



Karnataka High Court directs the tax authority if necessary to lift corporate veil to examine real nature of the transaction while dismissing a writ in relation to indirect acquisition of Sesa Goa Ltd

Recently, the Karnataka High Court (High Court) disposed off a writ petition filed by Richter Holdings Ltd.¹ (taxpayer) against the order of the tax department for failure to withhold tax on indirect acquisition of Sesa Goa Ltd. The High Court directed the taxpayer to approach the tax officer who will consider the case and pass an appropriate order in accordance with law.

Facts of the case

- The taxpayer, a company incorporated in Cyprus and West Globe Ltd., a company incorporated in Mauritius acquired all the shares of the Finsider International Company Ltd (UK based company) from Early Guard Ltd. (another UK based company) for a consideration of USD 981 million. Accordingly, the taxpayer, held 60 percent shares in Finsider International Company Ltd (Finsider).
- Finsider was holding 51 percent shares of Sesa Goa Ltd, which is an Indian Company.
- The tax department held that the taxpayer had indirectly acquired 51 percent in Sesa Goa Ltd without deducting tax at source. Accordingly, the tax department issued a notice to taxpayer under Section 201(1) and 201(1A) of the Income-tax Act, 1961(the Act) for failure to deduct tax at source.
- The tax department sought for further information from the taxpayer. The taxpayer furnished its reply regretting its inability to provide information pertaining to Early Guard Ltd and filed a writ before the Karnataka High Court.

¹ Richter Holding Ltd. v. ADIT [2011-TII-14-HC-KAR-INTL]

Taxpayer's contentions

- Relying on the Bombay High Court's decision in the case of Vodafone International Holdings B.V.² the taxpayer contended that the transfer of share in non-resident company from one non-resident company to another non-resident company does not amount to acquisition of immovable property or controlling the management. Accordingly, it is only an incident of ownership of the shares in a company which flows out of the holding of shares.
- Further, the taxpayer contended that controlling interest is not an identifiable or distinct capital asset independent of the holding of shares and the nature of the transaction has to be ascertained from the covenants of the contract and from the surrounding circumstances.
- The transaction is only an acquisition of shares and does not amount to acquisition of immovable property. Therefore, the question of treating the same as capital gains and to deduct tax from capital gains does not arise. Accordingly, the demand notices issued for initiating proceedings under Section 201 of the Act was bad in law.

Tax department's contentions

- Shares held by Finsider in Sesa Goa Ltd constituted a capital asset as per Section 2(14) of the Act. Therefore, when the shares of Finsider were purchased by the taxpayer, the same amounts to a transfer of a capital asset, 51 percent shares of Sesa Goa Ltd. as per Section 45 read with Section 2(47) and Section 9 of the Act.
- As per Section 195 of the Act any person paying to a non-resident is liable to deduct tax at source. Accordingly, the taxpayer falls within the definition of person and was liable to deduct tax in respect of payments made for purchase of capital asset i.e. 51 percent shares of Sesa Goa Ltd.
- Placing reliance on Supreme Court's decision in the case of Vodafone International Holdings B V³ the tax department contended that a taxpayer should appear before the tax department for clarification as to whether tax is to be deducted while making the payment.

Karnataka High Court's ruling

- Taxpayer should urge all contentions before the tax department to demonstrate that the purchase of 51 percent shares does not amount to transfer of capital asset.

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

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

- The agreement with Early Guard Ltd. for purchase of shares may be insufficient to determine the nature of transaction between Finsider and Sesa Goa Ltd. since it is premature at this stage to arrive at a conclusion that there is no avoidance of tax obligations and taxpayer was not liable to tax on capital gains.
- It may be necessary for the tax department to lift the corporate veil to look into the real nature of transaction to ascertain vital facts.
- It should also be examined whether the taxpayer, as a majority shareholder, enjoys the power by way of interest and gains in the assets of the company and whether transfer of shares in the present case includes indirect transfer of assets and interest in the company.
- The taxpayer should approach the tax officer who will consider the case and pass an appropriate order in accordance with law.

Our Comments

The tax authority in the case of Vodafone International B.V. sought to tax capital gains arising due to transfer of shares of a foreign holding company of an Indian subsidiary on the ground that such transfer involves indirect transfer of shares/controlling interest of the Indian subsidiary. This matter is pending before the Supreme Court for hearing which is scheduled on 19 July 2011.

The High Court in the present case has directed the tax department to lift the corporate veil to look into the real nature of transaction to ascertain vital facts.

The above decision and the tax department's approach to tax such transactions make it imperative for the foreign investors to effectively plan tax risks associated with structuring Indian acquisitions.

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