

## Title

Whether capital receipts received by an assessee on issue of equity shares to its non-resident holding entity and the short-fall between fair market price and issue price of its equity shares can be considered as income within the meaning as defined under the Income Tax Act, 1961?

## Court

Bombay High Court

## Brief

The Petitioner, Vodafone India Services Pvt. Ltd., is a wholly owned subsidiary of a non-resident company, Vodafone Tele-Services (India) Holdings Limited (the holding company). In AY 2009-10, the Petitioner issued equity shares on a premium to its holding company for its telecommunication services in India which resulted in the Petitioner receiving a total consideration from its holding company on issue of shares in 2008. AO and TPO contended that the shares are to be valued on application of the Transfer Pricing provisions in Chapter X of the Income Tax Act 1961 as against Capital Issues (Control) Act, 1947 and that the shortfall of Rs.1308.91 crores is income which should be treated as deemed loan given by the Petitioner to its holding company and periodical interest thereon is to be charged to tax as interest income of Rs.88.35 crores in the A. Y. 2009-10. The Petitioner contended that Act neither taxes inflow of capital into the country, nor does it create any legal fiction to treat such alleged shortfall in capital receipt on issue of equity shares by an Indian company to its non-resident holding company, as income and thus no question of treating the alleged shortfall as a deemed loan or taxing the alleged deemed interest on a deemed loan arises. The Court ruled in favour of Vodafone India Services Pvt. Ltd.

## Citation

Vodafone India Services Pvt. Ltd. – Petitioner – Versus – Union of India – Respondents

## Judgement and facts of the case

### **IN THE HIGH COURT OF JUDICATURE AT BOMBAY ORDINARY ORIGINAL CIVIL JURISDICTION**

WRIT PETITION NO.871 OF 2014

#### **Vodafone India Services Pvt. Ltd.**

Having its registered office at  
Vodafone House, Corporate road,  
Prahllad Nagar, Off.S.G.Highway  
Ahmedabad-380051, Gujrat, India.

**Petitioner**

**Versus**

**1. Union of India,**  
Through the Secretary, Ministry of Finance,

North Block, New Delhi-110001.

**2. Addl. Commissioner of Income Tax**

Transfer Pricing II(6), Mumbai,  
Room No.15, III floor, B Wing,  
Mittal Court, Nariman Point,  
Mumbai- 400 021.

**3. Dy. Commissioner of Income Tax,**

Circle 3(3), Ayakar Bhawan, R.No.609,  
Churchgate, Mumbai 400 020.

**4. Dispute Resolution Panel II,**

Room No.13, Ground floor,  
Scindia House, N.M.Marg,  
Ballard Estate, Mumbai-400 038.

**Respondents**

Mr. Harish Salve, Senior Advocate with Anuradha Dutt, Ms. Fereshte Sethna, Ms. Gayatri Goswami, Tushar Jerwal, Adhiraj Malhotra and Khushboo Satia i/by Dutt Menon Dunmorr Sett, for the Petitioner.

Mr. Ranjit Kumar, Solicitor General, with Mr. Ben Chatterjee, Senior Advocate with Benu Tamtar with Abhay Ahuja, Girish Dave and Tejveer Singh, for the Respondents.

**BEFORE CORAM :**

**MOHIT S. SHAH, C.J. AND M.S. SANKLECHA, J.**

**RESERVED ON: 18 SEPTEMBER 2014.**

**PRONOUNCED ON: 10 OCTOBER 2014.**

**CAV JUDGMENT (Per Chief Justice):-**

At the request of the learned Counsel for both the sides the petition was taken up for final disposal.

2 The Petitioner, Vodafone India Services Pvt. Ltd., is a wholly owned subsidiary of a non-resident company, Vodafone Tele-Services (India) Holdings Limited (the holding company). The Petitioner required funds for its telecommunication services project in India from its holding company during the financial year 2008-09 i.e. Assessment Year (AY) 2009-10. On 21 August 2008, the Petitioner issued 2,89,224 equity shares of the face value of Rs.10/- each on a premium of Rs.8,509/- per share to its holding company. This resulted in the Petitioner receiving a total consideration of Rs.246.38 crores from its holding company on issue of shares between August and November 2008. The fair market value of the issue of equity shares at Rs.8,519/- per share was determined by the Petitioner in accordance with the methodology prescribed by the Government of India under the Capital Issues (Control) Act, 1947.

