Impact of SC Judgement in Vodafone Case on Indian Economy

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Introduction

This matter concerns a tax dispute involving the Vodafone Group with the Indian Tax Authorities [the Revenue], in relation to the acquisition by Vodafone International Holdings BV [VIH], a company resident for tax purposes in the Netherlands, of the entire share capital of CGP Investments (Holdings) Ltd. [CGP], a company resident for tax purposes in the Cayman Islands [CI] vide transaction dated 11.02.2007, whose stated aim, according to the Revenue, was "acquisition of 67% controlling interest in HEL", being a company resident for tax purposes in India which is disputed by the appellant saying that VIH agreed to acquire companies which in turn controlled a 67% interest, but not controlling interest, in Hutchison Essar Limited (HEL). According to the appellant, CGP held indirectly through other companies 52% shareholding interest in HEL as well as Options to acquire a further 15% shareholding interest in HEL, subject to relaxation of FDI Norms. In short, the Revenue seeks to tax the capital gains arising from the sale of the share capital of CGP on the basis that CGP, whilst not a tax resident in India, holds the underlying Indian assets. (Para 2 of SC Judgment)

Facts of The Case

Vodafone International Holdings B.V. (VIHB), a Dutch based Vodafone entity, acquired a controlling stake in Hutchison Essar Limited [(HEL), name changed to as Vodafone Essar Limited VEL)], an Indian company, from Cayman Islands based Hutchison Telecommunications International Limited (HTIL) by acquiring shares of CGP Investment (CGP), a Cayman Islands company [which belonged to (HTIL)] in February 2007. CGP held various Mauritian companies, which in turn held a majority stake in HEL. In September 2007, the Revenue Authorities issued a show-cause notice to VIHB for failure to withhold tax on the amount paid for acquiring the said stake, as the Revenue Authorities believed that HTIL was liable for capital gains it earned from the transfer of shares of CGP, as CGP indirectly held stake in HEL.

VIHB filed a writ petition in the Bombay High Court challenging the notice, contending that the Revenue Authorities had no jurisdiction over the transaction, as the transfer of shares had taken place outside India between two companies incorporated outside India and the subject of the transfer was shares, the situs of which was outside India. However, the Bombay High Court dismissed the writ petition of VIHB. In appeal, the Supreme Court remanded the matter to the Revenue Authorities. Accordingly, Revenue Authorities passed the order which was challenged by VIHB by a Writ Petition, which was dismissed by the Bombay High Court (329 ITR 126) (Bom). Aggrieved by the order of the High Court, VIHB preferred an appeal before the Supreme Court.

Sequence of Important Events

2007

- February – Vodafone buys 67% in Hutchison Essar $11.5 billion. Companyrenamed Vodafone Essar.
- April – FIPB clearsdeal subject to condition that minority shareholders can sell only to resident Indians.
- September – Income tax (IT) department slaps Vodafone with a tax demand of ₹11,000 crores. Says asset for which deal was done in India.
- October – Vodafone goes to Bombay High Court. Saying "it was a share transfer carried outside India"

2008

- February – Government amends Section 201 of IT Act, makes with holding tax mandatory with retrospective effect Vodafone becomes a Pan-India Player by acquiring licences in the 7 Circles it was not present in.
- December – HC dismisses Vodafone's petition, says IT department has right to investigate the case, Vodafone appeals to Supreme Court.

2009

- January – SC dismisses Vodafone's appeal, leaves decision on jurisdiction of deal to the IT Department. Also refers case back to Bombay HC.
- October – IT Department issues a new show cause notice.
- Minority Share Holders Analjit Singh & Asim Ghosh want to sell stake back to Vodafone.
- December – FIPB approves stake sales by Singh and Ghosh.

