



TAX DEPARTMENT DECIDES TO FOLLOW HIGH COURT'S RULING IN 'VODAFONE'

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On October 10, 2014, the Bombay High Court had pronounced the ruling in case of Vodafone India Services Private Limited ("Vodafone") bringing a big relief to the UK-based mobile service provider. The decision bought a lot of cheer amongst taxpayers and was celebrated by the taxpayer and the practitioner's community.

For ease of recollection, the litigation had arisen as Vodafone India had issued equity shares to its holding company at a premium. The Assessing Officer transferred the case to the Transfer Pricing Officer who concluded that the Petitioner had undervalued the shares up to the extent of Rs. 45,265 per share. The IT department treated the shortfall on the premium amount as income and also computed notional interest on the same.

The issue before the HC was whether the alleged shortfall in share premium on the issue of shares by Vodafone constituted 'income' in the hands of Vodafone?

The HC, ruling in favour of Petitioner, held that the issue of equity shares at premium by the resident subsidiary to its non-resident holding company did not give rise to any income from international transaction, so as to attract the provisions of Chapter X of the Income Tax Act, 1961 (the "Act"). Chapter X of the Act was a machinery (computational) provision to arrive at the ALP of a transaction between AEs. In the absence of a charging Section

in Chapter X of the Act, it was not possible to read a charging provision into Chapter X of the Act. The issue of shares at a premium was a capital account transaction and the same does not give rise to any income. Also, it was held that issue of shares is a capital transaction and since there is no express provision regarding capital receipt from a non-resident it failed to form part of income as is understood under Section 2(24) of the Act.

Subsequent to the decision, the eyes were on the Government to see whether they would walk their talk or would continue to act the same way their predecessors acted.

The government has taken took a conscious decision to avoid '**fruitless litigation**' and won't appeal against the HC's decision.

In an **Instruction no. 2/2015 [f.no.500/15/2014-apa-i], dated 29-1-2015** to its field officers, the Central Board of Direct Taxes has stated that "*It is hereby informed that the Board has accepted the decision of the High Court of Bombay in the above mentioned petition. In view of the acceptance of the above judgement, it is directed that the ratio-decidenti of the judgement must be adhered to by the field officers in all cases where this issue is involved.*"

The above will impact all the past and future cases involving the taxation of equity issued by an Indian subsidiary to an affiliated enterprise - the heart of the Vodafone case. Most of the cases are at various stages of litigation and that cases, such as those involving IBM, Microsoft Corp, Sony Corp, India's Essar Group and others, could now be resolved instead through negotiation.

The government has conveyed a clear message to foreign investor's world over that this is a government where decision would be fair, transparent and within the four corners of law. The

string of high profile tax cases include the issue of retrospective taxation had scared investors and prompted them to go slow on their investment plans in the country. The Modi government is keen to attract foreign investment to boost growth and is keen to provide a "predictable and transparent tax regime."

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