant licences and regulatory clearances granted under Indian Laws. There has been a transfer of controlling interest in HEL from one non-resident to another non-resident. The business of HEL is based on property located within India. The gains received by HTIL through the transfer of the CGP share, the value of which was determined on the basis of the enterprise value of HEL being property situated in India and other valuable rights transferred by way of agreement are chargeable to tax in India. The gains are deemed to arise once the subject matter of the transaction constitutes a capital asset and its location is in India. Section 2(14) defines the expression "capital asset" in wide terms to mean property of any kind held by assessee. This will include rights and interests which are capable of being owned and transferred. The definition of the word "transfer" in Section 2(47) is wide enough to comprehend any method of transfer. The entire enterprise value attributed to HEL, was only on account of the fruits of the

investment made by HTIL in India, goodwill/brand value generated by HTIL for the Hutch Brand in India, the telecom licences granted in India, customer base in India and the prospect of future development and expansion of business in India. Further, all obligations cast upon the parties as per the transaction documents, were performed in India, including FIPB approval, Option Agreements, Term Sheet Agreements, Shareholder Agreements, Framework agreements with TII and Omega, Divestment of petitioners interest in Bharti Airtel Ltd., Settlement agreement with Essar, Trade Mark License. Further, the Non-compete condition was enforceable only in India and the Loan/Debt agreement/assignment to the Petitioner, was in respect of funds utilized in Indian business. Thus, the income from the transaction accrues or arises in India and is chargeable to tax under the first limb of Section 5(2)(b) of the Act.

(xix) The words “accrue” or “arise” indicate some origin or source of income and have to be determined on the cumulative effect of the facts in each case. They have a definite co-relation to a place where such income is derived and what must be considered

is the originating source of the gains, profits or income. The entire income which is derived by HTIL had its source in India and arose or accrued in India. The transaction in the present case, involves a transfer of a bundle of interests in various entities and it would be simplistic to assume that what was transferred was only a share of a Company in Cayman Islands and that all the other rights were incidental to the transfer.

(xx) The acquisition of an interest in a joint venture does amount to the acquisition of a capital asset. The acquisition of a bundle of interests amounted to acquisition of property in India. HTIL could transfer its controlling interest in HEL only upon extinguishing its rights in the Indian Company. A divestment of its right, title or interest necessarily preceded divestment of the controlling interest. The divestment by HTIL of its interests would result in an enduring benefit to VIH BV, resulting in the acquisition of a capital asset in India. HTIL relinquished its asset, namely, its interest in HEL so as to fall within the ambit of the expression “transfer” as defined in Section 2(47). The object of the transfer was to enable the VIH BV to acquire a controlling interest in HEL

and thereby a right to manage HEL. In the present case a debt was also assigned in favour of the Petitioner.

(xxi) In the present case, VIH BV disregarded the Indian corporate personality of the intermediary companies in the transfer of the asset and in the appropriation of income. The mode of the transfer of an asset is not determinative of the nature of the asset. Shares in themselves may be an asset but in many cases like the present, they may be merely a mode or a vehicle to transfer some other assets. In the present case, the subject matter of transfer is not just the shares of the Cayman Islands Company but assets situated in India. The particular mode of transfer will not alter or determine the situs, nature or character of the asset.

(xxii) The expression “person” in Section 195 is not restricted to a person resident in India and the provision can be applied also to a non-resident. The provisions of a statute dealing with machinery for collection of tax have to be construed according to the ordinary rules of construction and to make the charge effective. The Legislature has deliberately not qualified the expression

"person" in restrictive terms and it would be impermissible to do so by interpretation. Even though the revenue laws of one country are not enforceable in another, this does not mean that the laws themselves will not be enforced by the Courts of one country against a resident of another country. While the enforcement of the law cannot be contemplated in a foreign State, it can nonetheless be enforced by the Courts of the enacting State to the degree that is permissible with the machinery available.

(xxiii) In the present case, the transfer was not incidentally or marginally related to India. It has been admitted that the price paid to HTIL by the Petitioner was based on the underlying value of the Indian asset. The fact of the change of ownership of the Indian asset is evident from the permission required, sought and obtained of the FIPB under the Telecom policy. This was intended to further the business interest of the Petitioner and the transaction resulted in the introduction of the Vodafone brand. The transaction has a substantial nexus which would result in an obligation being cast upon the Petitioner to deduct tax under Section 195.

(xxiv) Section 195 applies to all payments which wholly or partly represent a sum chargeable to tax. Once the income is chargeable, the nexus will exist both with regard to payee and the payer.

-(xxv) A deduction of tax at source is only a tentative deduction and does not cause any prejudice to the person who is responsible to deduct the tax from the monies payable. No prejudice is caused to the deductor or to the deductee. The obligation to deduct tax under Section 195 is activated once the payment being made has the character of income for the purpose of the Act. A payment which has a character of income as defined in Section 2(24) will be income chargeable to tax for purpose of Section 195 and tax must be deducted. Once the payment has a character of income in the hands of the payee, the payer has a duty to deduct tax and the deductor is not concerned whether on regular assessment, the Department will find the income chargeable or otherwise. The provision has adequate safeguards. If a deductor is unsure whether the particular payment is deductible he can under Sub-section (2)

of Section 195 seek a clarification. The obligation to deduct tax is not extinguished merely because the payment is made by a non-resident to another non-resident outside in India. If the amount paid has nexus with India, it is the duty of the payer either to deduct tax or to approach the Department and seek a clarification on whether the deduction should be made.

55. The submission can now be considered.

Structuring business for tax planning :

56. Indian Law recognises that an assessee, who engages in legitimate business activity and organizes business around accepted legal structures is entitled to plan his transactions in a manner that would reduce the incidence of tax. An assessee who does so, does not tread upon a moral dilemma or risk a legal invalidation. There is a recognition in our law of the principle that lawful forms of activity can legitimately be arranged by those who transact business to plan for tax implications. So long as the legal structures that are put into place and the instruments of law that are utilized have been utilized *bona fide for a* business purpose,

fiscal law – absent statutory provisions to the contrary – does not permit an enquiry into the motives of the assessee or an investigation into the underlying economic interest. But a transaction which is sham or, what the law describes as a colourable device, stands on an entirely different foundation. A transaction which is sham is one in which though parties employ a legal form, it is in reality a different transaction; one which in reality does not give rise to the legal rights and obligations which arise from its ostensible nature. A sham is ostensible but not real and borders on a fraudulent employment of legal form or structure in aid of collateral ends. Absent a case of a transaction which is sham, fraudulent or colourable, the law respects instruments and structures adopted by business entities within the framework of law in the pursuit of legitimate forms of business activity. The legal character of the transaction will not be disregarded in pursuit of substance. So long as parties have not chosen to conceal the nature of their legal relationship by a device which suggests to the contrary or something at divergence with the legal character assumed by them, the law respects their autonomy.

57. Over six decades ago, in 1940, the Privy Council in **Bank of Chettinad Ltd vs. C.I.T.**,[1] observed thus:

> "Their Lordships think it necessary once more, to protest against the suggestion that in revenue cases, 'the substance of a matter' may be regarded as distinguished from the strict legal position."

In 1967, the Supreme Court in **CIT vs. Motors and General Stores (P) Ltd.**,[2] held that "in the absence of any suggestion of bad faith or fraud, the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction." The Supreme Court held that when the transaction is embodied in a document between parties, the liability to tax depends upon the meaning of the language used in accordance with the ordinary rules of construction. In 1999, a Constitution Bench of the Supreme Court in **Mathuram Agrawal v. State of Madhya Pradesh**,[3] dealt with the issue in the following observations:

> "The intention of the Legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxing Act it is not possible to assume

1 (1940) 8 ITR 522
2 (1967) 66 ITR 692
3 (1999) 8 SCC 667

> any intention or governing purpose of the statute more than what is stated in the plain language. It is not the economic results sought to be obtained by making the provision which is relevant in interpreting a fiscal statute. Equally impermissible is an interpretation which does not follow from the plain, unambiguous language of the statute. Words cannot be added to or substituted so as to give a meaning to the statute which will serve the spirit and intention of the Legislature"

58. The principle of law is that in interpreting fiscal legislation, the Court is guided by the plain language and the words used. The Court would not ignore a legal relationship which arises out of a business transaction in search of substance over form or in pursuit of the underlying economic interest. This, however, does not preclude the Legislature from legislating otherwise. In certain areas of the law, legislation may adopt a look-through provision which mandates a rigorous scrutiny to trace subjects and sources. This is a legislative function. Courts do not assume jurisdiction to themselves to create legislative policy or to legislate by interpretation for that does not lie within the realm of judicial power. In matters involving the interpretation of economic and fiscal legislation, Courts follow interpretative techniques which promote certainty in the application of law. Certainty requires

Courts to don a traditional, if even conservative role, by following precedent, maintaining interpretational discipline and recognising that it lies within the realm of legislative policy to alter settled legal doctrine. The need for certainty is accentuated in fiscal and economic matters by two other considerations which are of significance. The first is the perceived lack of expertise on the part of Courts to make the complex decisions that affect fiscal and monetary policy in a seamless world of technology and finance. The second is the constitutional deference to the executive in drawing a balance in matters involving economic and financial policy, based on the fact that it is the executive which is accountable, in a society based on democratic governance, to Parliament and ultimately the people. Questions such as where the balance should lie in safeguarding the revenue on the one hand and encouraging foreign direct investment on the other involve policy choices. Judicial doctrine which is designedly intended by the Constitution to be isolated from the rough and tumble of democratic accountability to electoral colleges must, therefore, be structured so as not to intrude upon the field of legislative policies which lies within the domain of Parliament.

Azadi Bachao

59. On 1 April 1983 the Governments of India and Mauritius entered into a Convention on the Avoidance of Double Taxation. The object of the Convention was to avoid double taxation and to prevent fiscal evasion of taxes on income and capital gains and to encourage mutual trade and investment. Article 13 of the Convention enunciated rules for taxation of capital gains and Clause 4 provided that gains derived by the alienation of shares by a resident of a contracting state shall be taxable only in that state. Capital gains derived by a resident of Mauritius on the alienation of shares were taxable only in Mauritius. Article 4 defined the expression "resident of a contracting state" to be a person who under the laws of that state is liable to taxation therein by reason of his domicile, residence, place of management or a criterion of a similar nature. By a circular dated 30 March 1994, CBDT in exercise of powers under Section 90 of the Income Tax Act 1961 clarified that capital gains derived by any resident of Mauritius on the alienation of shares of an Indian company shall be taxable only in Mauritius according to the taxation laws of that country and

would not be liable to tax in India. Notwithstanding this, the income tax authorities issued notices to show cause in 2000 to Foreign Institutional Investors (FIIs) to explain why they should not be taxed for profits and dividends which accrued to them in India. The basis of the notices was that the recipients were shell companies incorporated in Mauritius whose main purpose was investment of funds in India. Moreover, it was alleged that those companies were controlled and managed from countries other than India and Mauritius and not by residents of Mauritius so as to derive the benefits of the Convention. Confronted by a withdrawal of funds by FIIs, CBDT issued a circular on 13 April 2000 clarifying that such entities incorporated under the laws of Mauritius would be considered as residents of Mauritius in accordance with the Convention and that when a certificate of residence is issued by Mauritian authorities, that shall constitute sufficient evidence for accepting the status of residence and beneficial ownership for applying the Convention. This was to also apply to income from capital gains on the sale of shares and accordingly such entities resident in Mauritius would not be taxable in India on income from capital gains arising in India on the sale of shares.

60. The circular issued by the CBDT was quashed by the Delhi High Court, in public interest petitions, on the ground inter alia that the circular was ultra vires the powers of the CBDT insofar as it directed income tax authorities to accept a certificate of residence issued by the authorities in Mauritius as sufficient evidence of the residential status of such an entity. The Delhi High Court held that the Income Tax Officer was entitled to lift the corporate veil to determine as to whether a company was actually resident in Mauritius and to find out whether the corporate veil had been adopted to avoid payment of tax. The Delhi High Court faulted the circular on the ground that the power of the Assessing Officer to pass orders holding that such entities had only a "paper existence in Mauritius without any economic impact" had been taken away. The judgment of the Delhi High Court was challenged by the Union of India before the Supreme Court.

61. The Supreme Court held that Section 90 of the Income Tax Act, 1961, enabled the Central Government to enter into an agreement with the Government of any foreign state inter alia for

the avoidance of double taxation and once such an agreement was entered into the provisions of the Act would apply only to the extent to which they were more beneficial to the assessee. The Central Government was empowered to make provisions necessary for implementing the agreement. The Supreme Court held that the circular was within the purview of Section 90 and would prevail even if it was inconsistent with the provisions of the Act in relation to assessees covered by the convention.

62. Before the Supreme Court, the Respondents criticized the act of incorporation of FIIs under Mauritian law as sham and a device actuated by improper motives. The Supreme Court adverted to the dictum of Lord Tomlin in **IRC v. Duke of Westminster**[4] that a person "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". The Court also referred to the earlier statement by Lord Sumner in **IRC v. Fisher's Executors**[5] that "the highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he

4 (1936) AC 1 (HL).
5 (1926) AC 395.

can do so within the law, and that he may legitimately claim the advantage of any expressed terms or of any omissions that he can find in his favour in taxing Acts". The Supreme Court held that far from being exorcised in its country or region, the dictum in **Duke of Westminster**'s case "continues to be alive and kicking in England". In holding thus, the Supreme Court noted that subsequent decisions of the House of Lords in **Craven v. White**[6], **Furniss v. Dawson**[7] and **W.T. Ramsay Ltd. v. IRC**[8] did not affect the validity of the principle which had been laid down in the **Duke of Westminster**'s case. The Supreme Court emphasized that the judgment of the majority of the Court in **McDowell and Co. Ltd. & Commercial Tax Officer**[9] regarded tax planning as legitimate provided it was within the frame work of law. What was frowned upon were colourable devices resorted to with the object of avoiding the payment of tax by resorting to dubious methods. The judgment of the Delhi High Court was reversed.

63. The following principles are now firmly embedded in our

6 (1988) 3 ALL ER 495.
7 (1984) 1 All ER 530 (HL).
8 (1982) AC 300.
9 (1985) 154 ITR 148.

jurisprudence :

-(i) A transaction or arrangement which is permissible under law which has the effect of reducing the tax burden of an assessee does not incur the wrath of the law;

-(ii) Citizens and business entities are entitled to structure or plan their affairs with circumspection and within the framework of law with a view to reduce the incidence of tax;

(iii) A transaction which is sham or which is a colourable device cannot be countenanced. A transaction which is sham or a colourable device is one in which the parties while ostensibly seeking to clothe the transaction with a legal form, actually engage in a different transaction altogether. A transaction which serves no business purpose other than the avoidance of tax is not a legitimate business transaction and in the application of fiscal legislation can be disregarded. Such transactions involve only a pretense and a facade to avoid compliance with tax obligations;

-(iv) Absent a case of a transaction which is sham or a

colourable device, an assessee is entitled to structure business through the instrument of genuine legal frameworks. An act which is otherwise valid in law cannot be disregarded merely on the basis of some underlying motive resulting in some economic detriment or prejudice. In interpreting a fiscal statute it is not the economic result sought to be obtained by making the provision which is of relevance and the duty of the Court is to follow the plain and unambiguous language of the statute.

Kharwar : the issue of subtance vs. form:

64. In **Commissioner of Income Tax v. B.M. Kharwar**[10], a partnership firm closed the manufacturing part of its business and transferred its machinery to a private limited company in the share capital of which the partners had the same interest. The Assessing Officer brought to tax the excess realized over the written down value of the machinery. The High Court held that in a tax case it would not look at the form which a transaction has, but at the real nature of the transaction and that though legally the transaction

10 (1969) 72 ITR 603.

was a sale, in substance it was only a readjustment made by certain persons to carry on business in one form than in another. The Supreme Court held that it was "now well settled that the taxing authorities are not entitled in determining whether a receipt is liable to be taxed to ignore the legal character of the transaction which is the source of the receipt and to proceed on what they regard as "the substance of the matter". The Supreme Court observed that while the authorities are bound to determine the true legal relations resulting from a transaction yet if the parties have chosen to conceal a legal relationship by a device, it would be open to them to unravel the device and determine the true character of the relationship. However, the Supreme Court noted that "the legal effect of a transaction cannot be displaced by probing into the substance of the transaction".