2010

- January – Vodafone replies to IT notice saying IT department does not have jurisdiction.
- April – Vodafone reaches 100 Million customers in India.
- May – Price wars in India cause Vodafone Group Plc to write down value of Vodafone Essar by £2.3 billion (₹15,157 cr)
- Vodafone pays ₹11,618 cr for 3G spectrum in 9 circles.
- June – Vodafone files petition in Bombay High Court challenging IT Departments' order that claims jurisdiction.
- September – High Court Says Vodafone must pay capital gains tax on the deal, Vodafone appeals to Supreme Court.
- November – Supreme Court asks Vodafone to deposit ₹2,500 cr and provide bank guarantees of ₹8,600 cr pending final verdict.

2011

- March – Vodafone receives tax notice from IT Department asking it to explain why it should not be liable for penalities of up to 100% of the tax found due.
- April – Supreme Court stays IT Department from enforcing any liabilities until outcome of final hearing.
- May – Vodafone makes first ever profit in India of 1.5 Million Euros in 2010-11.
- Supreme Court begins hearing the Case.
- Vodafone sells 5.5% of India business Piramlal Healthcare for $6.40 million (around ₹2,890 cr) to comply with FDI rules.

2012

- January – Vodafone appoints Investment Bank NM Rothschild to manage initial public offering (IPO)
- January 20 – Vodafone wins tax case in SC, SC held that Transfer of shares of a Foreign Company through a Special Purpose Vehicle, which holds underlying assets in India, by a non-resident to another non-resident would not be liable to tax in India.

Contention of The Revenue

1. There is a conflict between Union of India v. Azadi Bachao Andolan (263 ITR 706)(SC) and McDowell and Co. Ltd. v. CTO (154 ITR 148) (SC) and hence, Azadi Bachao Andolan needs to be overruled insofar as it departs from McDowell.

2. Income from the sale of CGP share would fall within Section 9 of the Income Tax Act, 1961 (the Act) as that section provides for a "look through".

3. HTIL, under the Share Purchase Agreement (SPA), had extinguished its rights of control and management over HEL and consequent upon such extinguishment, there was a transfer of capital asset situated in India.

4. Introduction of CGL was only with intention to avoid tax and it had no business and commercial purpose.

5. CGP was a mere holding company and since it could not conduct business in Cayman Islands, the situs of the CGP share existed where the "underlying assets are situated", that is in India.

6. The transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH and that there was a transfer of other "rights and entitlements", and these rights and entitlements constituted in themselves "capital assets".

7. As the transfer of controlling interest is taxable in India, VIHB should have deducted tax at source under Section 195 of the Act. HEL can be proceeded against as "representative assessee" under Section 163 of the Act.

Apex Court's Observations

1. There is no conflict between McDowell and Azadi Bachao Andolan. Views expressed by Chinnappa Reddy, J. in McDowell case are clearly only in the relation to tax evasion through the use of colorable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible.

2. The Revenue may invoke the "substance over form" principle or "piercing the corporate veil" test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant.

3. It is the task of the Revenue/Court to ascertain the legal nature of the transaction and, while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach.

4. The Revenue cannot start with the question as to whether the impugned transaction is a tax deferment/saving device; but that it should apply the "look at" test to ascertain its true legal nature.

5. Every strategic foreign direct investment (FDI) coming to India, as an investment destination, should be seen in a holistic manner. While doing so, the Revenue/Courts should keep in mind the following factors :

i. the concept of participation in investment;
ii. the duration of time during which the Holding Structure exists;
iii. the period of business operations in India;
iv. the generation of taxable revenues in India;
v. the timing of the exit;
vi. the continuity of business on such exit.

In short, the onus will be on the Revenue to identify the scheme and its dominant purpose.

6. A legal fiction has a limited scope. It cannot be expanded by giving purposive interpretation. Section 9(1) (i) of the Act cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situate in India.

7. The DTC Bill, 2010, proposes taxation of offshore share transactions. This proposal indicates in a way that indirect transfers are not covered by the existing Section 9(1)(i) of the Act. Such proposal, therefore, shows that in the existing Section 9(1)(i) the word indirect cannot be read on the basis of purposive construction.

8. The question of providing "look through" in the statute or in the treaty is a matter of policy. It is to be expressly provided for in the statute or in the treaty. Similarly, limitation of benefits (LOB) has to be expressly provided for in the treaty. Such clauses cannot be read into the Section by interpretation. Hence, we hold that Section 9(1)(i) is not a "look through" provision.

