

Tax Hotline

April 29, 2011

LIFTING OF CORPORATE VEIL IN CASE OF SALE OF SHARES BETWEEN TWO NON-RESIDENTS

The ruling of the Karnataka High Court in the case of *M/s Richter Holding Company vs. Assistant Director of Income Tax*¹, seems to have reignited the debate on form over substance, by observing that the Indian Income Tax Authorities (“Revenue Authorities”) have the latitude to “lift the corporate veil”, in order to ascertain the real intent behind the transaction.

BACKGROUND

In the case at hand, a Cypriot Company, Richter Holding Limited (“taxpayer”) together with a Mauritius Company West Globe Limited (“West Globe”) entered into an agreement to purchase and acquire the shares of a UK Company Finsider International Company Limited (“Finsider”) from another UK Company Early Guard Limited (“Early Guard”) in the year 2007. Finsider held 51% of the shares of an Indian Company Sesa Goa Limited (“Sesa Goa”).

The Revenue Authorities issued a show cause notice to the taxpayer since in their view the taxpayer had failed to deduct tax on the payments made by it to Early Guard for purchase of shares of Finsider which had led to the indirect transfer of shares of an Indian company. Aggrieved by the show cause notice issued by the Revenue Authorities, the taxpayer filed a Writ Petition before the Karnataka High Court (“the High Court”) challenging the legality of such notice.

CONTENTION BEFORE THE HIGH COURT

Before the High Court, the taxpayer placed reliance on the ruling in the case of *Vodafone International Holding B.V.*² and contended that the transfer in question was that of the shares of a UK company between two non residents. The taxpayer contended that such transfer did not tantamount to acquisition of immovable property or controlling the management of an Indian company and it was only an incident of ownership of shares which flowed out of holding of the shares. Thus, the question of treating the same as capital gains and obligation to withhold tax on the same did not arise.

The Revenue Authorities on the other hand contended that the sale of Finsider shares had led to an indirect acquisition of 51% of shares in Sesa Goa, an Indian company. The shares of Sesa Goa constituted a capital asset in terms of Section 2(14) of Income Tax Act (“ITA”), and thus the Revenue Authorities argued that an indirect transfer of a capital asset situated in India had taken place and the same was a taxable event as per the provisions of inter alia Section 9 of the ITA.

Further, as per Section 195 of the ITA, the taxpayer was liable to deduct tax in respect of payments made for purchase of capital asset and placing reliance on *Vodafone International*³ argued that the taxpayer should approach the Tax Authorities to obtain a clarification for non deduction of tax at source whilst making payment to a non-resident.

DECISION OF THE HIGH COURT

According to the High Court the validity of the show cause notice issued as per Section 195 of ITA was the issue under question and not the taxability per se in India of the share sale. The contentions regarding the non taxability of the same were in its view to be made before the Revenue Authorities. Thus, while upholding the legality of the show cause notice, the High Court directed the taxpayer to appear before the Revenue Authorities and present its case.

The High Court then proceeded to make certain interesting observations with respect to the merits of the arguments put forth before it and their view on facts of the case. They observed that the lack of information provided by the taxpayer makes it difficult to ascertain the nature of transaction between Finsider and Sesa Goa and as a consequence, it was premature to arrive at a conclusion that there was no tax avoidance and that the taxpayer was not liable to tax on capital gains in India.

Moreover, the High Court observed that “it may be necessary for the fact finding authority to lift the

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Moreover, the High Court observed that it may be necessary for the fact-finding authority to lift the corporate veil to look into the real nature of transaction to ascertain virtual facts³, and thus seemingly gave a tacit approval to the principal of form over substance.

ANALYSIS

The observations of the High Court, would no doubt add to the prevailing uncertainty with regard to the taxability of sale of shares between the non-residents in India. At first brush it may seem that the issue at hand relates to extra territorial application of the ITA, inasmuch as a transfer of shares between two non residents of shares of a foreign company are sought to be brought to tax in India. The issue has been subject matter of jurisprudence and the courts in India have in certain cases upheld the extra territorial jurisdiction of the ITA. However, the larger issue at hand is whether the principle of form over substance still holds good in the Indian context. The Supreme Court had in the case of *Azadi Bachao*⁴ seemingly laid the issue to rest by reinforcing the principle of form over substance and recognizing the right of a taxpayer to arrange his affairs in order to minimize tax incidence. However, the recent approach of the Revenue Authorities and observations made in certain judgments seem to be at variance with this settled principal. In our view, the judgment of the Supreme Court of India in the *Azadi Bachao* case must be treated as the law of the land and respected in letter and spirit. A taxpayer is entitled to certainty in planning his tax affairs and is permitted to arrange his affairs in a tax efficient manner within the four corners of law, and ignoring the principles laid down by the highest court of the land not only leads to uncertainty of action for the taxpayer but is against the principle of equity and natural justice.

- [Ankita Srivastava & Abhay Sharma](#)

You can direct your queries or comments to the authors

1 Writ Petition 7716/2011

2 Vodafone International Holdings B V vs. Union of India & Anr [2010] 329 ITR 126 (Bom)

3 Vodafone International Holdings B V vs. Union of India & Anr [2009] 179 Taxman 129 (SC)

4 Union of India v. Azadi Bachao Andolan, 263 ITR 706 (SC)

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