Walfort

65. These principles have now been reiterated in a recent judgment of the Supreme Court in **Commissioner of Income Tax**

v. Walfort Share and Stock Brokers Pvt. Ltd.[11]. While construing the provisions of Section 14A and Section 94(7) of the Income Tax Act 1961 Mr. Justice S.H. Kapadia, the Learned Chief Justice of India, observed as follows :

> "At the outset, we may state that we have two sets of cases before us. The lead matter covers assessment years before insertion of Section 94(7) vide Finance Act, 2001 w.e.f. 1.4.2002. With regard to such cases we may state that on facts it is established that there was a "sale". The sale price was received by the assessee. That, the assessee did receive dividend. The fact that the dividend received was tax-free is the position recognized under Section 10(33) of the Act. The assessee had made use of the said provision of the Act. That such use cannot be called "abuse of law". Even assuming that the transaction was pre-planned there is nothing to impeach the genuineness of the transaction. With regard to the ruling in McDowell & Co. Ltd. v. Commercial Tax Officer [154 ITR 148(S)], it may be stated that in the later decision of this Court in Union of India v. Azadi Bachao Andolan [263 ITR 706 (SC)]it has been held that a citizen is free to carry on its business within the four corners of the law. That, mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon even by the judgment of this Court in McDowell & Co. Ltd.'s case (supra)."

66. The governing principle therefore is that tax planning is legitimate so long as the assessee does not resort to a colourable device or a sham transaction with a view to evade taxes. A genuine

11 2010(6) Scale 471.

transaction within the framework of law will not be impeached.

Shares as capital assets :

67. Section 2(14) of the Income Tax Act, 1961 defines the expression “capital asset” to mean “property of any kind held by an assessee, whether or not connected with his business or profession”. The definition proceeds to list in clauses (i) to (vi) what is not included within the ambit of the expression. Clause 42A of Section 2 defines the expression “short-term capital asset” to mean a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. The proviso stipulates, inter alia, that in the case of a share held in a Company or any other security listed in a recognised stock exchange in India, the provisions of the clause would have effect as if the words “twelve months” have been substituted for “thirty-six months”. Sub-clause (c) of Clause (i) to Explanation 1 provides that in determining the period for which any capital asset is held by the assessee, in a case where the asset consists of a share of an Indian Company which becomes the property of the assessee in

consideration of a transfer referred to in clause (vii) of Section 47, the period for which the shares in the amalgamating company were held by the assessee shall be included. Shares constitute capital assets within the meaning of clause (14) of Section 2. Shares are recognized as assets and a transfer of shares is recognized in clause (42A) of Section 2. Clause 47 of Section 2 defines the expression "transfer" in relation to a capital asset to include a sale of the asset. The definition of the expression "transfer" artificially brings in certain cases where in law, there may not have been a transfer. For instance, a transaction by which possession of immovable property is taken or retained in part performance of a contract under Section 53A of the Transfer of Property Act, 1882, is brought within the ambit of the provision. Similarly, by sub-clause (vi) any transaction which has the effect of transferring or enabling the enjoyment of any immovable property, is within the ambit of the expression "transfer". Sub-section (1) of Section 45 brings to tax any profits or gains arising from a transfer of a capital asset effected in the previous year under the head of "capital gains".

Principles governing shares and the rights of shareholders.

68. Now, at the outset, it must be noted that under the general principles of law, a share as a chose in action comprises of an indivisible set of rights, not capable of being separately transferred at law. (**Gore Browne** on Companies).[12] Under the Indian Law, the privilege of membership can be exercised only by a person whose name is entered in the Register of Members. In **Balkrishna Gupta vs. Swadeshi Polytex Ltd.**,[13] the Supreme Court held, while applying this principle that a receiver whose name is not entered in the Register of Members, cannot exercise any of the rights and privileges of membership unless in a proceeding to which the Company is a party an order to that effect has been passed. Several rights emanate from the holding of shares including principally (i) The right to vote at a general meeting; (ii) The right to requisition an extra-ordinary general meeting; (iii) The right to receive a notice of a general meeting; (iv) The right to appoint a proxy and inspect a Proxy Register; (v) In the case of a body corporate which is a member of the Company, the right to attend a general meeting on its behalf; (vi) The right to receive dividend; and (vii) The right to require the Company to

12 Volume 2 Chapter 23-2
13 (1985) 2 SCC 167

circulate its resolutions. These rights attach to and are inseparable from the ownership of shares. A Company recognizes as its members, persons whose names are borne on the Register of Members to whom dividend declared by a company is payable. As between the transferor and transferee certain equities may arise at law. Among them, is the right to claim the dividend declared and paid by the Company. These equities, however, as noted by the Supreme Court, "do not touch the Company, and no claim by the transferee whose name is not in the Register of Members can be made against the Company." As between the shareholders in a Company, the right to vote belongs to a person legally entitled to the shares by reason of his presence on the Register of Members. Even an order of attachment does not deprive the holder of shares to the title to shares.

69. Ownership of shares may in certain situations result in the assumption of an interest which has the character of a controlling interest in the management of the Company. The extent of shareholding which is sufficient to vest in the holder of shares an interest which assumes the character of a controlling

interest may again vary from case to case. In **C.I.T. vs. Messrs Jeewanlal Ltd.**,[14] a Constitution Bench of the Supreme Court, while considering the ambit of the expression "controlling interest" under Section 2(21) of the Excess Profits Tax Act, defined the concept thus:

> "In common parlance a person is said to have a "controlling interest" in a company when such a person acquires, by purchase or otherwise, the majority of the vote-carrying shares in that company, for the control of the company resides in the voting powers of its shareholders. In this sense, the directors of a company may well be regarded as having "a controlling interest" in the company when they hold and are entered in the share register as holders of the majority of the shares which, under the Articles of Association of the company, carry the right to vote."

The Supreme Court emphasized the principle that when a shareholder, holding a majority of the shares, authorised an agent to vote for him, the agent acquired no interest, legal or beneficial, for the title to the shares continued to vest in the shareholder.

70. A controlling interest does not for the purpose of the Income Tax Act, 1961 constitute a distinct capital asset. That is

14 (1953) 24 ITR 475

simply because the assumption of control is a right which emanates from the acquisition of a sufficient number of shares in the Company as would enable the holder of the shares to exercise a voting power of a degree and nature as would result in a control of the management. A controlling interest is an incident of the ownership of the shares in a Company; something which flows out of the holding of shares. A controlling interest is, therefore, not an identifiable or distinct capital asset independent of the holding of shares. In **Smt.Maharani Usha Devi vs. C.I.T**.,[15] the Madhya Pradesh High Court considered whether in a situation where the assessee paid an excess over the market price of the shares for the acquisition of a controlling interest in the Company, such an interest constituted property under Section 2(14) of the Income Tax Act, 1961. In that case, the assessee had acquired a large block of shares at a price substantially higher than the market price. The Tribunal had held that the price at which shares were acquired by the assessee did not represent the cost of acquisition because in addition to the shares, the assessee had acquired a controlling interest. The excess paid by the assessee was considered by the

15 (1981) 131 ITR 445

Tribunal to represent the price of the controlling interest. The High Court did not find any justification for the view of the Tribunal and held as follows:

> "This view of the Tribunal proceeds on the assumption that controlling interest is a distinct capital asset which can be acquired or transferred independently of the shares. We see no justification for the view. Controlling interest is an incidence arising from holding a particular number of shares in a company. It cannot be separately acquired or transferred. It flows from the fact that a number of shares are held by a person. If for acquiring that number of shares, a person is required to pay more than the market price of a share and if the transaction is genuine, as has been found in the present case, then, really speaking, the cost of acquisition of the block of shares purchased by the assessee is that which she has in fact paid for holding that block."

Referring to a judgment of the Bombay High Court in **Baijnath Chaturbhuj v. CIT,**[16] where a composite consideration had been paid by the assessee for the transfer of shares and the assignment of a Managing Agency, the Court observed that in such a case, "there should be two distinct assets each capable of being acquired or transferred separately". However, a controlling interest could not by itself be acquired or transferred but was an incident which arose out of the holding of a particular number of shares.

16 (1957) 31 ITR 643

71. In **Commissioner of Wealth Tax vs. Mahadeo Jalan**,[17] the Supreme Court recognised the same legal position in Indian Law, holding that "a share is not a sum of money, but is an interest measured by a sum of money made up of various rights contained in the articles of association." In **Vekatesh vs. C.I.T.**,[18] a Division Bench of the Madras High Court held that the price paid by the purchaser of shares even if it was higher than the market price – the difference representing a controlling interest which was transferred by the seller to the buyer – nonetheless remains the price for the shares. The Division Bench held that the Tribunal was correct in upholding the order of the Commissioner and the Assessing Officer who had assessed the sum mentioned in the assessment order as long term capital gains arising out of the sale of the shares held by the assessee under Section 45 of the Income Tax Act, 1961. In that context, the Division Bench held thus:

> "The fact that the vendor has controlling interest and is in a position to place the vendee in control of the company by transferring all his shares or such part as would enable the vendee to exercise control over the company with the aid of the shares so transferred would only enhance the value of the shares transferred. The

17 (1972) 86 ITR 621
18 (2000) 243 ITR 367

> price paid by the vendee for acquisition of such shares remains the price of those shares though the price so paid is higher than the market price. Controlling interest is but an incidence of the shareholding and has no independent existence."

The Division Bench noted that it was as a result of the control of shares that the holder was enabled in exercising control of management and without control over the shares, there could be no question of any controlling interest. Hence, the price paid for the shares by the purchaser constituted the price paid for the acquisition of the shares and the entire consideration would have to be taken into account for computing the capital gains in the hands of the seller.

72. In **Carew & Company vs. Union of India**,[19] the undertaking of the Appellant consisted of a Sugar Factory and two distilleries. The Sugar Factory was in financial difficulty. The Appellant proposed to float a Company for taking over the sugar unit and for working it as an undertaking of the Company to be formed. The Appellant was to be entitled to the allotment of all the

19 AIR 1975 SC 2260

shares of the new Company in addition to the consideration paid for the transfer of the sugar unit. The Appellant sought the approval of the Company Law Board under Section 372 of the Companies' Act, 1956 which was declined. The issue before the Supreme Court was whether the provisions of Section 23(4) of the Monopolies and Restrictive Trade Practices Act, 1969 were attracted. These provisions applied where an undertaking proposed to acquire by purchase, takeover or otherwise, the whole or part of an undertaking which would result in the creation of an undertaking to which the Part applied or in an undertaking becoming an interconnected undertaking of another undertaking to which the part applied. A Constitution Bench of the Supreme Court held that by the proposal to acquire all the shares of the Company which was to be floated, the Appellant could acquire only control and the right to manage the Company. The Appellant would not, as a result, acquire the undertaking owned by the new Company by purchase, takeover or otherwise. Applying the doctrine that the Company has a distinct juristic personality from its shareholders, the Supreme Court held that the purchase of all the shares would not have the effect of an acquisition of the

undertaking. Dealing, as it was, with regulatory legislation designed to give effect to the Directive Principles of State policy, the Supreme Court held that nonetheless Parliament would not be imputed with the intention of sweeping aside fundamental legal concepts governing the incorporation of a Company. Mr.Justice K.K.Mathew, speaking for the Bench, observed as follows:

> "It is well settled that a company has separate legal personality apart from its shareholders and it is only the company as a juristic person that could own the undertaking. Beyond obtaining control and the right of management of Shahjahanpur Sugar Private Ltd., the purchase of 100 per cent shares had not the effect of an acquisition of the undertaking owned by it. No doubt, on a dissolution of the company, the share-holders would be entitled to a distributive share of the assets of the company. But it does not follow that while the company is a going concern, the shareholders are the owners of its assets including any undertaking. It is the company as a separate entity which alone can own the undertaking and the purchase by the appellant of 100 per cent shares did not make it the owner of the undertaking. We are aware that we are dealing with an economic legislation calculated to give effect to the Directive Principles of State Policy set out in clauses (b) and (c) of Article 39 of the Constitution and that the purpose of the legislation should be kept in mind in interpreting its provisions; but we are not prepared to assume that the legislature has, by a side-wind, swept away the well established fundamental legal concepts of the law of corporation in making the legislation."

A Division Bench of the Delhi High Court, consisting of Mr.Justice D.P.Wadhwa and Mr.Justice Dalveer Bhandari (as their Lordships then were) in **Corrasco Investments Ltd. vs. Special Director, Enforcement Directorate**,[20] adopted a similar approach in the context of Section 29(1)(b) of the Foreign Exchange Regulation Act, 1973. Applying the doctrine established by the judgment of the Supreme Court in **Bacha F.Guzdar vs. CIT**,[21] that the Company has a juristic personality distinct from its shareholders, the Delhi High Court held that the undertaking of a Company cannot be equated with the shares held in a Company. The judgment of the Delhi High Court held thus:

> "The "undertaking" of a company is not the same thing as "shares" of that company. ... Even though a shareholder acquires a right to participate in the profits of the company, the shareholder acquires no interest in the assets of the company. The Supreme Court in *Mrs.Bacha F.Guzdar v. CIT* [1955] 25 Comp Cas 1 (SC); AIR 1955 SC 74, observed that a shareholder had got no right in the property of the company and that it was true that the shareholders had the sole determining voice in administering the affairs of the company and were entitled, as provided in the articles of association, to declare that dividends should be distributed out of the profits of the company to the shareholders but the interest of the shareholder either individually or collectively did not amount to more than a right to participate in the profits of the company."

20 (1994) 79 Comp Cases 631
21 (1955) 25 Comp Cases 1

In its decision in **Bacha Guzdar**, which is the *locus classicus* on the point, the Supreme Court in a decision of five Learned Judges laid down the following principle which has been consistently applied. The principle of law expounded in the case is thus:

> "That a shareholder acquires a right to participate in the profits of the company may be readily conceded but it is not possible to accept the contention that the shareholder acquires any interest in the assets of the company. .. A shareholder has got no interest in the property of the company though he has undoubtedly a right to participate in the profits if and when the company decides to divide them. The interest of a shareholder vis-a-vis the company was explained in the *Sholapur Mills* case, (1950) S.C.R. 869 at 904. That judgment negatives the position taken up on behalf of the appellant that a shareholder has got a right in the property of the company. It is true that the shareholders of the company have the sole determining voice in administering the affairs of the company and are entitled, as provided by the articles of association, to declare that dividends should be distributed out of the profits of the company to the shareholders but the interest of the shareholder either individually or collectively does not amount to more than a right to participate in the profits of the company. The company is a juristic person and is distinct from the shareholders. It is the company which owns the property and not the shareholders."

The principle that companies which are incorporated under the Companies' Act, 1956 have a corporate personality of their own, distinct from that of the shareholders was applied in the context of a Government Company by the Supreme Court in **Western Coalfields Ltd. vs. Special Area Development Authority.**[22] The Supreme Court held that as a result, the property of a Company in which the shareholding was held by the Union of India did not constitute the property of the Union Government so as to be exempt from municipal taxation under Article 285(1) of the Constitution of India.

73. This position has also consistently held the field in the U.K. In a 1920 decision of Astbury J. in **Wise vs. Lansdell**,[23] the registered owner of certain fully paid shares of a private Company, charged them in favour of another and handed over to him blank transfer deeds. He subsequently, gave other equitable charges to other mortgagees. On the bankruptcy of the owner his trustees disclaimed all his interest in the shares. As a blank transfer was not completed and lodged, the name of the bankrupt remained on the

22 (1982) 1 SCC 125
23 (1921) Chancery Division 420

Register. The Court held that as between himself and the Company, the bankrupt so long as his name remains on the Register was entitled to vote in respect of the shares though as between himself and the mortgagees he could only vote as they dictate. Nearly forty years prior to the decision in Wise **Vs. Lansdell**, Chitty, J in **re: Wala Wynaad Indian Gold Mining Mining Co**. had observed that a shareholder means "the holder of the shares" and that the term as commonly used "only means the person who holds the shares by having his name on the Register."