9. There is a conceptual difference between preordained transaction which is created for tax avoidance purposes and a transaction which evidences investment to participate in India. In order to find out whether a given transaction evidences a preordained transaction or investment to participate,

one has to take into account the factors enumerated hereinabove, namely, duration of time during which the holding structure existed, the period of business operations in India, generation of taxable revenue in India during the period of business operations in India, the timing of the exit, the continuity of business on such exit, etc.

10. Applying these tests to the facts of the present case, it was held that the Hutchison structure has been in place since 1994. It operated during the period 1994 to 2007. It has paid income tax ranging from INR 3 crores to INR 250 crores per annum during the period 2002-03 to 2006-07. Thus, it cannot be said that the structure was created or used as a sham or tax avoidant. It cannot be said that HTIL or VIH was a *"fly by night"* operator/short time investor.

11. On the facts and circumstances of this case, under the HTIL structure, as it existed in 1994, HTIL occupied only a persuasive position/influence over the downstream companies qua manner of voting, nomination of directors and management rights. Hence, there was no extinguishment of rights as alleged by the Revenue.

12. The sole purpose of CGP was not only to hold shares in subsidiary companies; but also to enable a smooth transition of business, which is the basis of SPA. Therefore, it cannot be said that CGP had no business or commercial purpose.

13. Under the Indian Companies Act, 1956, the situs of the shares would be where the company is incorporated and where its shares can be transferred. In this case, the transfer of the CGP share was recorded in the Cayman Islands, where the register of members of the CGP is maintained and this ground is not controverted by the Revenue. Hence, the court is not inclined to accept the arguments of the Revenue that the situs of the CGP share was situated in the place (India) where the underlying assets stood situated.

14. The High Court ought to have examined the entire transaction holistically. The transaction has to be looked at as an entire package. The High Court has failed to appreciate that the payment of US$ 11.08 billion was for purchase of the entire investment made by HTIL. The parties to the transaction have not agreed upon a separate price for the CGP share and for what the High Court calls as *"other rights and entitlements"* (including options, right to non-compete, control premium, customer base etc.). Thus, it was not open to the Revenue to split the payment and consider a part of such payments for each of the above items.

15. In this case the transaction is of *"outright sale"* between two non-residents of a capital asset (share) outside India. Further, the said transaction was entered into on principal to principal basis. Therefore, no liability to deduct tax under Section 195 arises.

16. Section 163(1)(c) is not attracted as there is no transfer of a capital asset situated in India.

17. Certainty is integral to Rule of Law. Certainty and Stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner.

Observations and Finding of Hon'ble Justice K.S. Radhakrishnan

Although all the three judges has given an unanimous decision, however, Hon'ble Justice K.S. Radhakrishnan has passed a separate order, of which certain principles, observations and finding are of prime importance. They are :

1. Case in hand is an eye-opener of what we lack in our regulatory laws and what measures we have to take to meet the various unprecedented situations, that too without sacrificing National Interest. Certainty in law in dealing with such cross-border investment issues is of prime importance, which has been felt by many countries around the world and some have taken adequate regulatory measures so that investors can arrange their affairs fruitfully and effectively.

2. Corporate structure is primarily created for business and commercial purposes and multinational companies who make offshore investments always aim at better returns to the shareholders and the progress of their companies. Corporation created for such purposes are legal entities distinct from its members and are capable of enjoying rights and of being subject to duties which are not the same as those enjoyed or borne by its members.

3. Sound commercial reasons like hedging business risk, hedging political risk, mobility of investment, ability to raise loans from diverse investments, often underlie creation of such structures. In transnational investments, the use of a tax neutral and investor-friendly countries to establish a Special Purpose Vehicle is motivated by the need to create a tax efficient structure to eliminate double taxation wherever possible and also plan their activities attracting no or lesser tax so as to give maximum benefit to the investors.

