

Bombay HC ruling in favour of Vodafone in transfer pricing case

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The judgment of a division bench, headed by Chief Justice Mohit Shah and Justice M Sanklecha, of the Bombay High Court on October 10, 2014 in *Vodafone India Services Pvt. Ltd. v. Union of India* [\[1\]](#), brings more clarity and certainty to India's transfer-pricing regime.

In this case, Vodafone India ("Vodafone"), a wholly owned subsidiary of Vodafone Tele-Services (India) Holdings Limited (the "Holding Company") issued shares of a face value of Rs. 10 each at a premium of Rs.8,509 per share to the Holding Company. The price was arrived at based on the methodology prescribed by the Controller of Capital Issues. However, the income tax department questioned the transaction on the ground that Vodafone should have valued each share at Rs.53,775, and on that basis there was a shortfall in premium to the extent of Rs.45,256 resulting in an aggregate shortfall of Rs.1,308.91 crores for all of the shares so issued. The income tax department sought to treat the aggregate shortfall as income as a consequence of which the amount was to be treated as a deemed loan given by Vodafone to the Holding Company, and periodical interest upon it was chargeable to tax as interest income.

Vodafone challenged the income tax department's position through a writ petition before the Bombay High Court on the principal ground that the shortfall does not constitute income and also that Chapter X of the Income Tax Act, 1961 (the "Act") relating to transfer pricing was not applicable to this case due to which the transfer pricing officer ("TPO") did not possess jurisdiction. The High Court referred the jurisdictional issue to the Dispute Resolution Panel (the "DRP") under Section 144C(2) of the Act. After consideration of the issues, the DRP passed an order dated February 11, 2014 holding that the income tax department had the jurisdiction to consider the issue of shares by Vodafone to its Holding Company and also to tax the shortfall as income. It is against this order that Vodafone preferred a writ petition to the Bombay High Court that resulted in its present judgment.

The primary question before the Court related to the applicability of Chapter X of the Act. This is because that chapter in certain circumstances permits the revenue to be imputed at "arm's length price" in case of an international transaction between resident and non-resident (two entities being closely connected). The Court began by observing that income arising from an International Transaction is a condition precedent for application of Chapter X of the Act. Hence, the issue to be determined in the present case was whether the issue of shares by Vodafone India to the holding company at a premium gave rise to "income" to attract the provisions of Chapter X.

On this basis, the Court began an analysis of the meaning of "income", especially where it involved capital receipts. It found based on an interpretation of section 2(24) of the Act that "income will not in its normal meaning include capital receipts unless it is so specified, as in Section 2(24)(vi) of the Act". Since an issue of shares is a transaction on the capital account, the premium cannot be treated as income. The Court also drew a contrast with Section 56(2)(viib) of the Act where a capital transaction is deemed by legal fiction to amount to income. However, that provision applies only to premium received from a resident and that too where that premium is in excess of the fair market value of the shares. The Vodafone case was far from that scenario because the premium was less than the alleged fair value of the shares, and that too received from a non-resident. One can glean from the analysis of the Court another difference which is that in Section 56(2)(viib) there is an actual receipt of the excess of amount, whereas in this case there is only an imputed amount of the difference without any actual receipt. On this ground, the Court unequivocally concluded that neither the capital receipts in the form of the issue price (par value plus premium) nor the imputed difference with the fair market value could be considered income for the purpose of the Act.

Given the absence of "income", which expression was supplied with a narrow interpretation, the Court concluded that Chapter X of the Income Tax Act relating to transfer pricing and arm's length determination of income from international transaction was not applicable in this case.

[1] [External Link](#)