74. In **Inland Revenue Commissioners vs. Bibby & Sons Ltd.**,[24] the House of Lords considered whether the Director of a Company had a controlling interest upon which rested the outcome of an assessment to excess profits tax. The House of Lords held that by that expression what was meant was "the extent to which they have vested in them the power of controlling by votes, the decisions which will bind the Company in the shape of resolutions passed by the shareholders in general meeting" and the fact that a vote carrying share was vested in a Director as a trustee was

24 (1946) 14 ITR (Suppl) 7

immaterial. Even if power were exercised in breach of trust, the vote would be treated as validly cast vis-a-vis the Company and the resolution would be binding on it. The Control of a Company, opined the Law Lords, resides in the voting power of its shareholders. Farwell, J. in a judgment of the Chancery Division in **Borland's Trustee vs. Steel Brothers & Co.Ltd**.,[25] noted that "a share is the interest of a shareholder in the Company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se" in accordance with the Companies' Act. A share represents an interest "made up of various rights contained in the contract, including the right to a sum of money". The same principle has been reiterated in the judgment of Viscount Hailsham LC in **Commissioner of Inland Revenue vs. Crossman.**[26]

75. The Court of Appeals in **Gramophone & Typewriter Ltd. vs. Stanley**,[27] dealt with a case where an English Company which carried on business in the U.K. held shares of a German Company

25 (1901) 1 Ch 279
26 (1936) 1 All ER 762
27 1908-1910 All ER 833

which was registered as a Company of limited liability under German Law. The members of the Board of the German company were also directors of the English company. By German law, the German company was obliged to transfer to its patents account, a certain sum equivalent to depreciation of the value of patents owned by it. The Court of Appeals held that despite the fact that all the shares of the German company belonged to the English company, the business of the German company did not become the business of the English company. The German company was an entity distinct from the German company. Hence, the English company was not liable to income tax in respect of the amount transferred to the patents account but only in respect of such profits of the German company which had actually been received in the U.K. Sir Herbert Cozens Hardy M.R., placed the issue of principle thus:

> "The fact that an individual by himself or by his nominees holds practically all the shares in a company may give him the control of the company in the sense that it may enable him by exercising his voting powers to turn out the directors and to enforce his own views as to policy, but it does not in any way diminish the rights or powers of the directors or make the property or assets of the company his as distinct from the corporation's. Nor does it make any difference if he acquires not practically

> the whole, but absolutely the whole of the shares. The business of the company does not thereby becomes his business. He is still entitled to receive dividends on his shares, but no more."

Fletcher Moulton, L.J. and Buckley, L.J. held that the English holder was only liable for such profits as he actually received in the U.K. by way of dividend and was not responsible for what the actual profits of the Corporation shall have been. The profits of the Corporation were not the profits of any business carried on by them in a foreign country, as the English holders did not carry on the business of the Corporation:

> "This legal proposition that the legal corporator cannot be held to be wholly or partly carrying on the business of the corporation is not weakened by the fact that the extent of his interest in it entitles him to exercise a greater or less control over the manner in which that business is carried on. Such control is inseparable from his position as a corporator and is a wholly different thing both in fact and in law from carrying on the business himself. .. The control of individual corporators is something wholly different from the management of the business itself. Now, is this principle less true when the holding of the individual corporator is so large that he is able to override the wishes of the other corporators in matters relating to the control of the business of the company. The extent but not the nature of his power is changed by the magnitude of his holding."

76. The position of law which has consistently held the field for over a hundred years in the U.K. and for well over five decades in India, is that the business of a corporation is not the business of its shareholders. The undertaking and the assets of a corporation are not the undertaking and assets of its shareholders. A corporation as an entity incorporated under legislation governing companies has a distinct juristic personality. A shareholder has during the subsistence of the corporate personality, no interest in the assets owned by the corporation. The right of the shareholder is to participate in the profits by receiving the dividend that may be declared by the corporation. A share represents an interest of a shareholder which is made up of various rights contained in the contract embodied in the Articles of Association. The right of a shareholder may assume the character of a controlling interest where the extent of the shareholding enables the shareholder to control the management. A controlling interest which a shareholder acquires is an incident of the holding of shares and has no separate or identifiable existence distinct from the shareholding. The extent of the power of the shareholder would

depend upon the magnitude of the holding but the nature of the power is not altered by it. Shares and the rights which emanate from them, flow together and cannot be dissected. In the felicitous phrase of Lord Macmillan in **Crossman**, shares in a Joint Stock Company consist of a "congearies of rights and liabilities" which are a creature of the Companies' Acts and the Memorandum and Articles of the particular company. The rights and liabilities appurtenant to a share may vary widely within the law, but they cannot exist independently of the inherent attributes with which a share has been created. Control and management is one facet of the holding of shares.

Taxation of non-residents:

77. The jurisdiction of a State to tax non-residents is based on the existence of a nexus connecting the person sought to be taxed with the jurisdiction which seeks to tax. The nexus may arise as a result of the physical presence of the non-resident. The nexus of a non-resident with the taxing jurisdiction arises where the source of income originates in the jurisdiction. The source of income is determined in accordance with source rules. The source

of income may be relevant in a number of ways. For example, the source enables the taxing jurisdiction to determine whether a country may tax a particular item of income under the source principle of taxation or to determine whether the income has a foreign source so as to be eligible for a foreign tax credit. The source principle of taxation is also used to refer to the category of income from which a particular item of income originates. The source principle of taxation is a principle for allocating taxing jurisdiction over income, according to which a country may tax income having its source in that country, regardless of the residence of the tax payer.[28] Nations recognize that both the country of residence and the country of source have a valid claim to tax income. Explaining this, Professor Michael J.Graetz of the Yale Law School in his **Foundations of International Income Taxation** notes that in contrast, a nation that is neither the country of source, or of residence or citizenship, is generally not recognized as having a right to tax.[29] If both, the resident and source country exercised their right to tax simultaneously, this is

28IBFD International Tax Glossary revised 6th edition, Ed.Julie Rogers-Glabush pp 294, 394.

29Michael J. Graetz, Professor of Law, Yale Law School: Foundations of International Income Taxation (Foundation Press 2003).

liable to result in double tax which is generally regarded as being unfair because it may create substantial barriers to cross border activity and investment. International tax policy seeks to mediate between the claims of residents and source in an effort to ensure that income is taxed only once. In India international agreements on the avoidance of double taxation, such as the one with Mauritius, are sanctified by Section 90 of the Income Tax Act, 1961.

Section 5(2) and Section 9(1) : identification of nexus :

78. The charge of income tax under Sub-section (1) of Section 4 is on the total income of every person for a previous year at the rate or rates enacted in a Central Act. Under sub section (1) of Section 5, in the case of a person who is a resident, the total income of any previous year includes all income from whatever source it is derived, which is received, accrues or arises or is deemed to be received, accrued or arise in India. The global income of a person resident in India is brought within the ambit of total income. In the case of a resident, the nexus for the purposes of taxation is provided by residence in India, and hence, income

irrespective of where it is earned, is brought within the purview of the total income that is chargeable to tax. In the case of a non-resident, Sub-section (2) of Section 5 enunciates that the total income of any previous year would include all income from whatever source derived which (i) is received or is deemed to be received in India by or on behalf of such person; or (ii) accrues or arises or is deemed to accrue or arise to him in India during such year. Hence, in the case of a non-resident, the nexus for the purpose of chargeability to income tax is provided by the receipt or accrual of the income in India.

79. Sub-section (1) of Section 9 stipulates incomes which shall be deemed to accrue or arise in India. Clause (i) of sub-section (1) is to the following effect :

> "(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."

Explanation (1) provides in clause (a) that where all the operations of a business are not carried out in India, the income of the

business which is deemed 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. Clause (b) stipulates that in the case of a non-resident, no income shall be deemed to accrue or arise in India from operations confined to the purchase of goods within the country for the purpose of export. Explanation (2) declares that for the removal of doubts that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident, -

> "(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or
>
> -(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
>
> -(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:"

Under the proviso, however, a business activity carried out through a broker, or an agent with an independent status, acting in the

ordinary course of business, is not to constitute a business connection. Whether, however, a broker or an agent works mainly or wholly on behalf of a non-resident or the non-resident and other non-residents controlled by the principal non-resident or having a controlling interest in the principal non-resident or subject to common control, he shall not be deemed to be an agent with an independent status.

80. By the provisions of Sub-section (2) of Section 5, the income of a non-resident from whatever source derived is includible in the total income if it is received or deemed to be received in India or if it accrues or arises or is deemed to accrue or arise to him in India during the year. Breaking down sub section (2) into is components, it covers income of a non-resident which (i) is received in India; (ii) accrues in India; (iii) arises in India; (iv) is deemed to be received in India; (v) is deemed to accrue in India; or (vi) is deemed to arise in India.

81. Income is said to accrue or arise when the assessee has a right to receive the income. The words “accrue” and “arise” are

used in distinction to the word "receive". The words "accrue and arise" indicate a right to receive. In **Seth Pushalal vs. C.I.T.**,[30] a Bench of three Learned Judges of the Supreme Court adopted this test in determining the ambit of the expressions "accrue" and "arise":

> "The words "accrue" and "arise" do not mean actual receipt of the profits or gains. Both these words are used in contradistinction to the word "receive" and indicate a right to receive. ... It is clear, therefore, that the income may accrue to an assessee without actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to accrue to him, though it may be received later, on its being ascertained. The basic conception is that he must have acquired a right to receive the income (see E.D. Sassoon and Co. Ltd. v. Commissioner of Income-tax, (1954) 26 ITR 51."

Section 9(1) defines the circumstances in which income is deemed to accrue or arise in India. Sub-section (1) of Section 9 defines in clause (i), income which shall be deemed to accrue or arise in India. Sub clause (i) is in turn, distributed into four categories. These categories cover income accruing or arising, whether directly or indirectly: (i) Through or from any business connection in India; (ii) Through or from any property in India; (iii) Through or from

30 (1967) 66 ITR 159

any asset or source of income in India; or (iv) Through the transfer of a capital asset situated in India. In each of these four categories, the law has postulated the existence of a nexus with India which invokes taxing jurisdiction. The nexus is provided in the case of the first category from a business connection in India; in the second, by the situs of the property in India; in the third, from any asset or source of income in India; and in the fourth, by the situs of the capital asset which is transferred, in India. Parliament has been careful to ensure that even while adopting a deeming fiction in defining incomes which are deemed to accrue or arise in India that there must exist a nexus with India upon which the jurisdiction to tax is founded.

Apportionment :

82. In certain instances which are known to tax legislation, a need for apportioning income arises when the source rule applies and the income can be taxed in more than one jurisdiction. Judicial precedent emanating from the Supreme Court and the High Courts has analysed situations where a person has earned profits on the sale and purchase of goods abroad or where an

assessee engages in a composite activity – such as manufacture and sale – and one component takes place within the jurisdiction of the taxing territory, while another has occurred outside the taxing jurisdiction. Such instances have arisen in British India. A question of apportionment has arisen.

83. In **C.I.T. vs. Chunilal B.Mehta**,[31] the assessee was a resident of British India and was held liable during the course of assessment proceedings to pay tax upon profits derived by him from contracts made for the purchase and sale of goods in foreign markets outside British India. The assessee disputed his liability in respect of such profits on the ground that they were not profits “accruing or arising in British India”. Sir George Rankin, delivering the judgment of the Privy Council, held that it was not possible to lay down any rule of general application to all classes of foreign transaction for, to do so would be “nearly impossible and wholly unwise”. The Privy Council held that a person resident in British India, carrying on business there and controlling transactions abroad in the course of such business, was not by these mere facts

31 AIR 1938 PC 232

liable to tax on the profits of such transactions. If the profits were not received in or brought into British India, it became necessary to consider whether they accrue or arise there. In certain cases, the place of the formation of the contract would prevail while in another acts done under the contract could not be ruled out *a priori*. In that case, the Privy Council held that the contracts were neither framed, nor carried out in British India and the High Court's conclusion that the profits accrued or arose outside British India was well founded.

84. In **C.I.T. vs. Ahmadbhai Umarbhai**,[32] an assessee was a resident of British India and besides a manufacturing facility in Mumbai, had a manufacturing unit in the State of Hyderabad at Raichur. The assessee contended that a part of the profits derived from sale in British India of oil manufactured at Raichur, was attributable to the manufacturing operation at Raichur and should be excluded from assessment for excess profits tax. Chief Justice Harilal Kania, who delivered one of the judgments of the Constitution Bench, held that the question as to where income has

32 (1950) 18 ITR 472

accrued has to be determined on the facts of each case. The income may accrue or arise at the place of the source or elsewhere. When the manufacturing portion of the activity of the assessee was in one province and the sale in another, the whole of the profits would not necessarily be construed as arising from the sale though they may be received from the sale of the product. The profits could be apportioned between manufacturing and trading activities, particularly when the assessee carried on business of a manufacturer and trader together. Under Section 42 of the Income Tax Act, 1922, an apportionment could be carried out for ascertaining the profits of a business, a part only of whose operations were carried out in British India where such part could be regarded either as "a business connection in British India" or "a source of income in British India". The result was that the profits received at Bombay from the sale of oil manufactured at Raichur were liable to be apportioned under sub-Section (3) between the two operations of manufacture and sale and only such portion of the profits as was reasonably attributable to the sale could be deemed to accrue or arise in British India. The rest of the profits attributable to the manufacture at Raichur would have to be

regarded as accruing or arising at Hyderabad State. Mr.Justice Mahajan in his judgment also emphasized that it was the operation of manufacture at Raichur that enabled the assessee to sell oil and some portion of the profits must necessarily be attributable to the manufacturing process. In the case of a composite business where a person carries on a number of businesses or activities, the profit or loss would have to be apportioned between the different businesses and activities.

85. **Ahmedbhai Umarbhai** is an illustration of the application of the doctrine of apportionment where an assessee carries on multiple activities as part of a composite business which straddles more than one taxing jurisdiction. The income which results from those activities has to be apportioned so as to determine what part of the income can be attributable to the business which is carried on in the taxing jurisdiction. Such a principle of apportionment of business income is adopted in the Act of 1961 in clause (a) of Explanation (1) to Section 9(1)(i). The need for apportionment arises when the source rule applies and the income can be taxed in more than one jurisdiction. Apportionment

pre-supposes a multiplicity of activities from which income accrues or arises.

86. In **Seth Pushalal Mansinghka (P) Ltd. vs. C.I.T**. (supra), a Bench of three Learned Judges dealt with a case where the assessee had mica mines and a factory at Bhilwara in Rajasthan which was a Part-B State. After processing, the mica was exported to locations in Part A and C States and was sold to purchasers there. The Supreme Court held that the profits had accrued to the assessee at the place where the sales were effected and the property in the goods passed to purchasers. The assessee became entitled to the price of the goods only when the title to the goods passed to purchasers in the Part A and C States and the income was, therefore, regarded as having accrued in those States.

87. In **Chainrup Sampatram vs. Commissioner of Income Tax, West Bengal**,[33] the assessee which was a partnership firm, carried on business at Calcutta and despatched in the year of account bars of silver to the Indian State of Bikaner where the

33 (1953) 24 ITR 481

partners resided and their value at cost was credited in the assessee's books. The case of the assessee that the silver had been sold to the partners was found not to be genuine and the finding was that the silver still formed a part of the assessee's stock-in-trade. In the assessment, a sum representing the excess arising from the valuation of the silver bars at the market rate at which the rest of the closing stock at Calcatta was valued was included. Affirming the finding that the aforesaid value was in law, assessable to tax, the Supreme Court held that it was a misconception to presume that any profit arises out of the valuation of closing stock and the situs of its arising or accrual is where the valuation is made. The valuation of the unsold stock at the close of an accounting period was held to be a necessary part of determining the trading results and was not the "source" of such profits. The Supreme Court held that the place where the valuation was made could not be regarded as the situs of accrual and observed that "the source of profits and gains of a business is indubitably and the place of their accrual is where the business is carried on". The judgment is, therefore, a precedent for the proposition that the place of the accrual of the profits and gains of

a business, is the place where the business is carried on since the source of those profits is the business itself.

88. A decision of the Division Bench of the Calcutta High Court in **Income Tax Officer vs. Shriram Bearings Ltd**.,[34] involved an agreement between the Respondent and a Japanese Company. The agreement consisted of two parts, one for the sale of trade secrets and the other for technical assistance. The agreement specifically recorded that the sale of the trade secrets was effected in Japan. The consideration for both parts of the agreement was separately provided. On these facts, the Calcutta High Court held that the transaction of the sale and purchase of trade secrets took in Japan and the entire consideration was paid in Japan. No part of the activity or operation was carried on by the non-resident Company in India.

89. While affirming the judgment of the Calcutta High Court, the Supreme Court in I**ncome Tax Officer vs. Shriram Bearings Ltd.**,[35] held :

34 (1987) 164 ITR 419
35 (1997) 224 ITR 724

> "The agreement is in two parts. It is true that the two parts are interdependent but yet the consideration for the sale of trade secrets and consideration of technical assistance is separately provided for and mentioned under separate sections. So far as the consideration for the technical assistance is concerned, its taxability is not in doubt. The only controversy is with respect to the taxability of 1,65,000 U.S. dollars which is stipulated as the consideration for sale of trade secrets. The agreement specifically says that the said sale is effected in Japan. We are unable to see on what basis it can be said that any part of the said amount has been earned in India."

The judgment of the Calcutta High Court, therefore, clearly proceeded on the basis that the sale of the trade secrets took place outside India and that no part of the activity or operation of the non-resident company was carried on in India. The judgment of the Supreme Court emphasized that the sale of the trade secrets had taken place in Japan. The Supreme Court held that no part of the amount had been earned in India.