4. There is a fundamental difference in transnational investment made overseas and domestic investment. Domestic investments are made in the home country and meant to stay as it were, but when the transnational investment is made overseas away from the natural residence of the investing company, provisions are usually made for exit route to facilitate

an exit as and when necessary for good business and commercial reasons, which is generally foreign to judicial review.

5. Revenue/Courts can always examine whether the corporate structures are genuine and set up legally for a sound and veritable commercial purpose. Burden is entirely on the Revenue to show that the incorporation, consolidation, restructuring etc. has been effected to achieve a fraudulent, dishonest purpose, so as to defeat the law.

6. Corporate governors can also misuse their office, using fraudulent means for unlawful gain, they may also manipulate their records, enter into dubious transactions for tax evasion. Burden is always on the Revenue to expose and prove such transactions are fraudulent by applying look at principle.

7. Many of the offshore holdings and arrangements are undertaken for sound commercial and legitimate tax planning reasons, without any intent to conceal income or assets from the home country tax jurisdiction and India has always encouraged such arrangements, unless it is fraudulent or fictitious.

8. Often, complaints have been raised stating that the Offshore Financial Centres (OFCs) are utilized for manipulating market, to launder money, to evade tax, to finance terrorism, indulge in corruption etc. All the same, it is stated that OFCs have an important role in the international economy, offering advantages for multi-national companies and individuals for investments and also for legitimate financial planning and risk management. It is often said that insufficient legislation in the countries where they operate gives opportunities for money laundering, tax evasion etc. and, hence, it is imperative that that Indian Parliament would address all these issues with utmost urgency.

9. Necessity to take effective legislative measures has been felt in this country, but we always lag behind because our priorities are different. Lack of proper regulatory laws leads to uncertainty and passing inconsistent orders by Courts, Tribunals and other forums, putting Revenue and tax payers at bay.

10. The business of a subsidiary is not the business of the holding company.

11. Controlling interest forms an inalienable part of the share itself and the same cannot be traded separately unless otherwise provided by the Statute. Controlling interest is not an identifiable or distinct capital asset independent of holding of shares and the nature of the transaction has to be ascertained from the terms of the contract and the surrounding circumstances. Controlling interest is inherently a contractual right and not a property right and cannot be considered as transfer of property and, hence, a capital asset unless the Statute stipulates otherwise.

12. Lifting the corporate veil doctrine can be applied in tax matters even in the absence of any statutory authorisation to that effect. Principle is also being applied in cases of holding company—subsidiary relationship—where, in spite of being separate legal personalities, if the facts reveal that they indulge in dubious methods for tax evasion.

13. Ramsay approach ultimately concerned with the statutory interpretation of a tax avoidance scheme and the principles laid down in Duke of Westminster, it cannot be said, has been given a complete go by Ramsay, Dawson or other judgments of the House of Lords.

14. DTAA and Circular No. 789 dated 13.4.2000, in our view, would not preclude the Income Tax Department from denying the tax treaty benefits, if it is established, on facts, that the Mauritius company has been interposed as the owner of the shares in India, at the time of disposal of the shares to a third party, solely with a view to avoid tax without any commercial substance.

15. No court will recognise sham transaction or a colorable device or adoption of a dubious method to evade tax, but to say that the Indo-Mauritian Treaty will recognise FDI and FII only if it originates from Mauritius, not the investors from third countries, incorporating company in Mauritius, is pitching it too high, especially when statistics reveals that for the last decade the FDI in India was US$ 178 billion and, of this, 42% i.e. US$ 74.56 billion was through Mauritian route.

16. Large amounts can be routed back to India using Tax Residency certificate (TRC) as a defence, but once it is established that such an investment is black money or capital that is hidden, it is nothing but circular movement of capital known as Round Tripping; then TRC can be ignored, since the transaction is fraudulent and against national interest.

17. Facts stated above are food for thought to the legislature and adequate legislative measures have to be taken to plug the loopholes, all the same, a genuine corporate structure set up for purely commercial purpose and indulging in genuine investment be recognized.

18. Certainly, in our view, TRC certificate though can be accepted as a conclusive evidence for accepting status of residents as well as beneficial ownership for applying the tax treaty, it can be ignored if the treaty is abused for the fraudulent purpose of evasion of tax.