However, according to the Assessing Officer (AO) and Transfer Pricing Officer (TPO), the Petitioner ought to have valued each equity share at Rs.53,775/- as against the aforesaid

valuation done under the Capital Issues (Control) Act, 1947 at Rs.8,519/- and on that basis shortfall in premium to the extent of Rs.45,256/- per share resulted into total shortfall of Rs.1308.91 crores. Both the AO and the TPO on application of the Transfer Pricing provisions in Chapter X of the Income Tax Act 1961, (the Act) held that this amount of Rs.1308.91 crores is income. Further, as a consequence of the above, this amount of Rs.1308.91 crores is required to be treated as deemed loan given by the Petitioner to its holding company and periodical interest thereon is to be charged to tax as interest income of Rs.88.35 crores in the financial year 2008-09 i.e. A. Y. 2009-10.

According to the Petitioner, the Act does not tax inflow of capital into the country so as to impede its coming into India. Nor does the Act create any legal fiction to treat such alleged shortfall in capital receipt on issue of equity shares by an Indian company to its non-resident holding company, as income. The Petitioner also contends that consequently, there could be no question of treating the alleged shortfall as a deemed loan or taxing the alleged deemed interest on a deemed loan. The Petitioner has, therefore, moved this Court under Article 226 of the Constitution of India challenging the jurisdiction of the respondent-authorities to tax an International Transaction such as the present one which has not generated any income as defined under the Act. In short, the Petitioner's contention is that absent income arising from an International Transaction, Chapter X of the Act has no application. The Assessment Year involved in this proceeding is A. Y. 2009-10.

3 This petition is a sequel to the order dated 29 November 2013 passed by this Court in Writ Petition No.1877 of 2013 (Vodafone-III) filed by the present Petitioner. In Vodafone-III, the challenge by the Petitioner was to the order dated 28 January 2013 of the TPO passed in terms of Section 92CA of the Act and the consequent draft assessment order dated 22 March 2013 passed by the AO in terms of Section 143(3) read with Section 144(C)(1) of the Act, relating to A.Y. 2009-10.

4 The basis of the challenge in Vodafone-III was that the issue of equity shares by the Petitioner to its holding company did not give rise to any income from International Transaction, so as to attract the provisions of Chapter X of the Act. This on the ground that arising of income on account of International Transaction is a condition precedent for application of Chapter X of the Act. Thus, it was a jurisdictional issue. However, the jurisdictional issue was neither determined by the TPO or the AO in spite of the Petitioner having raised it before both the Authorities. This Court in Vodafone-III accepted the plea of the Petitioner that a jurisdictional issue of application of Chapter X of the Act does arise and the same was not considered either by the TPO or by the AO. At that time, we did not deal with the jurisdictional issue as the Counsel for the Respondent-Revenue refused to address us on merits of the jurisdictional issue on the ground that same could be raised before the authorities under the Act. Thus, as the Petitioner had already filed its objections (excluding the issue of jurisdiction) to the Draft Assessment Order, before the Dispute Resolution Panel (DRP) under Section 144C(2) of the Act and it was pending, the DRP was directed to first decide only the jurisdictional issue raised by the Petitioner as preliminary issue within two months from the date on which the Petitioner files its objection on the question of jurisdiction. Consequently to the directions of this Court in Vodafone-III, the DRP has considered the issue of jurisdiction as raised by the Petitioner and by an order dated 11 February 2014 rejected the Petitioner's preliminary objection thereto. This petition essentially challenges the order dated 11 February 2014 passed by the DRP holding that the Respondent-Revenue has jurisdiction to tax the Petitioner's issue of shares to its holding company at a premium to the extent the premium is not received under Chapter X of the Act, as income does arise in the above International Transaction.

5 For the purposes of completeness, we are setting out the facts leading to this Petition in four parts:-

I. Till passing of the order by TPO.

II. After passing of the order by TPO till filing of the previous Writ Petition (Vodafone-III).

III. Observations made by this Court in Vodafone-III.

IV. Hearing before DRP and impugned DRP order dated 11 February 2014.

### **I. Basic Facts :**

6.(a) It is an undisputed position that the holding company is an Associated Enterprise (AE) of the Petitioner for the purpose of Chapter X as defined in Section 92A of the Act;

(b) The Petitioner issued 2,89,224 equity shares of a face value of Rs.10/- each at the premium of Rs.8,519/- per share to its holding company. This resulted in the Petitioner receiving at the rate of Rs.8519/- per share a total consideration of Rs.246.38 crores from its holding company on issue of shares. The Petitioner received an amount of Rs.86.93 crores on 21 August 2008 and the balance amount of Rs.159.46 crores on 5 November 2008 from its holding company. The allotment of the 2,89,224 equity shares was made on 5 February 2009. The Fair Market Value of the issue of equity shares was determined by the Petitioner in accordance with the methodology prescribed under the Capital Issues (Control) Act 1947;