90. In the context of the transfer of a capital asset, there is a judgment of a Division Bench of the Delhi High Court consisting of S.B.Sinha, C.J. (as His Lordship then was) and A.K.Sikri, J. in **C.I.T.**

vs. Quantas Airways Ltd.[36] Quantas which is a non-resident incorporated in Australia carried on a worldwide air transport business and sold aircraft which were its capital assets. The sales were effected outside India. The question before the Delhi High Court was as to whether the sale of such capital assets was income proportionately assessable in terms of the provisions of the Act. Both the Commissioner of Appeals and the Tribunal had disapproved the view of the Assessing Officer that the profits arising out of the sale of a capital asset would be income at the hands of the assessee. The Delhi High Court held that while capital gains may be income, that would have been so if the transaction has taken place either in India or through or from any property in India or from any asset or source of income from India or through the transfer of a capital asset situated in India. The assessee only had some part of its business operation in India. Its capital assets has nothing to do with the business connection in India and the words “business connection” for the purposes of Sections 5 and 9 are confined to profits arising out of business. The Delhi High Court relied upon the judgment of the Supreme Court in **CIT vs.**

36 256 ITR 84

R.D.Aggarwal & Co.,[37] in which it was noted that the expression "business connection" postulates a real and intimate relation between the trading activity carried out outside the taxing territory and trading activity within the territory, and the relation between the two, contributes to the earning of income by the non-resident in his trading activity. The Delhi High Court held as follows:

> "Having regard to the purport and object thereof, if the words "business connection in India" were wide enough to cover all transactions including transactions in capital assets, in our opinion, there was no reason for Parliament to specifically include income (a) through or from any property in India, (b) through or from any asset or source of income from India, and (c) through or from sale of a capital asset situate in India.
>
> The very fact that in terms of section 9 of the Act, the transfer of a capital asset situate in India has been brought within the purview of the deemed income under section 9 of the Act and rule 10(ii) of the Rules, the intention of Parliament was not to bring within its purview any income derived out of sale or purchase of a capital asset effected outside India."

91. In the case of a capital asset clause (i) of Sub-section (1) of Section 9 postulates that the income must accrue or arise by the transfer of a capital asset situated in India. The situs of the capital asset is the crucial jurisdictional condition that must be fulfilled in

37 (1965) 56 ITR 20

order to attract chargeability to tax of income arising from the transfer of a capital asset. The statutory provision recognizes the principle that income from the transfer of a capital asset arises at the place where the asset is situated. The situs of the capital asset within India is what determines exigibility to tax.

92. Having now dealt with the position in Indian law, it would be appropriate to turn to the transnational law on the subject.

Transnational Law :

93. Transnational law recognizes that the jurisdiction of a State to tax non-residents is based on the existence of a nexus of the person sought to be taxed or his activities with the taxing jurisdiction. Such nexus may exist either as a result of physical presence or, in relation to the source rule, where the income earned by the non-resident has a source in the taxing jurisdiction.

94. Shares constitute capital assets and are recognized to be so in transnational jurisdictions. Dicey, Morris and Collins in their

seminal work on The Conflict of Laws,[38] explain the situs of shares thus:

> "(7) Shares in companies ... the basic principle here is that shares are situate in the country where, under the law of the country in which the company was incorporated, they can be effectively dealt with as between the owner for the time being and the company. The law of the place of incorporation of the company decides how shares in the company may be transferred. If they may be transferred only by registration on a particular register, they will be regarded as situate at the place where the register is kept."

The reason for this, note the authors, is that shares as an interest in a company are subject to the law of the place of incorporation of the company, which governs all matters concerning the constitution of the company.

95. As far back as in 1924, the Privy Council in **Brassard vs. Smith**,[39] recognized that the evidence of title to shares would be the Register of shareholders and the situs of the property would be where the register is situated. A person who was a resident of Nova Scotia died there owning shares in a Bank which were

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38Fourteenth Edition, under the general editorship of Sir Lawrence Collins, Sweet & Maxwell 2006 Edition, Vol.2 pages 1125-6

39 (1925) AC 371

registered at an office maintained by the Company in the same province. The company had its head office in the province of Quebec. The Privy Council followed the established principle that a transfer, in the case of shares, is effectuated by a change in the register where the shares are registered and the shares could be effectively dealt with only at that place.

96. The Petitioner in the present case, has filed expert opinions from diverse jurisdictions for elucidating the principles adopted in several jurisdictions for invoking the jurisdiction to tax non-residents. These opinions explain the position under the laws of Australia, Canada, France, Germany, Italy,U.K. and the U.S. The expert opinions indicate that corporate structures of groups of multi-national enterprises have evolved and gained in complexity over a long period of time in response to a variety of considerations. The ownership structure of various assets and businesses may be segregated or aggregated to enable various assets, interest in assets or groups of assets to be dealt with either separately or in common by dealing with the shares of the Company or Companies formed to hold those assets, interests or

groups of assets.

97. In Australia, the Capital Gains Tax (CGT) regime prescribes under Provision 855, rules applicable to non-residents. Taxable Australian property is defined to include an indirect Australian real property interest. Where a CGT event happens in relation to an indirect Australian real property interest owned by a non-resident, the non-resident is subject to Australian tax. An entity (the holding entity) has an indirect Australian real property interest in another entity if the holding entity has a membership interest in the latter and that interest satisfies two tests; a non-portfolio test and principal assets test. The non-portfolio test is satisfied if the direct participation interest held by the holding entity is ten per cent or more. The principal assets test requires that more than fifty per cent of the value of the assets held are attributable to Australian real property, whether held directly or indirectly. Australian law contains legislation in the nature of a look-through provision under which the holding of an indirect real property interest implicates the capital gains tax regime. Canadian legislation contains provisions for the imposition of capital gains

tax on the disposition of taxable Canadian property. Look-through provisions have been enacted to bring within the ambit of the taxing power situations involving the holding of a specified proportion of assets or shares in real property or resource property. Legislation in the U.S. also provides rules with respect to the investment of a foreign person in real property and provides that the gain on the disposition of a United State Real Property Interest (USRPI) would be subject to tax. Such an interest is defined as an interest in real property located in the U.S. and any interest in a domestic corporation which is a real property holding corporation. In the case of income in the form of capital gains on the disposal of assets situated within a territory, some countries do not tax non-residents on such gains at all. This is the position in the United Kingdom which does not tax non-residents on capital gains, even gains on the sale of U.K. land.

98. The **U.N. Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries** describes the principles of international taxation underlying tax treaties:

"1. INTERNATIONAL DOUBLE TAXATION

A. Concepts and issues

-1. The jurisdiction to impose income tax is based either on the relationship of the income (tax object) to the taxing state (commonly known as the source or situs principle) or the relationship of the taxpayer (tax subject) to the taxing state based on residence or nationality. Under the source principle, a State's claim to tax income is based on the State's relationship to that income. ...

-2. ...

-3. Under the residence principle, a State's claim to tax income is based on its relationship to the person deriving that income. For example, a State would invoke the residence principle to tax wages earned by a resident of that State without reference to the place where the wages were earned. In general, a State invokes the residence principle to impose tax on the worldwide income of its residents."

99. An illustration of the operation of a provision in a tax treaty is contained in the Capital Gains Article of the 2008 version of the OECD Model which is as follows :

"Article 13

CAPITAL GAINS

-1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State

may be taxed in that other State.

-2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

-3. Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transports or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

-4. Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

-5. Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident."

The OECD Model is illustrative of the manner in which a value driven deeming nexus may be created by legislation. Thus, capital gains derived from an alienation of shares which derives more than fifty per cent of their value from immovable property situated in an another Contracting State may be taxed in that State. Hence,

where the underlying asset is land situated in the source State and where a transfer of shares in a foreign company or other entity owning the land results in an effective transfer of ownership of the land the source State may by legislation impose the tax.

100. Broadly speaking, source rules limit themselves to the taxation of capital gains arising on property situated within the taxing jurisdiction. The OECD model indicates an attempt to initiate provisions which would look behind corporate structures particularly where the ownership of shares represents an interest of a certain value in real estate or immovable property situated within the taxing jurisdiction. We must, however, hasten to add that in this case, the Court is essentially required to construe the provisions of our own taxing legislation.

The FIPB Process

101. On 12 January 2005, the Government of India, in the Ministry of Commerce and Industry, issued Press-note 1. The Press-note provided that new proposals for foreign investment/technical collaboration would henceforth be allowed under the 'automatic

route', subject to sectoral policies, in accordance with the guidelines formulated therein. The Press note contained guidelines governing the approval of foreign/technical collaborations under the automatic route with previous ventures/tie ups in India. Under the Press note, the prior approval of the Government to new proposals for foreign investment/technical collaboration would be required only where a foreign investor had an existing joint venture or a technology transfer/trade mark agreement in the same field.

102. On 20 February 2007 VIH BV submitted an application to FIPB under Press Note 1 (2005 series) in respect of the proposed acquisition of an indirect interest in HEL from HTIL. The application stated that (i) In December 2005 VIH BV had acquired a 5.61 % equity stake in Bharti Airtel; (ii) VIH BV proposed to acquire the entire issued share capital of CGP Investments (Holdings) Limited, a company incorporated in the Cayman Islands; (iii) CGP owned through its subsidiaries an aggregate of 42.34% of the issued share capital of HEL and had indirect interest in 9.62% of HEL's issued share capital; (iv) The

acquisition of the entire share capital in CGP from HTIL was an overseas transaction under which there was a transfer of shares of an overseas company from one non-resident to another. This acquisition according to VIH BV did not fall within the jurisdiction of the FIPB though the overseas transaction would require to be noted by the FIPB. As a result of the transaction VIH – BV would acquire an indirect controlling interest of 51.96% in HEL. Since Bharati Airtel and HEL were engaged in activities in the same field as stated in the provisions of Press Note 1 the approval of the Government was necessitated. VIH BV stated that the overseas transaction did not require the approval of FIPB, being a transfer of shares of an overseas company from one non-resident to another. The application was, however, submitted in order to enable the FIPB to note the revised position following the completion of the overseas transaction. In addition, since as a result of the overseas transaction VIH – BV would acquire an indirect interest in HEL, a company competing in the same field with Bharti Airtel the provisions of Press Note 1 were attracted. On 9 February 2007 Bharti Airtel had furnished its consent to the indirect acquisition of shares by VIH BV in HEL. FIPB was requested to take note of the

overseas transaction and additionally to give its approval under Press Note 1.

103. Upon receipt of the application, the Government of India in the FIPB unit of the Ministry of Finance addressed a letter on 28 February 2007 to HEL seeking details of the direct and indirect foreign holding in HEL and details of Indian companies together with their stake in HEL. The Government also sought a clarification as to which entity had the beneficial ownership of stakes held in HEL by the entities of Shri Asim Ghosh and Shri Analjit Singh viz. Indusind Telecom Network Private Limited and Telecom Investments India Private Limited together with their subsidiaries. Asim Ghosh clarified by his letter dated 2 March 2007 to HEL, in response to FIPB's letter, that through his 100% Indian companies he held 23.97 % equity in a joint venture company, TII Private Limited which in turn held 19.54% of HEL. Accordingly his indirect equity or beneficial interest in HEL worked out to 4.68%. Asim Ghosh clarified that his interest in these companies was entirely owned by him and that he had received credit support for his investment which had been disclosed publicly. A similar

clarification was issued by Analjit Singh on 5 March 2007 to FIPB. On 6 March 2007 HEL responded with a clarification to the Government of India.

104. On 6 March 2007, Essar Teleholdings Limited lodged an objection with the FIPB to the application for approval moved by VIH BV under Press Note 1. The ground of objection was that the proposed transaction sought to link two direct competitors. Essar claimed that with a shareholding in HEL of more than 10% it was a stakeholder and that its interest would be jeopardized by the proposed transaction since both HEL and Bharti Airtel are competitors.

105. On 14 March 2007 the FIPB sought a clarification from HEL. The letter stated that HTIL in its filings before the Securities and Exchange Commission (SEC) in the U.S. in March 2006 had stated that the HTIL group will continue to hold a 42.34% interest in HEL and an additional indirect interest through joint venture companies, being non-wholly owned subsidiaries of HTIL which held an aggregate of 19.54%. Hence, the combined holding of the

HTIL group would be 61.88%. However, on 6 March 2007 a communication had been sent to FIPB in which the direct and indirect interest of HTIL was stated to be 51.96%. A clarification was sought on the discrepancy. HEL furnished a clarification on 14 March 2007 stating that as a company listed on the New York Stock Exchange HTIL's filings were made in accordance with the requirements of the SEC. Under U.S. GAPP requirements, HTIL had to consolidate the assets and liabilities of companies even though they were not owned or controlled by HTIL in accordance with U.S. accounting standards. This accounting consolidation was required even though these companies were not legally subsidiaries. This was not the case under Indian GAAP requirements under which the aggregate of the direct and indirect FDI held by HTIL was 51.96%. The difference between 61.88% disclosed to the SEC in the U.S. and 51.96% reported in India was stated to be due to different accounting standards applied in the two jurisdictions. HEL furnished a clarification to the FIPB on 14 March 2007. VIH – BV in a letter addressed to the FIPB on 14 March 2007 clarified that in addition to obtaining a controlling interest of 52% in HEL as a result of the acquisition of the CGP

share, HEL's existing Indian partners Asim Ghosh and Analjit Singh and IDFC, who between them held 15% interest in HEL had agreed to retain their shareholding. VIH BV would be entitled <u>subsequently</u>, directly and indirectly, to acquire shares in TII and Omega if permitted under Indian regulatory requirements including the maximum limitation prescribed on foreign direct investment in the telecommunications sector. If and when VIH BV was able to acquire these shares, it would own a 67% interest in HEL.

106. On 19 March 2007 FIPB sought a clarification from VIH BV of the circumstances in which it had agreed to pay a consideration of US $ 11.08 billion for acquiring 67% of HEL when the actual acquisition was only of 51.96% as claimed in the application filed before the FIPB. In its response dated 19 March 2007 VIH BV stated that it had agreed to acquire from HTIL for US $ 11.08 billion, interest in HEL which included a 52% equity shareholding. This price included a control premium, use and rights to the Hutch Brand in India, a non-compete agreement, loan obligations and an entitlement to acquire subject to Indian foreign

investment rules a further 15% indirect interest in HEL. These elements together equated to about 67% of the equity capital. On 22 March 2007 FIPB sought a break up of the valuation attached to each of the items mentioned by VIH BV in its letter together with supporting documents and other filings. VIH BV in its letter dated 27 March 2007 stated that in arriving at the consideration it had not individually placed a price on each of the components but its approach was to look at the package of assets, liabilities and other intangible factors represented by the ownership of CGP and to assess the total value.

107. FIPB by its letter dated 7 May 2007 communicated its approval to allow the transaction by which VIH BV "is acquiring or has acquired" effective shareholding of 51.96 % in HEL. The conditions subject to which the approval was granted was that VIH BV shall indicate and ensure that its shareholding taken along with the shareholders of three other entities will be compliant with Press Note 3 of 2007 dated 19 April 2007 by which the sectoral cap of foreign direct investment in the telecom sector was fixed at 74%. The approval was also subject to the condition that the foreign

collaborator had no existing joint venture or technology transfer / trademark agreement in the same field for which approval is granted. Now VIH BV had moved the FIPB initially to take note of its proposed overseas transaction as a result of which, through the acquisition of the issued share capital of CGP from HTIL, VIH BV would acquire a 51.96% controlling interest indirectly in HEL. In addition, FIPB approval was sought in terms of Press Note 1 in view of the fact that it held a 5.61 % stake in Bharati Airtel which was a competitor in the same sector. FIPB after an enquiry accorded its permission in terms of Press Note 3 subject to compliance of the sectoral cap of 74%. Counsel for VIH BV has stated before the Court that if and when the put agreements are enforced, there would be an acquisition of the shares of an Indian company upon which capital gains would be liable to be taxed under Indian tax legislation.

Section 195 of the Income Tax Act 1961

108. Section 195 postulates that any person responsible for paying to a non-resident, not being a foreign company, or to a

foreign company any interest or any other sum chargeable under the provisions of the 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 by draft or by any other mode whichever is earlier, deduct income tax thereon at the rates in force. Under sub section (2), where a person responsible for paying any such sum chargeable under the Act to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the Assessing Officer to determine the appropriate proportion of such sum so chargeable. Upon a determination by the Assessing Officer tax is liable to be deducted only on that proportion of the sum which is so chargeable. Under sub section (3) any person entitled to receive interest or other sum on which income tax has to be deducted under sub section (1) may make an application in the prescribed form to the Assessing Officer for a certificate authorizing him to receive the sum without deduction of tax. Where a certificate is granted every person responsible for paying such interest or sum to the holder of the certificate shall so long as the

certificate is in force make payment without deducting tax thereon.