19.Revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that

he is not bound to choose that pattern which will replenish the treasury. Revenue's stand that the ratio laid down in McDowell is contrary to what has been laid down in Azadi Bachao Andolan, in our view, is unsustainable and, therefore, calls for no reconsideration by a larger branch.

20. According to the Revenue, the substance of the transaction was the transfer of various property rights of HTIL in HEL to Vodafone attracting capital gains tax in India and at moment CGP share was transferred off-shore, HTIL's right of control over HEL and its subsidiaries stood extinguished, thus leading to income indirectly earned, outside India through the medium of sale of the CGP share. All these issues have to be examined without forgetting the fact that we are dealing with a taxing statute and the Revenue has to bring home all its contentions within the four corners of taxing statute and not on assumptions and presumptions.

21. Transfer of CGP share automatically results in host of consequences including transfer of controlling interest and that controlling interest, as such, cannot be dissected from CGP share without legislative intervention.

22. Agreements referred in this case, including the provisions for assignments in the Share Purchase Agreement, indicate that all loan agreements and assignments of loans took place outside India at face value and, hence, there is no question of transfer of any capital assets out of those transactions in India, attracting capital gains tax.

23. At times an agreement provides that a particular amount to be paid towards non-compete undertaking, in sale consideration, which may be assessable as business income under Section 28(va) of the IT Act, which has nothing to do with the transfer of controlling interest. However, a non-compete agreement as an adjunct to a share transfer, which is not for any consideration, cannot give rise to a taxable income. In our view, a non-compete agreement entered into outside India would not give rise to a taxable event in India. An agreement for a non-compete clause was executed offshore and, by no principle of law, can be termed as "property" so as to come within the meaning of capital gains taxable in India in the absence of any legislation.

24.The bare license to use a brand free of charge, is not itself a "property" and, in any view, if the right to property is created for the first time and that too free of charge, it cannot give rise to a chargeable income.

25.We conclude that on transfer of CGP share, HTIL had transferred only 42% equity interest it had in HEL and approximately 10% (pro-rata) to Vodafone, the transfer was off-shore, money was paid off-shore, parties were non residents and hence there was no transfer of a capital asset situated in India. Loan agreements extended by virtue of transfer of CGP share were also off-shore and hence cannot be termed to be a transfer of asset situated in India. Rights and entitlements referred to also, in our view, cannot be termed as capital assets, attracting capital gains tax and even after transfer of CGP share, all those rights and entitlements remained as such, by virtue of various Framework Agreements (FWAs), SHAs, in which neither HTIL nor Vodafone was a party.

26. Section 9 of the Income-Tax Act,1961 on a plain reading would show, it refers to a property that yields an income and that property should have the situs in India and it is the income that arises through or from that property which is taxable. Section 9, therefore, covers only income arising from a transfer of a capital asset situated in India and it does not purport to cover income arising from the indirect transfer of capital asset in India.

27. Source in relation to an income has been construed to be where the transaction of sale takes place and not where the item of value, which was the subject of the transaction, was acquired or derived from. HTIL and Vodafone are off-shore companies and since the sale took place outside India, applying the source test, the source is also outside India, unless legislation ropes in such transactions.

28. Substantial territorial nexus between the income and the territory which seeks to tax that income, is of prime importance to levy tax. Expression used in Section 9(1)(i) is *"source of income in India"* which implies that income arises from that source and there is no question of income arising indirectly from a source in India. Expression used is *"source of income in India"* and not *"from a source in India"*.

29. On transfer of shares of a foreign company to a non-resident off-shore, there is no transfer of shares of the Indian Company, though held by the foreign company, in such a case it cannot be contended that the transfer of shares of the foreign holding company, results in an extinguishment of the foreign company control of the Indian company, and it also does not constitute an extinguishment and transfer of an asset situate in India. Transfer of the foreign holding company's share off-shore, cannot result in an extinguishment of the holding company right of control of the Indian company nor can it be stated that the same constitutes extinguishment and transfer of an asset/management and control of property situated in India.