(c) On 30 September 2009, the Petitioner filed its return of income for Assessment Year 2009-10 with the respondent-revenue. Along with its return of income, the Petitioner also filed Form 3-CEB dated 28 September 2009 by an Accountant in accordance with Section 92-E of the Act. In the said Form-3CEB, the transaction of issuance of equity shares by the Petitioner to its holding company was declared as an International Transaction and also the ALP of the shares so issued, was determined. However, a note was appended to its Form 3-CEB report by the Accountant making it clear that the transaction of issue of equity shares did not affect the income of the Petitioner and was being reported only as a matter of abundant caution. The note read as under:-

**“ Note 1:-**

*“ The company has issued 289224 equity shares of Rs.10/-each fully paid at a premium of Rs.8500 per share aggregating to total consideration of Rs.2,46,38,99,016. As per Section 92(1) of the Income Tax Act, 1961 any income arising shall be computed having regard to the arm's length price. This transaction of issue of equity shares does not affect income of the Company. However, out of abundant caution, the same is reported here.”*

(d) On 30 August 2010, the A.O. issued a notice under Section 143(2) of the Act to the Petitioner for the purposes of carrying out scrutiny assessment. On 11 July 2011, the AO referred all the transactions reported by the Petitioner in Form 3-CEB dated 28 September 2009 to the TPO. This was for determining the ALP of the reported International Transactions in accordance with Section 92CA(1) of the Act;

(e) On 14 December 2012, the TPO issued a show cause notice to the Petitioner. In the above notice, in so far as relevant to these proceedings, the Petitioner was inter alia, called upon to show cause why:

(i) the issue price (including the premium) of the equity shares to its holding company as declared by the Petitioner should be accepted for the purposes of computing ALP under the Act; and

(ii) the ALP of the shares issued by the Petitioner to its holding company be not determined on the basis of its Net Asset Value (in short “NAV”), after taking into account the transfer pricing adjustment for the Assessment Years 2007-08 and 2008-09. The above adjustment would result in the NAV being enhanced from Rs.12,341.80 millions to Rs.75,564.28 millions.

This would result in the ALP per share being enhanced leading to a price adjustment of Rs. 2034.95 crores to arrive at the ALP of the equity shares.

(f) The Petitioner filed its replies on 24 December 2012, 7 January 2013 and 22 January 2013 to the show cause notice issued by the TPO. The Petitioner in all its replies contended that Chapter XI.e. Transfer Pricing provisions do not apply to the issue of equity shares. Therefore, it was contended that the notice was completely without jurisdiction as Chapter X of the Act is inapplicable. It was also clarified that the replies should not be construed as submitting to jurisdiction under Chapter X of the Act;

(g) On 28 January 2013, the TPO passed the impugned order, inter alia, recording the following:

(i) The issue of equity shares is an International Transaction governed by Chapter X of the Act as is evident from Form 3CEB dated 28 September 2009 filed by the Petitioner;

(ii) The transaction was an International Transaction as is evident from the Explanation (i)(c) and (e) to Section 92-B of the Act, which provides that capital financing and restructuring of business would be so;

(iii) The issue whether any Income has arisen and/or affected by the International Transaction for purposes of Chapter X of the Act would be determined by the A.O. The jurisdiction exercised by TPO is only to determine the ALP of International Transactions and not compute and/or assess the income arising out of such International Transactions;

(iv) The consequence of issue of shares by the Petitioner to its holding company at a lower premium resulted in the Petitioner subsidizing the price payable by the holding company. This deficit would be a loan extended by the Petitioner to its holding company and such loan would have bearing on the profit of the assessee in terms of interest;

(v) The ALP of the issue of equity shares by the Petitioner to its holding company as determined by the Accountant under Section 92E of the Act was rejected. This on the ground that methodology of valuation adopted is not suitable to derive the ALP;

(vi) The Transfer Pricing adjustment for the A.Y.s 2007-08 and 2008-09 have to be taken into account to determine the fair value of the Petitioner's business;

(vii) Finally, the TPO determined the ALP of equity shares issued by the Petitioner to its holding company as under:-

#### **“ 7.5 Determination of Arm's Length Price:**

Thus, based on the above discussion, the ALP of equity shares of the company as on 31-03-2008 is computed as below:-

To read the full judgement, please find the attached file.

Attached File:

<http://bombayhighcourt.nic.in/generatenewauth.php?auth=cGF0aD0uL2RhdGEvanVkZ2VtZW50cy8yMDE0LyZmbmFtZT1PU1dQNTk5MTQucGRmJnNtZmxhZz1O>