TAXSUTRA All rights reserved

taxsutra

SC appeal against Vodafone ruling – Opportunity for Government to "walk the talk"?

Date : 16 October 2014

Mr. Jairaj Purandare (Chairman, JMP Advisors Private Limited)

The Bombay High Court has delivered a landmark transfer pricing ruling in favour of Vodafone India [TS-308-HC-2014(BOM)-TP] for alleged undervaluation on issue of shares to its 100% foreign holding company. This ruling is a welcome step on the issue of a transfer pricing adjustment taxing notional share premium.

In March 2013, the Revenue department issued a notice to Vodafone India for levying tax on the difference between the so called Arm's Length Price ('ALP') of the shares and issue price of the shares, issued during FY 2008-09, to its 100% holding company in Mauritius. In addition to the above adjustment, the Revenue department also made a secondary adjustment by treating such shortfall in the value of shares as a deemed loan to the parent company and sought to tax the notional interest on such deemed loan in the hands of Vodafone India.

According to the Revenue department, by issuing shares at a lower value, Vodafone India eroded the tax base in India. Further, the Solicitor General of India argued on the fresh ground that what was brought to tax under transfer pricing provisions was not the share premium but was the "cost" incurred by the assessee in passing the benefit to its holding company by issuing shares at a premium less than the ALP. This benefit, according to the Revenue, is the difference between ALP and the issue price and would fall under the head "Income from Other Sources".

The Bombay High Court has rightly ruled that issue of shares at a premium does not give rise to any income and thus Chapter X of the Income Tax Act, 1961 ('the Act') cannot apply in such a case. The High Court also observed that section 92(1) of the Act very clearly brings out that "income" arising from an international transaction is a condition precedent for application of Chapter X of the Act. Consequentially, the secondary adjustment was also struck down.

Looking at the fact pattern of the case, one can identify flaws in the Revenue's argument. Even if one assumes that India is indeed deprived of the funds, are such funds to be construed as income? Would capital inflows into India be taxable? Further, why should a taxpayer be asked to pay tax on share premium "not received" when the share premium actually "received" is not taxed at all! Moreover, when a primary adjustment is struck down, the secondary adjustment should also not survive.

This is a timely decision in view of the fact that the government is inviting investment into India by foreign investors. This ruling is a golden opportunity for the government to "walk the talk" and to showcase their intention of creating a rational taxation regime, which will act as a catalyst in bringing stability and certainty in the business environment in India. The Government must consider the merits of the case on which this ruling has been delivered. The Ministry of Finance will presumably consult the Ministry of Law before deciding whether to challenge the said ruling in the Supreme Court of India. However, in such consultation, there may be a possible conflict of interest given the fact that the Solicitor General of India is arguing the case on behalf of the Revenue.

The decision reinforces the independence of the Indian judiciary and sends a positive message to investors around the globe. The ruling will benefit multinationals which are facing similar transfer pricing adjustments.

Therefore, one hopes that a holistic view is taken by the Indian Government and the ruling is not challenged before the Apex Court, especially since this ruling is delivered on merits by one of the premier High Courts and keeping in mind the objective of the government to encourage foreign investment into India.