30. Section 9 has no *"look through provision"* and such a provision cannot be brought through construction or interpretation of a word 'through' in Section 9. In any view, *"look through provision"* will not shift the situs of an asset from one country to another. Shifting of situs can be done only by express legislation. Section 9, in our view, has no inbuilt *"look through mechanism"*.

31. The expression *"any person"*, in our view, looking at the context in which Section 195 has been placed, would mean any person who is a resident in India. This view is also supported, if we look at similar situations in other countries, when tax was sought to be imposed on non-residents.

32. In the instant case, undisputedly, CGP share was transferred offshore. Both the companies were incorporated not in India but offshore. Both the companies have no income or fiscal assets in India, leave aside the question of transferring, those fiscal assets in India. Tax presence has to be viewed in the context of transaction in question and not with reference to an entirely unrelated transaction. Section 195, in our view, would apply only if payments made from a resident to another non-resident and not between two non residents situated outside India. In the present case, the transaction was between two non-resident entities through a contract executed outside India. Consideration was also passed outside India. That transaction has no nexus with the underlying assets in India. In order to establish a nexus, the legal nature of the transaction has to be examined and not the indirect transfer of rights and entitlements in India. Consequently, Vodafone is not legally obliged to respond to Section 163 notice which relates to the treatment of a purchaser of an asset as a representative assessee.

33. It is difficult to agree with the conclusions arrived at by the High Court that the sale of CGP share by HTIL to Vodafone would amount to transfer of a capital asset within the meaning of Section 2(14) of the Act and the rights and entitlements flow from FWAs, SHAs, Term Sheet, loan assignments, brand license etc. form integral part of CGP share attracting capital gains tax. *Consequently, the demand of nearly INR 12,000 crores by way of Capital Gains tax, in my view, would amount to imposing capital punishment for capital investment since it lacks authority of law.*

Supreme Court's Ruling

Transfer of shares of a Foreign Company through a Special Purpose Vehicle, which holds underlying assets in India, by a non-resident to another non-resident would not be liable to tax in India.

What it means to each Stakeholder?

In accordance with this Judgment the transfer of shares of a Foreign Company through a Special Purpose Vehicle, which holds underlying assets in India, by a non-resident to another non-resident would not be liable to tax in India. The Apex Court also reaffirmed the validity of India-Mauritius Tax Treaty in case of *Azadi Bachao Andolan*.

Here is an analysis what does this judgment mean for each of the stakeholders in the Indian economy.

(i) For Vodafone **:** This is the end of a long drawn legal battle for Vodafone and its battery of lawyers. The SC has asked the revenue to return the tax collected along with interest of 4% p.a. and vacating the bank guarantee. There must be a feeling of justice delayed but not denied in the Vodafone camp.

(ii) For other Litigants **:** Encouraged by the success in the preliminary round of litigation, the revenue has raised tax claim in several other cases where shares of overseas companies have been sold. This judgment is now law of the land. The revenue may not be able to collect tax on transfer of offshore holding companies with similar fact pattern. These companies will be spared of agony and legal costs. However, the SC has left a window open for the revenue to *'look through'* the structures in case of sham.

(iii) For FDI Investors **:** They can heave a sigh of relief. The SC has upheld the separate entity principle and recognised the need for holding structures. By enunciating the 'look at' principle this judgment asks that the revenue should look at the entire transaction to ascertain its true legal nature. Further, the onus has been placed on the revenue to identify a scheme and its dominant purpose. So, if an investor exits at the holding company level, it cannot be taxed in India on the basis that the underlying investment is in India. It is time to focus on building value in the business and not lose sleep over taxes.

(iv) For Mauritius Investors **:** While the treaty was not the issue before the SC, The judgment sets to rest the controversy about *Azadi Bachao Andolan* case. In the absence of Limitation of Benefit provisions, treaty must be respected and the tax residency certificate cannot be ignored unless the treaty is abused for fraudulent purpose of tax evasion.