109. The submission which has been urged on behalf of the Petitioner is that the expression “any person” must mean a person subject to Indian law. A nexus with Indian law would exist either when a person is a resident or if the transaction was consummated in India or where the payment is made from and out of India. It has been urged that though textually the expression “person” is wider than the expression “resident”, a contextual interpretation must be adopted in order to avoid absurdity. While paying out to a non-resident and before payment is made, tax has to be deducted. A positive obligation is cast on a payment out of the country because the beneficiary is beyond the reach of the Indian law. The person on whom a positive obligation is cast is subject to Indian law. Hence, it was urged that the expression “any person” must mean a person who has a nexus with India. VIH BV, it has been urged has no such nexus. It is not a resident, it has no office in India and has no sum chargeable in India. Hence, it was urged on behalf of the Petitioner that two tests must be satisfied before Section 195 can be invoked, the first of which is express and the

second implicit: (i) The sum must be chargeable under the Act. If there is a dispute on quantum, an obligation still arises, but if it is not chargeable at all then the Section does not apply and this would raise a jurisdictional issue; (ii) The person is one on whom the Revenue can legitimately, consistent with the principles of the conflict of laws cast an obligation.

110. Now while evaluating the submission it would be necessary to elucidate the essential requirements of sub section (1) of Section 195. The first requirement is that there is a person responsible for paying to a non-resident any interest or any other sum. Responsibility postulates a legally enforceable obligation to pay a non resident. An obligation may arise under a contract or otherwise. The second requirement is that the interest or the other sum must be chargeable under the provisions of the Act other than under the head of 'salaries'. Chargeability under the Act is mandated before the obligation to deduct arises. If these requirements are met, income tax thereon has to be deducted at the rates in force "at the time of credit of such income to the account of the payee" or at the time of payment, whichever is

earlier.

111. In ***Transmission Corporation of A.P. Limited V/s. Commissioner of Income Tax***[40], the State Electricity Board made certain payments to a non-resident against the purchase of machinery and equipment and against work executed by the non-resident in India of erecting and commissioning the machinery and equipment. The question was whether for these payments, the Board was under an obligation to deduct tax at source under Section 195. The question before the High Court was whether the Board was liable to deduct income tax under Section 195 in respect of payments made to the non-resident and if so whether the tax deductible was liable to be determined on the gross sum paid to the non-resident. On behalf of the assessee, it was contended before the Supreme Court that when the payment made to a non-resident did not entirely comprise of income, but was a trading receipt, no question of deducting income tax at source would arise. In other words, it was urged that tax could be deducted at source when the entire sum paid represented total income chargeable under Section

40 (1999) 239 ITR 587 (S.C.)

5. The Supreme Court held that sub-sections 1, 2 and 3 of Sections 195 and 197 left no doubt about the position that the expression "any other sum chargeable under the provisions of this Act" would mean a sum on which income-tax is leviable. If the sum was income or if income was "hidden or otherwise embedded" therein, tax was required to be deducted. The Scheme of tax deduction at source was held to apply not only to the amount paid, which wholly bears an income character, such as salaries, dividends and interest on securities but also to **gross** sums, **the whole of which may not be income or profit** of the recipients, such as payments to contractors. The Supreme Court held that Section 195(1) is a provision for a **tentative deduction** of income-tax subject to regular assessment and the rights of parties are not adversely affected by a deduction of income tax. The Supreme Court rejected the contention of the assessee that the expression "any other sum chargeable under the provisions of this Act" would not include cases where any sum payable to the non-resident is a trading receipt which may or may not include pure income. However, the obligation of the assessee to deduct tax under Section 195 is limited only to the appropriate portion of income chargeable

under the Act.

112. In ***Vijay Ship Breaking Corporation V/s. Commissioner of Income Tax***[41], the issue which arose for determination before the Supreme Court was whether the assessee was bound to deduct TDS under Section 195(1) in respect of usance interest paid for the purchase of a vessel for ship breaking. The assessee contended that usance interest had the character of the purchase price and hence TDS was not deductible. The Supreme Court held that it was not required to examine this question in the light of the judgment of the Gujarat High Court since after the judgment in the Appeal was delivered, Explanation 2 was added by an amendment to Section 10(15)(iv)(c) to declare that usance interest payable outside India by an undertaking engaged in the business of ship breaking in respect of the purchase of a ship from outside India would be deemed to be interest payable on a debt incurred in a foreign country in respect of the purchase outside India. On reading Explanation 2, it was clear that usance interest is exempt from the payment of income-tax, if paid in respect of ship breaking activity.

41 (2009) 314 ITR 309 (S.C.)

The Supreme Court held that "the assessee was not bound to deduct tax at source once Explanation 2 to Section 10(15)(iv)(c) stood inserted **as TDS arises only if the tax is assessable in India**". Since tax was not assessable in India, there was no question of TDS being deducted by the assessee.

113. In a subsequent decision in ***Commissioner of Income Tax V/s. Eli Lilly and Company (India) Private Limited***[42], the assessee had seconded expatriates to a joint venture in India. The assessee was a joint venture company and the appointment of the expatriates was routed through a Board comprising of the Indian partner. Only a part of the aggregate remuneration was paid in India by the tax deductor assessee. No work was performed by the employees for the foreign company. The Assessing Officer found that the total remuneration paid was only on account of services rendered in India and, therefore, in terms of Section 9(1)(ii) the income derived by the expatriates was taxable in India. Accordingly, the tax deductor assessee was asked to explain why it should not be declared as an assessee in default under Section

42 (1009) 15 SCC 1

201(1) as it had failed to deduct tax at source on the aggregate salary received by the expatriates. The defense was that the joint venture company deducted tax at source under Section 192(1) in respect of the salary paid to the expatriates in India and that no tax stood deducted in respect of the home salary paid by the foreign company to the expatriates outside India, dehors the contract of employment in India. Mr. Justice S.H. Kapadia (as the learned Chief Justice then was) noted that unlike other sections of Chapter XVII-B regulating tax deducted at source, Section 192 requires a deduction on estimated income chargeable under the head salary and at the time of payment of salary. The Supreme Court held that "if a sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted". The question which fell for consideration was whether the TDS provisions of Chapter XVII-B which were in the nature of machinery provisions would apply to payments made abroad by a foreign company which had seconded expatriate employees for rendering services in India to the tax deductor assessee. On the question of extraterritoriality, the Supreme Court observed as follows :

"65. *On the question of extraterritorial*

> *operation of the 1961 Act* the general concept as to the scope of income tax is that, given a sufficient territorial connection or nexus between the person sought to be charged and the country seeking to tax him, income tax may extend to that person in respect of his foreign income. The connection can be based on the residence of the person or business connection within the territory of the taxing State; and the situation within the State of the money or property from which the taxable income is derived (see *The Law and Practice of Income Tax* by Kanga and Palkhivala, 7th Edn. At p. 10)".

The Supreme Court held, following the decision of the Federal Court in ***A.H. Wadia V/s. CIT, (1949) 17 ITR 63 (FC),*** that if the payments of home salary abroad by the foreign company to the expatriate has any connection or nexus with his rendition of service in India then such payment would constitute income which is deemed to accrue or arise to the recipient in India as salary earned in India in terms of Section 9(1)(ii). Section 9, held the Supreme Court, was a typical example of a combination of a machinery provision which also provides for chargeability. The Court held that the 1961 Act has extraterritorial operations in respect of subject-matters and subjects which is permissible under Article 245 of the Constitution and the provisions are enforceable within the

area where the Act extends through the machinery provided under it. If a particular income falls outside Section 4(1), the Supreme Court held that TDS provisions would not set in. The conclusion which was arrived at by the Supreme Court was as follows :

> "88 .. Firstly, it cannot be stated as a broad proposition that the TDS provisions which are in the nature of machinery provisions to enable collection and recovery of tax are independent of the charging provisions which determine the assessability in the hands of the assessee employee. Secondly, whether the home salary payment made by the foreign company in foreign currency abroad can be held to be "deemed to accrue or arise in India" would depend upon the in-depth examination of the facts in each case. If the home salary / special allowance payment made by the foreign company abroad is for rendition of services in India and if as in the present case of M/s.Eli Lilly & Co. (India) (P) Ltd. no work was found to have been performed for M/s.Eli Lilly Inc., Netherlands then such payment would certainly come under Section 192(1) read with Section 9(1)(ii)".

On facts, it was held that no work had been performed for the foreign company by the four expatriates and the entire remuneration was paid only for services rendered in India. In such a case, the tax deductor assessee was statutorily obliged to deduct tax under Section 192(1).

114. In **Kanchanganga Sea Foods Ltd. vs. C.I.T.**[43] the Appellant which was a company incorporated in India, had a permit to fish in the exclusive economic zone of India and was engaged in the sale and export of sea food. Under an agreement with a non-resident company incorporated in Hong Kong, the Appellant obtained trawlers on charter hire, each on an annual payment of US $ 600,000. The Appellant was to receive a stipulated sum or 15% of the gross value of the catch, whichever was more. The charter fee was payable from the earnings from the sale of fish and for that purpose, 85% of the gross earnings were to be paid to the non-resident. The vessels were delivered at Chennai Port, from where the voyage commenced and concluded. The catch was brought from the high seas to Chennai where it was surveyed. The assessee carried the catch to the destination after clearance at Chennai. The Supreme Court confirmed the findings arrived at by the Assessing Officer, the Commissioner, Tribunal and the High Court that the assessee was liable to deduct tax at source and was in default of its obligation to do so. The Supreme Court held that the chartered vessels together with the entire catch were brought to

43 2010 (6) SCALE 442.

an Indian Port, where the catch was certified for consumption, valued and it was after Customs and Port clearances that the non-resident received 85% of the catch. It was after the catch was apportioned at Chennai, that the non-resident obtained control over its share of 85%. The Supreme Court held that the question as to whether income had arisen or accrued or whether it would be deemed to have arisen or accrued in India would have to be determined in the light of the terms of the contract. The receipt of 85% of the catch being in India, the Supreme Court observed that this being the first receipt in the eye of law would be chargeable to tax in India. The income earned by the non-resident was in substance, a receipt for value in India and was held to be chargeable to tax under Section 5(2). The Supreme Court distinguished its earlier judgments in **C.I.T. vs. Toshoku Ltd.**[44] and in **Ishikawajima Harima Heavy Industries Ltd. v. Director of Income Tax**[45]. In **Toshoku** a non-resident assessee had acted as selling agent outside India and did not carry on business operations in the taxable territory. The commission received by the non-resident for service rendered outside India was held not to

44 (1980) 125 ITR 525.
45 (2007) 288 ITR 408.

have accrued or arisen in India and the mere making of a book entry by the statutory agent was held not to amount to a receipt in India. **Ishikawajima**, the Supreme Court noted, was one where the entire transaction had been completed on high seas and the profits of sale did not arise in India. In contrast, in the case at hand, the Supreme Court held that the entire catch of fish was brought to an Indian Port and after valuation was complete, the charter fee in the form of 85% of the catch was paid to and received by the non-resident in India. Section 195 was therefore attracted.

UNITED KINGDOM : Extra territoriality and the obligation to deduct tax.

115. In 1879, the Court of Appeal held that it was a governing principle that all English Legislation is primarily territorial (Ex parte BLAIN In Re Sawers)[46]. Brett, L.J. held that the legislation of any country binds its own subjects and the subjects of other countries who for the time bring themselves within the allegiance of the legislating power. James, L.J. spoke thus :-

46 (1879) XII Chancery Division 522 at 528

> "It appears to me that the whole question is governed by the broad, general, universal principle that English legislation, unless the contrary is expressly enacted or so plainly implied as to make it the duty of an English Court to give effect to an English statute, is applicable only to English subjects or to foreigners who by coming into this country, whether for a long or a short time, have made themselves during that time subject to English jurisdiction. ... But, if a foreigner remains abroad, if he has never come into this country at all, it seems to me impossible to imagine that the English Legislature could have ever intended to make such a man subject to particular English legislation."

116. In ***Clark (Inspector of Taxes) V/s. Oceanic Contractors Inc.***[47], the House of Lords dealt with a case where a non-resident overseas company which was engaged in laying of pipes and platform construction in the North Sea employed 400 workers on its barges and other vessels. The company carried on operations throughout the world, among them in the United Kingdom sector of the North Sea, which were designated areas under the Continental Shelf Act 1964. The Company deducted PAYE tax in respect of its employees, who were employed at establishments in United Kingdom. But those employed in the United Kingdom sector of the North Sea were paid in United States Dollars free of tax. The employees were liable to tax under Schedule E in respect

47 (1983) 1 All ER 133

of their earnings in the U.K. Sector of the North Sea. The Crown claimed that the company was required by Section 204 of the Income and Corporation Tax of 1970 to deduct PAYE tax payable under Schedule E from wages and salaries paid to the employees, who worked in the U.K. sector of the North Sea. The Court of Appeal had held that although Section 204 was general, Parliament could not have intended to cast on a foreigner who was not resident of the United Kingdom the role of tax collector for the Revenue and Section 204 was to be presumed not to have extraterritorial effect. The House of Lords allowed the Appeal and reversed the decision of the Court of Appeal. Lord Scarman observed that the liability to tax under the Act of 1970 depends on the location of the source from which the taxable income is derived or the residence of the person whose income is to be taxed. If either the source of income or the residence of the owner of the income is in the United Kingdom, the income is liable to tax. Section 204 imposes the PAYE system of tax collection in respect of any income assessable under Schedule E and contains no extraterritorial limitation on the extent of the obligation which it imposes. The only limitations were that : (i) Residence is not a

necessary condition of tax liability if there be otherwise a sufficient connection between the source of the income, profit or gain and the United Kingdom; and (ii) Section 204, silent itself as to the territorial extent of the obligation it imposes, is a machinery section for the collection of Schedule E tax. Lord Scarman, while adverting to the decision in Ex parte BLAIN (supra) observed thus :

> "Put into the language of today, the general principle being there stated is simply that, unless the contrary is expressly enacted or so plainly implied that the courts must give effect to it, United Kingdom legislation is applicable only to British subjects or to foreigners who by coming to the United Kingdom, whether for a short or long time, have made themselves subject to British jurisdiction. Two points would seem to be clear : first, that the principle is a rule of construction only and, second, that it contemplates **mere presence within the jurisdiction as sufficient to attract the application of British legislation. Certainly there is no general principle that the legislation of the United Kingdom is applicable only to British subjects or persons resident here. Merely to state such a proposition is to manifest its absurdity. Presence, not residence, is the test".** (emphasis supplied).

117. The Law Lord observed that the same time, the Income-tax Acts impose their own territorial limits, since Parliament recognizes the almost universally accepted principle that fiscal legislation is not enforceable outside the limits of the territorial sovereignty of the kingdom. Fiscal legislation is drafted in the

knowledge that it is the practice of nations not to enforce fiscal legislation of other nations. But, in the absence of any clear indications to the contrary, it does not necessarily follow that Parliament has in its fiscal legislation intended any territorial limitation other than that imposed by such unenforceability. Having said this, Lord Scarman observed that the case was concerned with the territorial limitation to be implied into a Section which establishes a method of tax collection. The method is to require the person paying the income to deduct it from his payments and account for it to the Revenue. The only critical factor, so far as collection is concerned, is whether in the circumstances it can be made effective. The test which was applied by the House of Lords was that of a **trading presence** in the United Kingdom. A trading presence in the United Kingdom was held to suffice in order to attract the liability to deduct tax. On facts, it was held that the trading presence was made out. For the purposes of Corporation Tax, Oceanic carried on a trade in the United Kingdom which included its operations in the United Kingdom sector of the North Sea. For the purposes of this trade it employed a workforce in that sector, whose earnings were assessable to

British income tax. Finally, Oceanic had an address for service in the United Kingdom. For these reasons, Lord Scarman concluded that Oceanic by its trading operations within the United Kingdom and in the United Kingdom sector of the North Sea had subjected itself to the liability to deduct tax in respect of those emoluments of its employees which were chargeable to British income tax.

