

Shell follows Vodafone on issue of shares – Chapter X applies when income arises and is chargeable to tax

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In brief

Shell India Markets Private Limited (the taxpayer) had issued equity shares to its non-resident associated enterprises (AEs) at face value. The Transfer Pricing Officer (TPO) alleged short receipt of consideration for issue of shares and made an adjustment for the difference between the arm's length price (ALP) consideration (as computed by the TPO) and the consideration based on face value (as had been received by the taxpayer). The TPO also added an interest amount on the short receipt. Aggrieved, the taxpayer filed a writ petition before the High Court of Bombay (HC) on the issue of jurisdiction, i.e., the jurisdiction of Revenue to bring to tax amount received on capital account, *viz.*, issue of equity shares to its AEs under Chapter X of the Indian Income-tax Act, 1961 (the Act).

The HC held that the jurisdiction to apply Chapter X of the Act would occasion only when income arises out of an international transaction and such income is chargeable to tax under the Act.

Further, the HC held that the fact that the taxpayer chose not to declare issue of shares to its AEs in Form 3CEB as in its understanding it fell outside the scope of Chapter X of the Act, now stands vindicated by the decision of the HC in the case of Vodafone India Services Private Limited. Moreover, the HC clarified that mere non filing of Form 3CEB on the part of the taxpayer would not give jurisdiction to the Revenue to tax an amount which it does not have jurisdiction to tax.

In detail

Facts

The taxpayer¹ had issued equity shares to its AEs at face value. Since the taxpayer believed that no income arose from this transaction, it did not report the transaction in Form 3CEB. During the course of transfer pricing assessment proceedings, the TPO noticed the transaction of issue of shares. The TPO alleged short receipt of consideration for

issue of shares and made an adjustment for the difference between the ALP consideration (as computed by the TPO) and the consideration based on face value (as had been received by the taxpayer). The TPO also added an interest amount on the short receipt. The total adjustment amount was INR 15,220 crores (USD 2537 million).

Aggrieved, the taxpayer filed a writ petition before the HC on the issue of jurisdiction, i.e., the jurisdiction of Revenue to bring to tax amount received on capital account, *viz.*, issue

of equity shares to its AEs under Chapter X of the Act. As a matter of abundant caution, the taxpayer also filed objections against the draft assessment order before the Dispute Resolution Panel (DRP) on various issues including the issue of jurisdiction. However, before the HC, the taxpayer undertook to withdraw such objections, and therefore the HC considered it to be a fit case to be heard on merits.

¹ Shell India Markets Private Limited v. ACIT [2014] 51 taxmann.com 519 (Bombay HC)

Taxpayer's primary contentions

- Chapter X of the Act would not apply since the transaction of issue of equity shares to AEs did not give rise to any income as the transaction was on capital account.
- The issue was covered by the decision of the HC in the case of Vodafone India Services Private Limited² (Vodafone decision).

Revenue's primary contentions

Revenue accepted that the issue raised is in principle covered by the Vodafone decision. However, the Revenue contended that there were certain distinguishing features in the instant case on account of which the benefits of Vodafone decision could not be extended to the taxpayer in the instant case. The distinguishing features were as follows:

- The taxpayer had an alternative remedy to approach the DRP. In fact, in the present case, the taxpayer had also filed an application before the DRP raising an identical grievance on the issue of jurisdiction. In such circumstances, the current petition could not be entertained.
- The taxpayer, in its Form 3CEB, had not disclosed the transaction of issue of shares to its AEs even though it is an international transaction. This failure should have by itself disentitled the petitioner to any relief from the HC.
- Issue of shares by the taxpayer to its AEs would result in change in shareholding amongst the AEs, and would be covered by the definition of international

transactions as given in clause (e) in Explanation to section 92B of the Act, i.e., change in shareholding would amount to restructuring and/or reorganisation of the taxpayer.