This means that till the time treaty is amended, the capital gains tax exemption will be available to the Mauritius sellers. A word of caution for those who interpose treaty jurisdiction, as an afterthought, just before the exit. In such a case, it might be viewed as a preordained transaction and the revenue may challenge the treaty claim. Need for substance and razor sharp documentation cannot be undermined.

(v) For Private Equity Investors : Assurance of treaty benefits will bring in a lot more certainty. The options for exit will increase as now the buyers may be willing to buy offshore holding companies. The pressure from the buyers who were insisting on withholding tax or obtaining a nil withholding certificate will reduce. The big booster will be the reading down of Section 195 which provides for tax withholding on payments made to non-residents.

The judgment says that where the contract is executed outside India and the payment is made outside India by one non-resident to another, withholding tax burden cannot be imposed.

(vi)For M&A Aspirants : This would mean one less hurdle to cross before closing a transaction. Tax has been a deal breaker in several M&A deals. Negotiations around tax indemnities and escrows will reduce. Rule of law and clarity and certainty in tax policy will make India a worthy destination for new investors.

(vii) For Revenue : While the verdict might have come as a huge disappointment, the tax administrators and their counsels have become a lot more sharper and agile. They almost had everyone convinced that Indian law was wide enough to bring indirect transfers in the tax net. Now all the focus will be on the upcoming finance bill and how the source rules can be rewritten and taxing jurisdiction can be established.

(viii) For Government : Certainty in law in dealing with cross border investment issues is critical in attracting foreign investment. In words of Justice Radhakrishnan, this case is an eye opener of where we lack in our regulatory laws and what measures need to be taken without sacrificing national interest.

We may see a renewed attempt to renegotiate the treaties and to bring in general anti avoidance rule or substance over form rule in the current statute.

(ix) For Judiciary : This is a huge leap of faith. The judiciary's ability to interpret law without being swayed by the stakes involved will help India regain investor confidence.

(x) For Professionals : The anxiety of foreign investors and aggressive stance of revenue had led many professionals to be circumspect of advising on tax planning. Most chose to err on the side of caution and the level of confidence in expressing an opinion was on a sliding scale. This judgment should be helpful in future once general anti avoidance rule is introduced.

Conclusion

This decision is critical as it reiterates the first principles of interpretation of a taxing statute. It clearly brings out that where a transaction is ably supported by a legal framework outside India, and back by a commercial purpose, then such a transaction cannot be indirectly brought to tax in India, by purporting to use various legal doctrines to somehow fit the transaction in the Act, for e.g., by way of lifting of the corporate veil, look through provisions, purposive interpretation. As has been pointed out by Hon'ble Justice K. S. Radhakrishnan, the legislature will have to keep pace with the economic developments taking place outside India to enact the laws relevant to such developments.

This decision also emphasizes the importance of the business purpose test to be fulfilled by a taxpayer, to guard against the enquiry by the Revenue Authorities as to whether the transaction can be caught in the mischief of McDowell.

This decision also underlines the doctrine that the situs of shares, where the company is incorporated, where its shares can be transferred and where the register of members is maintained, and not the place where the underlying economic interests of such shares lies.

The most significant part of the judgment is its acceptance of investment structures in offshore tax-havens as genuine tax planning devices. Indeed, the verdict is a boost to tax planning through use of intelligent structures within the framework of the law so long as they are not outright sham structures conceived only to evade tax. The court held that a transaction between two foreign companies involving share acquisition is not taxable in India even if the underlying asset is located here. This knocked the base off the Income Tax Department's contention that the transaction was taxable as the asset – Hutch's telecom business – was located in India.

The judgment sends out an extremely positive signal to foreign companies and investors on the rule of law and the independence and fairness of the judiciary. The Supreme Court's observation that certainty and stability are the cornerstones of any fiscal system must have warmed the hearts of foreign investors who often complain of frequent changes in the tax laws.

Rather a silent spectator to the loss of revenues from such deals in future, the Government may possibly move to reinforce the relevant provisions in the new Direct Tax Code to specifically state that where the asset is situated in India, even deals between foreign companies involving share transfer in offshore entities will be liable to tax. ❒