118. In a subsequent decision in ***Agassi V/s. Robinson (Inspector of Taxes)***[48], the House of Lords revisited its earlier decision in **Oceanic**. Agassi, a well-known professional tennis player was neither resident nor domiciled in the United Kingdom and in the tax year relevant to the Appeal, he had participated in a tennis tournament in that country, including Wimbledon. Agassi held and controlled a company, whose business included entering into contracts with manufacturers of sports clothing and equipment which was sponsored or advertised by Agassi. Two contracts were entered into with Nike Inc and Head Sport AG, pursuant to which the company received payments during the taxation year. Sections 555 and 556 of the 1988 Act provided that where a person who is

48 (2006) 1 W.L.R. 1380

an entertainer or a sportsman of a prescribed description performs an activity of a prescribed description in the United Kingdom, the Chapter would apply if he is non-resident in the United Kingdom in the year of assessment in which the relevant activity is performed. Whenever a payment was made to whatever person which had a connection of a prescribed kind with the relevant activity, the person making payment was liable to deduct a sum representing income-tax. On behalf of Agassi, it was contended that Nike and Head were foreign companies with no trading presence in the United Kingdom and it was, therefore, to be presumed that Parliament did not intend them to be caught by the tax collection provisions. Lord Scott, while rejecting the submission, observed thus :

> "... The whole point of sections 555 to 558 is to subject foreign entertainers or sportsmen to a charge to tax on profits on gains obtained in connection with their commercial activities in the United Kingdom. Payments to foreign companies controlled by them are to be treated as payments to them. The infrequent or sporadic nature of their commercial activities and presence in the United Kingdom and the difficulty of collecting from them the section 556 tax on their profits and gains from those activities was one of the reasons why the new collection regime was introduced under the 1988 Act. To read into the statutory provisions a limitation preventing the collection regime from applying where the payer is a foreign entity with no UK presence and thereby relieving the foreign entertainer / sportsman from the charge to tax cannot, in my

> opinion, possibly be justified on the basis of a presumed legislative intention". (emphasis supplied).

119. The decisions in the United Kingdom indicate the following position :

-(i) Liability to tax depends on the location of the source from which taxable income is derived or the residence of the person whose income is to be taxed. If either the source of income or the residence of the owner of the income is in the United Kingdom, the income is liable to tax;

-(ii) If there exists a sufficient connection between the source of the income, profit or gain and the United Kingdom, residence is not a necessary condition of tax liability;

-(iii) The broad general principle is that unless the contrary is expressly enacted or plainly implied, United Kingdom legislation applies to British subjects or to foreigners who by coming to United Kingdom, whether for a short or long period of time, have made themselves subject to British jurisdiction;

-(iv) The principle set out in (iii) above is only a rule of construction and contemplates that a mere presence within the jurisdiction would be sufficient to attract the application of British

legislation;

-(v) Fiscal legislation is drafted in the knowledge that it is a practise of nations not to enforce fiscal legislation of other nations but it does not necessarily follow that Parliament intended any territorial limitation other than that imposed by such unenforceability;

-(vi) Where an obligation for the deduction of tax by a payer is created by a statutory provision, such a provision is in the nature of a machinery section for the collection of tax. The obligation to deduct tax arises when the payment is made and it arises only in respect of the income assessable under the charging provision;

(vii) The critical factor in so far as collection is concerned is whether in the circumstances it can be made effective. A trading presence in the United Kingdom will suffice.

In concluding this portion of the judgment, the principles which should govern the interpretation of Section 195 of the Income Tax Act, 1961 can be formulated as follows :

-(i) Section 195(1) provides for a **tentative deduction**

of income-tax, subject to a regular assessment;

-(ii) Section 195 postulates two requirements: Firstly, there is a person responsible for paying to a non resident, any interest or other sum. Secondly, the interest or other sum must be chargeable under the provisions of the Act, other than under the head of salaries;

-(iii) The obligation to deduct tax arises where the sum payable to a non-resident is chargeable to tax under the provisions of the Act. For the obligation to deduct to arise, the **entire** sum payable need not be income chargeable under the Act. If the sum payable to a non-resident represents income **or** if income is **hidden** or **otherwise embedded** in it, tax is required to be deducted on the sum. The obligation of the assessee in that event is to deduct tax under Section 195 limited to the appropriate portion of income chargeable under the Act;

-(iv) The liability to deduct tax arises if the tax is assessable in India. If the tax is not assessable in India, there is no question of TDS being deducted by an assessee;

-(v) The general principle of fiscal legislation is that given a sufficient territorial connection or nexus between the

person sought to be charged and the country seeking to tax him, income tax may extend to that person. The connection can be based on the residence of the person or a business connection within the territory of a taxing State or a situation within the State of the money or property from which the taxable income is derived;

-(vi) TDS provisions which are in the nature of machinery provisions constitute an integrated Code under the Act of 1961 together with charging provisions. Hence, those provisions are not independent of the charging provisions which determine assessability to tax;

-(vii) Whether a payment made by a foreign company in foreign currency abroad can be deemed to accrue or arise in India, would depend upon an examination of the facts and circumstances of each case. In **Eli Lily** the payment made abroad by the foreign company was for the rendition of service in India and no work was found to have been performed for the foreign company. Such a payment was held to fall within the ambit of Section 192(1) read with Section 9(1)(ii). The Indian company was liable to deduct tax on the aggregate salary received by the expatriates including payments made by the foreign company;

-(viii) Parliament, while imposing a liability to deduct tax has designedly imposed it on a **person** responsible for paying interest or any other sum to a non resident. Parliament has not restricted the obligation to deduct tax on a **resident** and the Court will not imply a restriction not imposed by legislation. Section 195 embodies a machinery that would render tax collection effective and must be construed to effectuate the charge of tax. There is no limitation of extra territoriality involved though Parliament is cognisant of the fact that the provisions of the law can be enforced within the territory to which the Act extends.

Analysing the facts:

120. The case of of the Petitioner is that the transaction was only in respect of one share of CGP in Cayman Islands and this being a capital asset situated outside India neither had any income accrued or arisen in India, nor would any income be deemed to have accrued or arisen in India. On the other hand, the case of the Revenue is that the subject matter of the transaction on a true construction of the Sale and Purchase agreement of 11 February

2007 and other transaction documents is a composite transaction involving a transfer of rights in HEL by HTIL resulting in an accrual or deemed accrual of income for HTIL from a source of income in India or from an asset in India or through the transfer of a capital asset situated in India.

How HTIL and VIH BV construed the transaction:

121. Before we analyse the transaction documents, it would be appropriate to consider how HTIL itself construed the transaction. What was the business understanding of the parties to the transaction? HTIL's interim report for 2007 contains the operating results for the six months which ended on 30 June 2007. Under the head "**India – Discontinued Operations**" the Chairman's statement records that until 8 May 2007 India had contributed H.K.$ 70,502 million to the profits for the period which was made up of H.K$ 1,159 million from operating activities and H.K.$ 69,343 million being "**a one–off gain on disposal**". The statement records that the group had sold its **entire interests** in CGP for US $ 11.1 billion (HK $ 86.6 billion) which resulted in a net cash inflow of H.K.$ 84.9 billion. In addition, a debt of US $ 2

billion was transferred as part of the transaction. As a result, the Group transitioned from having a net debt of H.K.$ 37,369 million as of 31 December 2006 to a net cash balance of H.K.$ 26,624 million as at 30 June 2007. The following extract from the report, indicates how HTIL viewed the transaction:

> "8. PROFIT FROM DISCONTINUED OPERATIONS
>
> On 11 February 2007, the company entered into an agreement to sell its entire interests in CGP, a company which held all of the company's direct and indirect equity and loan interests in its Indian mobile telecommunications operation, comprising Hutchison Essar Limited (now known as "Vodafone Essar Limited') ("Hutchison Essar") and its subsidiaries to Vodafone International Holdings B.V. ("Vodafone"), a wholly owned subsidiary of Vodafone Group Plc, for a cash consideration of approximately US$ 11.1 billion (approximately HK$ 86.6 billion)(the "Transaction"). Accordingly, the results of the Group's Indian mobile telecommunications operations were presented as discontinued operations in accordance with HKFRS 5 "Non-current assets held for sale and discontinued operations". The presentation of comparative information in respect of the six months ended 30 June 2006 which was previously reported in the 2006 interim accounts has been amended to conform with the requirements of HKFRS 5.
>
> Subsequently, Essar Teleholdings Limited ("ETH"), a shareholder of Hutchison Essar, and certain affiliates (collectively Essar") asserted various rights in relation to the Transaction and threatened to commence proceedings in the Indian courts in order to enforce those alleged rights, including by preventing completion of the

> Transaction. On 15 March 2007, the company entered into a conditional settlement agreement (the "settlement agreement") with Essar pursuant to which Essar agreed to, amongst others: (i) refrain from doing anything which would prevent, delay or inhibit completion of the Transaction; (ii) use all reasonable endeavours to ensure completion of the Transaction is achieved as soon as practically possible; (iii) waive rights it has or claims to have in respect of certain matters including those related to the Transaction; and (iv) terminate certain agreements, alleged agreements and understandings relating to the relationship connected to Hutchison Essar, in consideration, upon completion of the transaction, the company agreed to make scheduled payments aggregating US$415 million (approximately HK $3.2billion) before interest (the "Settlement Amount") of which US$373.5 million (approximately HK$ 2.9 billion) was paid during the six months ended 30 June 2007.
>
> On 8 May 2007, the company completed the Transaction, in consideration of Vodafone's agreement to waive certain potential claims against the company under the Agreement, the company agreed to a retention from the consideration of an amount of US$352 million (approximately HK$ 2.8 billion) (the "Retention Amount"). By a deed entered into on 8 May 2007 by Vodafone and the company (the "Supplemental Deed"), the parties agreed the basis and the terms on which Vodafone is entitled to apply an equivalent sum of the Retention Amount to meet certain specified liabilities which Vodafone may incur in connection with the interests effectively acquired through the Transaction during a period of up to ten years following the date of completion of the Transaction (the "Retention Period")."

The profit of discontinued operations for the period ending 8 May

2007 is stated to be H.K.$ 1,159 million and the profit on the disposal of discontinued operations H.K.$ 69,343 making a total of H.K.$ 70,502. During the period of six months ending 30 June 2007, HTIL stated that it had declared a special cash dividend ("the transaction special dividend") of H.K.$ 6.75 per share or approximately H.K.$ 32,234 million in aggregate. The transaction Special Dividend was paid out of the proceeds from the transaction.

122. HTIL in its Annual Report for 2007 stated that "in the first half we announced .. the completion of the sale of CGP Investments (Holdings) Limited which held through various subsidiaries all our interests in India". The report refers to the transaction of 11 February 2007 and reports "the results pertaining to the India mobile telecommunications operations .. presented as discontinued operations" in accordance with the Hong Kong Financial Reporting Standard (HKFRS). HKFRS adopts the classification "*held for sale*" and introduced a concept of the "*disposal group*", being a group of assets to be disposed of by sale or otherwise, together as a group in a single transaction and liabilities directly associated with those assets that would be transferred in

the transaction. The terms which are defined therein included "discontinued operations" as a component of an entity that either has been disposed of or is classified as held for sale and (a) representing a separate major line of business or geographical area of operations, (b) as part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) as a subsidiary acquired exclusively with a view to resale. The expression "disposal group" includes goodwill acquired in a business combination if the cash generating unit to which goodwill has been allocated, in accordance with the requirements of the reporting standard.

123. Both the interim and final reports are of significance, because they indicate clearly the perception of HTIL. For HTIL the transaction represented a **discontinuation of its operations in India** upon which it had generated a profit of H.K.$ 70,502 million. From the proceeds of the transaction, HTIL declared a transaction special dividend to its shareholders. From HTIL's perspective it had carried on "Indian mobile telecommunications operations" which were being discontinued as a result of the transaction.

124. The nature of the transaction can also be considered from the perspective of how VIH BV looked at it in the events which led to the Sale purchase agreement dated 11 February 2007. On 22 December 2006, Vodafone in its announcement stated that the mobile market in India has great potential and that it was considering the acquisition of a controlling interest in Hutch Essar which would be consistent with its strategy of seeking selective acquisition opportunities in developing markets. Vodafone's initial offer dated 22 December 2006 to HTIL was a non-binding offer for HTIL's 66.9848% share of HEL of US$ 11.055 billion based on an enterprise value of HEL of US$ 16.5 billion. On 9 February 2007, Vodafone submitted a revised offer of US$ 10.7078 billion. While submitting the offer, Vodafone confirmed that it would agree in consultation with HTIL to take into account amounts that would be paid directly to certain existing local partners in Hutch in order to extinguish certain obligations of HTIL to them. Vodafone also confirmed that it had "come to arrangements" with HTIL's existing local partners (Analjit Singh, Asim Ghosh and IDFC) to maintain the local Indian shareholdings in accordance with Indian FDI

requirements. VIH BV also expressed its willingness to offer to Essar the same finance terms for Essar shareholdings in HEL which were offered to HTIL. Alternatively, it expressed that it was willing to enter into a partnership with Essar on appropriate terms. Appendix-A to the offer set out the basis of working out the consideration payable to HTIL for HTIL's interest in HEL. The consideration was factored on the following basis:

	US$m
Hutch enterprise value	18,250.0
Less: Hutch net debt	(1,327.1)
Hutch equity value	16,922.9
66.9848% of Hutch equity value	11,335.8
Less: Holdco net debt	(628.0)
Less: Inter-company loans	(1,084.0)
Equity value of HTIL's 100% stake in CGP	9,623.8
Add: Inter-company Loans	1,084.0
Consideration to HTIL for HTIL's interest	10,707.8

The equity value of HTIL's 100% stake in CGP was computed on the basis of HELs enterprise value of US $ 18,250 million and by

computing 66.9848% of equity value. The entire value that was ascribed to HTIL's stake in CGP was computed only on the basis of the enterprise value of HEL.

125. Now it is in this background, that it would be necessary to consider and analyse the documents on the record:

(i) **Term Sheet agreement 5 July 2003**: On 5 July 2003, a Term sheet agreement was entered into between HTIL, Essar Teleholdings Ltd. and Usha Martin Telematics Ltd. The document contemplated that the operating companies would be consolidated by transferring all their shares to an Indian holding company, Holdco. The holding company became HMTL and thereafter HEL. The Term sheet postulated that a shareholders' agreement would be entered into for Holdco which would include amongst other things, HTIL's right to nominate the Chairman of the Board and HTIL management rights including nominating the Chief Executive Officer, Chief Financial Officer, Chief Commercial Officer, Chief Marketing Officer and Chief Technical Officer for all operations. ETH would grant HTIL a '*right of first refusal*' (ROFR) over any sale

of its share in Holdco. HTIL would grant to ETH '*tag along rights*' in respect of ETH's shareholdings in Holdco. So long as HTIL (together with its associated companies) in aggregate was the largest single shareholder and held at least 40% of the issued share capital of Holdco, decisions such as (i) Approval of the annual business and operating plan including those for operating subsidiaries; (ii) Entering into high value contracts of over US $ 20 million; (iii) Any change in the authorised or issued share capital; and (iv) Capital calls would be treated as reserved decisions.

(ii) The Sale Purchase Agreement dated 11 February 2007

A Sale Purchase Agreement ("SPA") was entered into on 11 February 2007 between Hutchison Telecommunications International Limited (HTIL) and Vodafone International Holdings B.V. (VIH BV). The Agreement contains the following two recitals:

> "(A) CGP is an indirect wholly-owned subsidiary of the Vendor. CGP owns, directly or indirectly, companies which control the Company Interests,
>
> (B) The Vendor has agreed to procure the sale of, and the Purchaser has agreed to purchase, the entire issued share capital of CGP on the terms and conditions set out in this Agreement. The Vendor has further agreed to procure the assignment of, and the Purchaser

> has agreed to accept an assignment of, the Loans on the terms and conditions set out in this Agreement and the Loan Assignments."

'Company interests' are defined to be the aggregate interests in 66.9848 % of the issued share capital of Hutchison Essar Limited (HEL).

Clause 2 of the SPA provides that "upon and subject to the terms and conditions of this agreement" HTIL agreed to procure the sale of and VIH BV agreed to purchase one ordinary share of CGP representing the entire issued share capital of CGP together with the rights attaching or accruing to it. HTIL also agreed to procure the assignment of loans (defined to mean all inter company loans owing by CGP and Array to a vendor group company). The obligation under Clause 2 was subject to the conditions prescribed in Clause 4.1, Sub-clause (a) of which required "all requisite consents of the FIPB to the sale and purchase of the share having been obtained". VIH BV was required to use all reasonable endeavours including communications with the FIPB to ensure satisfaction of this condition and by the third business day following the agreement

was required to submit an application to the FIPB for Press Note 1 consent. Hence, the transaction was subject to the consent and approval of FIPB. Fulfillment of the conditions set out in Clause 4.1 preceded the vesting of rights and obligations under the contract. The purchaser was entitled to waive the condition set out in Clause 4.1(a). Clause 4.3(c) stipulated that if FIPB approval was not obtained, HTIL could at its sole discretion terminate the agreement and parties would have no claim against each other. Under Clause 5.2 VIH BV was obliged to make an offer to Essar Teleholdings Limited for the acquisition of its entire shareholding in the company at a price which valued its interest in the company on the same basis as the interest of the vendor. The tag along rights of Essar, which was a minority shareholder, of HEL were thus recognized. Clause 6.1 defined the obligations of HTIL in relation to the conduct of business. Among them, in sub clause (ix) was the obligation not to amend, terminate, vary or waive any rights under any of the Framework agreements, TII Shareholders' agreement or SMMS Shareholders' agreement or exercise any of the options, rights or discretions under any such agreement other than in accordance with the transaction documents or the IDFC

Framework agreement. The Framework agreements were defined in the agreement to mean the Centrino Framework Agreement, the ND Callus Framework Agreement and the SMMS Framework Agreement.