High Court ruling

Alternative remedy

- The taxpayer had itself undertaken to withdraw its objections before the DRP on the issue of jurisdiction, and the HC had accepted such undertaking before considering the issue on merits.
- The issue under consideration in the instant case had been decided in the Vodafone decision, which would be binding on all authorities within the State till the Apex Court takes a different view on it. Therefore, in view of the fact that the Revenue did not dispute that the issue on merits stood covered by the Vodafone decision, it would serve no useful purpose by directing the taxpayer to prosecute its objections before the DRP and the DRP then disposing the same in accordance with the Vodafone decision.

Transaction not disclosed in Form 3CEB

- In the Vodafone decision the Revenue contended that as the taxpayer therein had filed Form 3CEB in respect of issue of shares to AEs, it had submitted to the jurisdiction of Chapter X of the Act and could not then contend that taxing the shortfall on capital account was without jurisdiction. In the instant case, an exactly opposite stand was being taken by the Revenue, i.e., failure on part of the taxpayer to disclose the transaction in its Form 3CEB should itself disentitle the

taxpayer to any relief from the HC. The Revenue is expected to be consistent and not change its stand from case to case.

- In the instant case, the fact that the taxpayer chose not to declare issue of shares to its AEs in Form 3CEB as in its understanding it fell outside the scope of Chapter X of the Act, now stands vindicated by the decision of the HC in the case of Vodafone (i.e., Vodafone decision). If the taxpayer did not file a particular transaction in Form 3CEB when so required to be filed, the consequences of the same as provided in the Act would follow. However, the mere non filing of Form 3CEB on the part of the taxpayer would not give jurisdiction to the Revenue to tax an amount which it does not have jurisdiction to tax.

Change in shareholding – business restructuring/ re-organisation?

In the present facts, this issue need not be examined because the jurisdictional requirement for Chapter X of the Act to apply is that income must arise, and following Vodafone decision, no income had arisen in the instant case. Thus, the jurisdictional requirement for application of Chapter X of the Act was not satisfied.

In conclusion

As held in the Vodafone decision, the jurisdiction to apply Chapter X of the Act would occasion only when income arises out of an international transaction and such income is chargeable to tax under the Act. The issues raised in the present petition were identical to the issues which arose for consideration before the HC in the Vodafone decision. Therefore, following the Vodafone decision, the TPO's order in the instant case, on the issue under consideration, was set aside.

² WP 871 of 214; 368 ITR Page-1 (Vodafone-IV)

The takeaway

Following Vodafone decision, the HC has in no uncertain terms concluded in the instant case that jurisdiction to apply Chapter X of the Act would occasion only when income arises out of an international transaction and such income is chargeable to tax under the Act. Accordingly, the HC's decision suggests that for Chapter X to apply the twin conditions of income arising from an international transaction and its chargeability to tax under the Act, should be satisfied.

Another notable observation made by the HC is in relation to reporting/ disclosure of an international transaction in the Form 3CEB in the absence of applicability of Chapter X. The HC in the instant case has held that the taxpayer's position of not declaring the transaction of issue of shares to its AEs in Form 3CEB (since the taxpayer believed that the transaction fell outside the

scope of Chapter X of the Act), is a position which has been upheld by the HC in the Vodafone decision. Impliedly, if the taxpayer believes that a transaction does not fall within the scope of Chapter X (i.e., income does not arise and it is not chargeable to tax under the Act), the taxpayer may take a position to not report/ disclose such transaction in its Form 3CEB. The HC additionally states that when a taxpayer does not file a transaction in Form 3CEB "when it is required to be filed" then the consequences as provided in the Act would follow. A conjoint reading of the above statements of the HC suggests that a taxpayer would be "required to" report/ disclose a transaction in Form 3CEB, when such transaction falls within the scope of Chapter X of the Act (i.e., income arises from such international transaction and the same is chargeable to tax under the Act), and not otherwise.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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