Now it is important to note that Centrino, ND Callus and SMMS are all companies incorporated in India under the Companies Act 1956. The expression “IDFC Framework Agreement” was defined to mean the framework agreement to be entered into between IDFC Private Equity Company Limited, the Infrastructure Development Finance Company Limited, SSKI Corporate Finance Private Limited, SMMS, Hutchison Telecommunications (India) Limited, HITL, Omega and GSPL. The TII shareholders’ agreement meant the shareholders’ agreement dated 1 March 2006 among Centrino, ND Callus, CGP India Investments Limited and TII Private Limited.

The vendor’s obligations prior to completion under Clause 6.2(b) was to procure that the wider group companies shall immediately inform VIH-BV if there had been any amendment,

variation or waiver of any of the rights under the framework agreements and shareholders' agreements and/or if any of the options granted pursuant to such agreements had been triggered or exercised. Under Clause 8.8 the completion of obligations of HTIL included the delivery of loan assignments duly executed by CGP or Array, as the case may be, and HTI (BVI) Finance; the written resignations in agreed terms of each of the directors of each group company; the execution of the Hutch brand licence; a tax deed duly executed by the vendor and the GSPL transfer agreement.

From Clause 8 it is evident that it was the obligation of HTIL to ensure execution of the terms of the transaction documents by the respective Indian entities. Through the modality of Clause 8.8 and Clause 8.9 the exercise of controlling power over HEL was effectively transferred to VIH BV. Clause 9.5 stipulated that for the purpose of assessing damages suffered by VIH BV for any breach of the agreement, the agreement shall be treated as requiring in HTIL to procure the delivery of 66.9848 % of the issued share capital of HEL to the purchaser and the vendor

will be deemed to have transferred 66.9848 % of the issued share capital to the purchaser on completion. Clause 10.4 envisaged that HTIL undertook to facilitate the procuring of a replacement of the Oracle licence for the relevant group companies. Clause 14.1 incorporated a non-compete agreement whereby HITL was restrained directly or indirectly from carrying on, engaging in or being economically interested in within India any business carried on in competition with the business now carried on by HEL or its subsidiaries. By the non-compete agreement HTIL and all its affiliates were restrained from carrying on telecom activity in India. Significantly, the restriction relates to the business which was being carried on in India by HEL, the control over which was transferred by the SPA from HTIL to VIH BV.

The diverse clauses of the SPA are indicative of the fact that parties were conscious of the composite nature of the transaction and created reciprocal rights and obligations that included, but were not confined to the transfer of the CGP share. The commercial understanding of the parties was that the transaction related to the transfer of a controlling interest in HEL

from HTIL to VIH BV. The transfer of control was not relatable merely to the transfer of the CGP share. Inextricably woven with the transfer of control were other rights and entitlements which HTIL and/or its subsidiaries had assumed in pursuance of contractual arrangements with its Indian partners and the benefit of which would now stand transferred to VIH BV. By and as a result of the SPA, HTIL was relinquishing its interest in the telecommunications business in India and VIH BV was acquiring the interest which was held earlier by HTIL.

(iii) **Term sheet agreement dated 15 March 2007 and the restated Term sheet agreement dated 24 August 2007.**

On 15 March 2007 the Vodafone and Essar groups entered into a term sheet agreement to regulate the affairs of HEL and the relationship of the shareholders of the company. Under the terms of the partnership Vodafone would have operational control over HEL while Essar would have rights consistent with its shareholding including proportionate board representation. The

term sheet agreement was restated on 24 August 2007 after the transaction received the approval of the FIPB, on the same terms as the earlier term sheet. The term sheet agreement dated 24 August 2007 records that VIH BV has acquired the entire indirect holding of HTIL in Vodafone Essar "**including all rights, contractual or otherwise, to acquire directly or indirectly shares in Vodafone Essar owned by others**". The recitals further state that parties had entered into the term sheet to regulate the affairs of Vodafone Essar (VEL) and the relationship between its shareholders. Under Clause 2.1, Vodafone and Essar acquired the right to nominate directors in proportion to their beneficial shareholding; initially the Vodafone group was entitled to nominate eight directors while the Essar Group was entitled to nominate four directors. Under Clause 2.2 the Chairman of the company was to be nominated by the Vodafone group. Under Clause 2.3 Vodafone acquired the right to nominate the Chief Executive Officer, Chief Financial Officer, Chief Commercial Officer, Chief Marketing Officer and Chief Technical Officer. Clause 5.1 imposes restrictions on the transfer of ownership of shares and inter alia provided that no share could be transferred other than pursuant to the provisions of the term sheet

or put option agreements. Clause 6 created a right of first refusal. Under Clause 7.1 a change of control in each group would entitle the other to require a sale of the shareholders' interest. By Clause 8 Vodafone granted to the Essar group tag along rights in respect of the shareholding of the Essar group . Under Clause 10 certain decisions were regarded as reserved so long as Vodafone continued to hold directly or indirectly at least 50% of the equity of the issued share capital of the company. Under Clause 16 the primary brand under which the company would trade was to be the Vodafone brand. Under Clause 22 Vodafone agreed not to compete with the business of VEL or to enter into any telecommunications business in India. Clause 28.7 provided that the term sheet would be governed by and in accordance with the laws of India.

By the Term sheet agreement of 24 August 2007, VIH BV as successor in interest of HTIL spelt out how the Indian company is to be operated and the rights and obligations of the shareholders inter se. This cannot by any means be regarded as a minor adjustment made by the parties pursuant to the acquisition of one share in CGP. On the contrary the acquisition of one share in CGP

was a mode chosen by the parties to facilitate the process. The fulfillment of the transaction required the putting into place of structural arrangements in India that would regulate the conduct of the business of the Indian company, the relationship between the shareholders of the company and the contractual entitlements accruing or arising in respect of agreements with the Indian partners. Valuable rights came to be recognized and conferred in the term sheet agreements. These were tangible rights having a direct nexus with India which enabled VEL to control and carry on business.

(iv) On 15 March 2007 Vodafone and Vodafone group PLC as guarantors of Vodafone entered into a put option agreement with Essar Teleholdings Limited and Essar Communications Limited, Mauritius requiring the Vodafone group to purchase from the Essar group shareholders all of the option shares held by them at a price payable for the first put option shares of US $ 5 Billion. Under the second put option the Essar group had an unconditional right to require Vodafone to purchase from the Essar group shareholders such shares as the Essar group may determine subject to a

minimum aggregate fair market value of US $ 1 Billion and upto a maximum aggregate fair market value of US $ 5 Billion.

(v) **Tax Deed of Covenant** :

Apart from the SPA a tax deed of a covenant was entered into between the HTIL and VIH BV on 8 May 2007 in pursuance of Clause 8.8(1) of the SPA indemnifying VIH – BV in respect of taxation or transfer pricing liabilities payable or suffered by the wider group companies (as defined by the SPA) on or before completion including any reasonable cost associated with any tax demand. Before this Court, VIH BV has stated that no arbitral proceedings have been initiated with HTIL pursuant to the agreement, and neither a claim nor a formal notice of claim has been served upon the vendor under the agreement. The documents exchanged between the parties include a disclosure letter dated 11 February 2007 issued by HTIL to VIH BV. The disclosure letter deems certain information to have been disclosed, so as to obviate future disputes.

(vi) **The Brand Licence Agreement**

The Brand Licence Agreement contains a transitional arrangement, for a limited duration, under which a non-transferable royalty free right was given to VIH – BV as licensee to use the trademarks and other intellectual property rights authorized by the licensor. As a matter of fact, after completion of the transaction VIH BV in conformity with its obligation under Clause 13(b) of the SPA took steps for the introduction of brand Vodafone into the Indian market and a trademark licence agreement was entered into on 19 December 2008 for the introduction of brand Vodafone into India by VIH BV. The Brand Licence had provided for a transitional arrangement till the Vodafone brand was introduced into India.

(vii) **<u>Loan Assignment Agreements</u>**

The structure at the time when the SPA was executed was that the share of CGP which was owned by HTI BVI was to be sold. However, loans had been advanced by a direct wholly owned subsidiary of HTIL. These loans owed by Array to an HTIL

subsidiary would now be repayable to VIH – BV. Accordingly, loan assignment agreements were entered into on 8 May 2007.

126. Now at this stage, it would be necessary to advert to the admitted position as it emerges from the disclosures made by the Petitioner before the FIPB. By its letter dated 14 March 2007 VIH BV informed the FIPB that its effective share holding in HEL will be 51.96 % and that "following completion of the acquisition of HTIL's share in Hutch Essar", the ownership of Hutch Essar will be as follows :

1. Vodafone will own a 42% direct interest in HEL through its acquisition of 100% of CGP;

2. Through CGP Vodafone will also own 37% in TII which in turn owns 20% in HEL and 38% in Omega which in turn owns 5% in HEL.

Both TII and Omega are Indian companies. These investments would give Vodafone a controlling interest of 52 % in HEL. In addition HTIL's existing Indian partners Asim Ghosh, Analjit Singh and IDFC who between them hold a 15 % interest in HEL had agreed to retain their shareholding with full control including voting rights and dividend rights.

127. By a letter dated 19 March 2007 VIH BV informed the FIPB that the price of US $ 11.08 Billion "includes a control premium, use and rights to the Hutch brand in India, a non-compete agreement with the Hutch group, the value of non-voting non convertible preference shares, various loan obligations and the entitlement to acquire, subject to Indian foreign investment rules, a further 15 % indirect interest in Hutch Essar". When called upon by the FIPB to disclose a break up of the value attributed to these components, VIH BV by its letter dated 27 March 2007 to the FIPB stated as follows :

> "1. The various assets and liabilities of CGP including (a) its 51.96 % direct and indirect equity ownership of Hutch Essar; (b) its ownership of non-voting, non-convertible, redeemable preference shares in Telecom Investments India Private Limited (TII") and Jaykay Finholding (India) Private Limited; (c) assumption of liabilities in various subsidiaries of CGP amounting to approximately US $ 630 million and (d) subject to Indian foreign investment rules, its rights and entitlements, including subscription rights at par value and call options, to

acquire in the future a further 62.75 % of TII, and call options, to acquire in the future, a further 54.21 % of Omega Telecom Holdings Private Limited ("Omega") which together would give us a further 15.03 % proportionate indirect equity ownership of Hutch Essar; and

2. Various other intangible factors such as control premium, use and rights to the Hutch brand in India and a non-compete agreement with HTIL.

We did not, in reaching this price, put an individual price on each of these components. Rather, they were viewed as the package based on which we should make our offer to HTIL. Our approach was to look at the total package of assets, liabilities and other intangible factors represented by the ownership of CGP and to assess the total value."

128. Now at this stage, it would be material to advert to the position of the Analjit Singh and Asim Ghosh companies, taking as the basis HTIL's letter dated 9 April 2007 to the FIPB. Analjit Singh together with his wife held a 100% stake in Scorpio Beverages, an Indian company which in turn held a 100 % stake in MV Health

Care Services (an Indian company). The latter held a 100 % stake in ND Callus which was also an Indian Company. Asim Ghosh held a 100 % stake in Gold Spot, an Indian company. Gold Spot in turn held 100 % in Plustech, also an Indian company which in turn held a 100 % stake in Centrino, an Indian company. TII is an Indian company of which 37.25% of the total share holding was held by CGP India Investments Limited, a Mauritian company indirectly held earlier by HTIL. Plustech and Centrino held 23.97 % in TII while ND Callus held 35.78 % in TII. TII directly held 12.95 % in HEL whereas 6.06 % was held through a down stream subsidiary, Usha Martin which also an Indian company. Jaykay which was an Indian subsidiary of TII held 0.51 %.

129. In the disclosure made by HTIL before the FIPB it was stated that in March 2006 when the Kotak group was exiting from HEL and HTIL was looking to simplify its ownership structure, it was clear that the only parties which could purchase the Kotak and HTIL stake were resident Indian citizens. These stakes of Kotak and HTIL were then valued at Rs.1,330 Crores. Both Analjit Singh and Asim Ghosh declined Kotak and HTIL's investment offers unless

they were provided with a 'down side protection' and assistance in obtaining financing necessary to make such investments. Accordingly, an agreement was reached by which HTIL was conferred, together with its group companies, certain future rights over the TII interests acquired by Analjit Singh and Asim Ghosh in consideration for the assistance and support which HTIL provided for financing their acquisitions. HTIL stated in its disclosure that put and call options over Analjit Singh and/or Asim Ghosh companies' shares were accordingly created in terms of the framework agreements. Under them, the Analjit Singh and Asim Ghosh companies may sell or an HTIL group company may call upon them to sell their entire respective share holdings in the MV Health Care and Plus Stake companies respectively to the HTIL group at a fair market value as may be agreed between the parties. This was subject to regulatory and legal compliance. These options provided for reciprocal rights for the realization of Analjit Singh and Asim Ghosh investments in TII. HTIL was also granted an option to subscribe for new shares in Centrino or ND Callus representing 97 % of their enlarged share capital. In order to effectuate the performance of the put and call options, Analjit

Singh, Asim Ghosh and their respective holding companies undertook not to transfer or allot shares except as allowed in the framework agreements.

IDFC group investments in Omega

130. Omega Telecom Holdings Private Limited ("Omega") is an Indian company in which Hutchison Telecommunications (India) Limited, a Mauritian company has a holding of 45.79 %. Omega held 5.11 % of the share holding of HEL. In June 2006 the Hinduja group and Sumitomo of Japan decided to sell their interest in HEL by disposing of all their interest in Omega. HTIL arrived at an agreement with the Hinduja group for an additional sale and purchase agreement under which HTIL purchased the foreign component of 45.79 % of Omega and HTIL would procure a third party to acquire the Indian stake in Omega. The Hinduja group sold 54.21 % of the Indian share holding in Omega to a joint venture company promoted by the IDFC group. HTIL provided a guarantee for financing. HTIL was in turn given future rights over the Omega interests acquired by the IDFC group in consideration of

the support extended by HTIL for financing their acquisition. Put and call options were contractually created under framework agreements under which inter alia the HTIL group was entitled to call upon the IDFC group to sell their share holdings in their investment vehicle (SMMS) to the HTIL group.

131. The facts which have been disclosed before the Court support the contention of the Additional Solicitor general that the transaction between HTIL and VIH BV took into consideration the following interests and entitlements :

1) HTIL held through eight down stream Mauritian subsidiaries an aggregate of 42.34 % interest in HEL;

2) In the Indian company TII, HTIL had 37.25% interest through CGPC and its down stream subsidiaries. TII directly held 12.95 % in HEL while its down stream subsidiary, Usha Martin held 6.06 % and its subsidiary Jaykay held 0.51 %. TII's direct and indirect holding in HEL was 19.54 % resulting in a prorata holding of 7.24% by HTIL in HEL;

3) In Omega which was an Indian company HTIL held 45.79% through its Mauritian subsidiary HTIM. Omega held a shareholding of 5.11 % in HEL resulting in a pro rata holding of 2.34 % interest by

HTIL in HEL;

4) Rights (and call and put options) by providing finance and guarantee to Asim Ghosh group of companies to exercise control over TII and indirectly over HEL through the TII shareholders' agreement and the Centrino framework agreement dated 1 March 2006;

5) Rights (and call and put options) by providing finance and guarantees to Analjit Singh group of companies to exercise control over TII and indirectly over HEL through TII shareholders' agreement and ND Callus framework agreement dated 1 March 2006;

6) Finance to SMMS to acquire shares in ITNC (formerly Omega) with a right to acquire the share capital of Omega in future;

7) Controlling rights over ITNC through the ITNC shareholders agreement including the right to appoint directors with a veto power to make its interest in HEL thereby holding a beneficial interest in 2.77 % of the share capital of HEL;

8) Interest in the form of a loan of US $ 231 Million to HTV BVI which was assigned to Array;

9) Interest in the form of a loan of US $ 952 Million through HTV BVI utilized for purchasing shares in HEL by eight Mauritian companies;

10) Interest in the form of preference share capital in JKF and TII to the extent of US $ 165.7 Million and US $ 337 Million attributing to a holding of 19.54 % of equity of HEL

132. The facts clearly establish that it would be simplistic to assume that the entire transaction between HTIL and VIH BV was fulfilled merely upon the transfer of a single share of CGP in the Cayman Islands. The commercial and business understanding between the parties postulated that what was being transferred from HTIL to VIH BV was the controlling interest in HEL. HTIL had through its investments in HEL carried on operations in India which HTIL in its annual report of 2007 represented to be the Indian mobile telecommunication operations. The transaction between HTIL and VIH BV was structured so as to achieve the object of discontinuing the operations of HTIL in relation to the Indian mobile telecommunication operations by transferring the rights and entitlements of HTIL to VIH BV. HEL was at all times intended to be the target company and a transfer of the controlling interest in HEL was the purpose which was achieved by the transaction. Ernst and Young who carried out a due diligence of the telecommunications business carried on by HEL and its subsidiaries have made the following disclosure in its report :

> **"The target structure now also includes a Cayman company, CGP Investments (Holdings) Limited. CGP Investments (Holdings) Limited was not originally**

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

The due diligence report emphasizes that the object and intent of the parties was to achieve the transfer of control over HEL and the transfer of the solitary share of CGP, a Cayman Islands company was put into place at the behest of HTIL, subsequently as a mode of effectuating the goal.

133. The true nature of the transaction as it emerges from the transactional documents is that the transfer of the solitary share of the Cayman Islands company reflected only a part of the arrangement put into place by the parties in achieving the object of transferring control of HEL to VIH BV. HTIL had put into place, during the period when it was in control of HEL, a complex structure including the financing of Indian companies which in turn had holdings directly or indirectly in HEL. In consideration call and put options were created and the benefit of those options had

to be transferred to the purchaser as an integral part of the transfer of control over HEL. Hence, it is from that perspective that the framework agreements pertaining to the Analjit Singh and Asim Ghosh group of companies and IDFC have to be perceived. These were agreements with Indian companies and the transaction between HTIL and VIH BV takes due account of the benefit of those agreements.

134. The price paid by VIH BV to HTIL of US $ 11.01 Billion factored in, as part of the consideration, diverse rights and entitlements that were being transferred to VIH BV. Many of these entitlements were not relatable to the transfer of the CGP share. Indeed, if the transfer of the solitary share of CGP could have effectuated the purpose it was not necessary for the parties to enter into a complex structure of business documentation. The transactional documents are not merely incidental or consequential to the transfer of the CGP share, but recognized independently the rights and entitlements of HTIL in relation to the Indian business which were being transferred to VIH BV.

135. We began the record of submissions by adverting to the contention of the Petitioner that if any of the shares held by the Mauritian companies were sold in India, there would be no liability to capital gains tax because of the Convention on the Avoidance of Double Taxation between India and Mauritius. The crux of the submission is that the entire transaction in the case is subsumed in the transfer of a share of an upstream overseas company which exercised control over Mauritian companies. As we have noted earlier, it is simplistic to assume that all that the transaction involved was the transfer of one share of an upstream overseas company which was in a position to exercise control over a Mauritian company. The transaction between VIH BV and HTIL was a composite transaction which covered a complex web of structures and arrangements, not referable to the transfer of one share of an upstream overseas company alone. The transfer of that one share alone would not have been sufficient to consummate the transaction. The transaction documents are adequate in themselves to establish the untenability of the Petitioner’s submissions.

136. The submission of VIH BV that the transaction involves merely a sale of a share of a foreign company from one non-resident company to another cannot be accepted. The edifice of the submission has been built around the theory that the share of CGP, a company situated in the Cayman Islands was a capital asset situated outside India and all that was transferred was that which was attached to and emanated from the solitary share. It was on this hypothesis that it was urged that the rights and entitlements which flow out of the holding of a share cannot be dissected from the ownership of the share. The purpose of the discussion earlier has been to establish the fallacy in the submission. The transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH BV. Intrinsic to the transaction was a transfer of other rights and entitlements. These rights and entitlements constitute in themselves capital assets within the meaning of Section 2(14) which expression is defined to mean property of any kind held by an assessee.

137. Under Section 5(2) the total income of a non-resident includes all income from whatever source derived which (a) is

received or is deemed to be received in India or (b) accrues or arises or is deemed to accrue or arise to him in India. Parliament has designedly used the words "**all income from whatever source derived**". These are words of width and amplitude. Clause (i) of Section 9 explains the ambit of incomes which shall be deemed to accrue or arise in India. Parliament has designedly postulated that all income accruing or arising whether **directly or indirectly**, (a) through or from any business connection in India or (b) through or from any property in India; or (c) through or from any asset or source of income in India or (d) through the transfer of a capital asset situate in India would be deemed to accrue or arise in India. Where an asset or source of income is situated in India or where the capital asset is situated in India, all income 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.

138. VIH BVs disclosure to the FIPB is indicative of the fact that the consideration that was paid to HTIL in the amount of US $ 11.01 Billion was for the acquisition of a panoply of entitlements including a control premium, use and rights to the Hutch brand in

India, a non-compete agreement with the Hutch group, the value of non-voting non convertible preference shares, various loan obligations and the entitlement to acquire subject to Indian foreign investment rules, a further 15% indirect interest in HEL.

139. The manner in which the consideration should be apportioned is not something which can be determined at this stage. Apportionment lies within the jurisdiction of the Assessing Officer during the course of the assessment proceedings. Undoubtedly it would be for the Assessing Officer to apportion the income which has resulted to HTIL between that which has accrued or arisen or what is deemed to have accrued or arisen as a result of a nexus within the Indian taxing jurisdiction and that which lies outside. Such an enquiry would lie outside the realm of the present proceedings. But once this Court comes to the conclusion that the transaction between HTIL and VIH BV had a sufficient nexus with Indian fiscal jurisdiction, the issue of jurisdiction would have to be answered by holding that the Indian tax authorities acted within their jurisdiction in issuing a notice to show cause to the Petitioner for not deducting tax at source.

140. In assessing the true nature and character of a transaction, the label which parties may ascribe to the transaction is not determinative of its character. The nature of the transaction has to be ascertained from the covenants of the contract and from the surrounding circumstances. In **National Cement Mines Industries Ltd. vs. C. I. T.,**[49] Mr.Justice J.C. Shah speaking for the Supreme Court emphasized the principles of interpretation to be adopted by the Court in construing a commercial transaction :

> "But in assessing the true character of the receipt for the purpose of the Income-tax Act, **inability to ascribe to the transaction a definite category is of little consequence**. It is not the nature of the receipt under the general law but in commerce that is material. It is often difficult to distinguish whether an agreement is for payment of a debt by installments or for making annual payments in the nature of income. The court has, on an appraisal of all the facts, to assess whether a transaction is commercial in character yielding income or is one in consideration of parting with property for repayment of capital in installments. No single test of universal application can be discovered for solution of the problem. **The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little moment, and the true nature and character of the transaction have to be ascertained from the covenants of the contract in the light of the surrounding circumstances."**

49 (1961) 42 ITR 69

In the judgment of the House of Lords in **Investors Compensation Scheme Ltd. vs. West Bromwich Building Society & Ors.**,[50] Lord Hoffmann, while adverting to the principles by which contractual documents are nowadays construed drew attention to the effort in the law "to assimilate the way in which such documents are interpreted by Judges to the common sense principles by which any serious occurrence would be interpreted in the ordinary life". The contemporary principles underlying the interpretation of commercial contracts have been set out in the judgment:

> "(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> -(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact", but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
>
> -(3) The law excludes from the admissible

50 (1997) UKHL 28

background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

-(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars' the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax. (see Mannai Investments Co.Ltd. v. Eagle Star Life Assurance Co. Ltd. (1997) 2 W.L.R. 945.

-(5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in The Antaios Comania Neviera S.A. v. Salen Rederierna A.B. 1985 A.C. 191, 201:

"...if detailed semantic and syntactical analysis

> of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense."

Giving effect to business common sense is the touchstone.

141. In **Hideo Yoshimoto vs. Canterbury Golf International Ltd.**,[51] the Court of Appeal in New Zealand, adverted to an article of Lord Steyn[52] in which the Law Lord has noted the distinct trend towards an objective theory of contract which gives effect to the reasonable expectations of honest people. The expectations which will be protected are those that are,in an objective sense, common to both parties. In this regard, there has been a shift away from a black-letter approach to questions of interpretation to a more purposive interpretation. The subject matter of the transaction in the present case, must, therefore, be viewed from a commercial and realistic perspective. That perspective respects the form of the transaction adopted by the parties. The terms of the transaction is what the court interprets applying rules of ordinary and natural construction. That perspective would adopt what a normal and

51 (2000) NZCA 350

52 Johan Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 LQR 433, at 433-434.

commercially prudent investor would have viewed. From the perspective of Income Tax Law what is relevant is the place from which or the source from which the profits or gains have generated or have accrued or arisen to the seller. The income accrued and arose and was derived as a consequence of the divestment of HTIL's interest in India. If there was no divestment or relinquishment of its interest in India, there was no occasion for the income to arise. The real taxable event is the divestment of HTIL's interests which comprises in itself various facets or components which include a transfer of interests in different group entities.

142. That leads to the question as to the obligation to deduct tax under Section 195. While construing the provisions of Section 18(3A) and Section 42 of the Indian Income Tax Act, 1922 in **Agarwal Chambers of Comerce Ltd. vs. Ganpat Rai Hira Lal**,[53] the Supreme Court held thus:

> "Those persons who are bound under the Act to make deduction at the time of payment of any income, profits or gains are not concerned with the ultimate results of the assessment.. The scheme of the Act is that deductions are required to be made out of "salaries", "interest on securities" and other heads of "income, profits and gains"

53 (1958) 33 ITR 245

> and adjustments are made finally at the time of assessment. Whether in the ultimate result the amount of tax deducted or any lesser or bigger amount would be payable as income tax in accordance with the law in force would not affect the rights, liabilities and powers of a person under section 18 or of the agent under sections 40(2) and 42(1). As to what would be the effect and result of the application of section 17 if and when any appropriate proceedings are taken is not a matter which arises in this appeal between the appellant and the respondent nor can that matter be adjudicated upon in these proceedings. That is a matter which would be entirely between the respondent and the Income tax authorities seized of the assessment."

In Transmission **Corporation of Andhra Pradesh vs. CIT** (supra), the Supreme Court once again emphasized that the scheme of sub-sections (1), (2) and (3) of Section 195 and Section 197 leaves no doubt that the expression "any other sum chargeable under the provisions of this Act" would mean a "sum" on which tax is leviable. The test is whether payment of the sum to a non-resident is chargeable to tax under the Act. The sum, as the Supreme Court observed, may be income or income hidden or otherwise embedded therein. If so, tax is required to be deducted on the sum. The sum which is to be paid may be income out of different heads of income. The scheme of tax deducted at source applies not only to

the amount paid which wholly represents income chargeable but also to gross sums which may not be income or profits of the recipient. The Supreme Court noted that in some cases, a fraction of the sum may be taxable income while in other cases such as interest, commission, transfer of rights of patents, goodwill or drawings for plant and machinery and such other transactions it may contain a large sum as taxable income under the Act. However, whatever may be the position, the Supreme Court held, the actual computation of income would arise at the time of the regular assessment. In other words, Section 195 is a provision for tentative deduction of income tax subject to regular assessment. The rights of the payee or of the recipient are safeguarded by sub-sections (2) and (3) of Section 195 and Section 197. For, as the Supreme Court observed:

> "Further, the rights of the payee or recipient are fully safeguarded under sections 195(2), 195(3) and 197. The only thing which is required to be done by them is to file an application for determination by the Assessing Officer that such sum would not be chargeable to tax in the case of the recipient, or for determination of the appropriate proportion of such sum so chargeable, or for grant of certificate authorising the recipient to receive the amount without deduction of tax, or deduction of income-tax at any lower rates or no deduction. On such determination, tax at the appropriate rate could be

> deducted at the source. If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such "sum" to deduct tax thereon before making payment. He has to discharge the obligation of tax deduction at source."

143. The same view was taken by Hon'ble Shri Justice S.H. Kapadia (as the Learned Chief Justice then was) when His Lordship spoke for a Division Bench of this Court in **Commissioner of Income Tax vs. Tata Engineering and Locomotive Co.Ltd**.[54] The Division Bench observed that the provision under Section 195 is only for a tentative deduction of income subject to regular assessment and the rights of parties are not in any manner adversely affected.

144. The basic test under Section 195 is that the payment has been made to a non-resident of a sum chargeable under the provisions of the Act. Any person responsible for paying such a sum to a non-resident is liable to deduct income tax at the time when a credit of such income is effected or at the time when payment is made. As the Supreme Court observed in **Eli Lily**, the

54 (2000) 245 ITR 823

provisions of Section 195 of the Income Tax Act, 1961 are in the nature of a machinery provision enacted in order to effectuate the collection and recovery of tax. Given a sufficient territorial connection or nexus between the person sought to be charged and the country seeking to tax him, income tax may extend to that person in respect of his foreign income. The connection can be based on residence or business connection within the taxing State or the situation within the State of an asset or source of income from which the taxable income is derived. Once the nexus is shown to exist, the provisions of Section 195 would operate. Even though the revenue laws of a country may not be enforceable in another, that does not imply that the Courts of a country shall not enforce the law against the residents of another within their own territories. The principle is explained by the Supreme Court in **Electronic Corporation of India Ltd.vs. CIT**,[55] thus:

> Now it is perfectly clear that it is envisaged under our constitutional scheme that Parliament in India may make laws which operate extra-territorially. Article 245(1) of the Constitution prescribes the extent of laws made by Parliament. They may be made for the whole or any part of the territory of India. Article 245(2) declares that no law made by the Parliament shall be deemed to be invalid on the ground that it would have extra-territorial

55 1989 Supp(2) SCC 642

> operation. Therefore, a Parliamentary statute having extra-territorial operation cannot be ruled out from contemplation. The operation of the law can extend to persons, things and acts outside the territory of India. The general principle, flowing from the sovereignty of States, is that laws made by one state can have no operation in another State. The apparent opposition between the two positions is reconciled by the statement found in *British Columbia Electric Railway Company Limited v. King* (2 (1946(AC 527:
>
> > "A legislature which passes a law having extra-territorial operation may find that what it has enacted cannot be directly enforced, but the act is not invalid on that account, and the courts of its country must enforce the law with the machinery available to them."
>
> In other words, while the enforcement of the law cannot be contemplated in a foreign State, it can, nonetheless, be enforced by the courts of the enacting State to the degree that is permissible with the machinery available to them. They will not be regarded by such courts as invalid on the ground of such extra-territoriality."

Chargeability and enforceability are distinct legal conceptions. A mere difficulty in compliance or in enforcement is not a ground to avoid observance. In the present case, the transaction in question had a significant nexus with India. The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The transaction between the parties covered within its sweep, diverse rights and entitlements. The

Petitioner by the diverse agreements that it entered into has a nexus with Indian jurisdiction. In these circumstances, the proceedings which have been initiated by the Income Tax Authorities cannot be held to lack jurisdiction.

145. By the order passed by the Supreme Court on 23 January 2009, the Second Respondent was directed to determine the jurisdictional challenge raised by the Petitioner. Liberty was reserved to the Petitioner to challenge the decision of the Second Respondent on the preliminary issue, if it was determined against the Petitioner, by addressing a challenge before this Court. The issue of jurisdiction for the reasons already noted earlier, has been correctly decided.

146. After Mr.Salve had concluded his submissions, Dr.Singhvi submitted that the tax authority is not competent to treat the Petitioner as an assessee in default under Section 201, as amended by the Finance Act, 2008 and the amendment to Section 201 by the Finance Act, 2008 is unconstitutional. We have not considered it appropriate to adjudicate upon the submission of

Dr.Singhvi at this stage because :

> (a) In the impugned order, the tax authority has not invoked jurisdiction on the basis of Section 201 as amended by the Finance Act, 2008; and

> (b) In fact, in paragraph 970 of the impugned order, it has been held that the amendment to Section 201 by the Finance Act, 2008 is clarificatory, meaning thereby that the liability sought to be fastened upon the Petitioner is based on the provisions as they stood prior to the amendment.

However, we clarify that it is open to the Petitioner to agitate before the tax authority that the Petitioner had reasonable cause and a genuine belief that it was not liable to deduct tax at source and that no penal liability can be fastened upon the Petitioner. In **Eli Lilly** (supra), the Supreme Court held that "the liability to levy of penalty can be fastened only on the person who does not have good and sufficient reason for not deducting the tax" the burden being on the person to prove the existence of good and sufficient reasons. (see also **Star India P. Ltd. vs. Commissioner of Central Excise.**[56]) We hence, keep this issue open to be urged by the

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56 (2006) 280 ITR 321 (S.C.)

Petitioner before the tax authority.

147. For the reasons which we have indicated, we do not find any merit in the petition. The petition is dismissed. There shall be no order as to costs.

(Dr.D.Y.Chandrachud, J.)

(J.P.Devadhar, J.)