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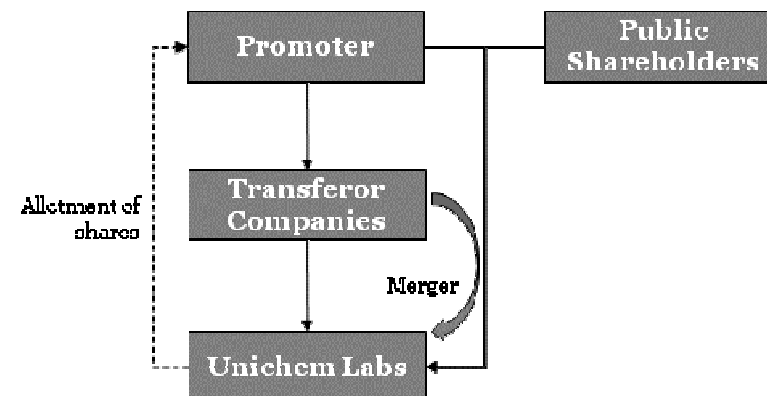
## Tax planning within the legal framework of the law is permissible

### In brief

The Bombay High Court (High Court), in a recent ruling in the case of AVM Capital Services Pvt. Ltd.<sup>1</sup> held that the implementation of a transaction under one of the alternative options available, which does not lead to any tax outflow, is not illegal or unlawful. The High Court has further held that such a transaction is permissible, provided it is within the framework of the law.

<sup>1</sup> AVM Capital Services Pvt. Ltd. [TS-512-HC-2012 (BOM)]

### Schematic representation



## Facts

- Five companies (transferor companies) were being merged into Unichem Laboratories Ltd. (Unichem Labs), a listed company under a Scheme of Arrangement (scheme).
- The assets of the transferor companies predominantly consisted of shares in Unichem Labs.
- All the companies filed petitions before the High Court for sanction of the scheme and complied with the procedures prescribed under the Companies Act, 1956.
- Amongst others, the scheme provided for the cancellation of shares held by the transferor companies in Unichem Labs and allotment of shares to the shareholders of the transferor companies, i.e. promoters.
- A minority shareholder of Unichem Labs objected to the scheme, on the ground that the objective of the scheme was to avoid capital gains tax on transfer of shares held by the transferor companies in Unichem Labs to the promoters.

## Revenue's contentions

### *Transaction is a colourable device*

- The objective of the scheme was to transfer shares in Unichem Labs to the promoters, without any tax outflow.
- Implementation of the scheme would not achieve long-term stability, as claimed by the companies.

- “Avoidance of tax was unethical and if a transaction is a device to avoid tax, it should not be permitted” – excerpts from the decision in the case of McDowell and Company<sup>2</sup> was relied upon.
- The ruling of the Authority for Advance Rulings (AAR) in the case of Groupe Industrial Marcel Dassault<sup>3</sup> was also relied upon.
- The decision of the Supreme Court in the case of Azadi Bachao Andolan<sup>4</sup> should not be applicable, as it is contrary to the Constitutional Bench's decision in the McDowell case.
- In the case of Wood Polymer Ltd<sup>5</sup>, the Gujarat High Court refused to sanction the scheme as it was found to be a tax evasion device.

### *Income-tax department should be a party*

- Income-tax department has to be made a party, given potential tax avoidance through the scheme.

## Unichem Labs' contentions

In reply to the objecting shareholder's contentions, Unichem Labs made the following arguments:

### *Contentions against regarding the transaction as a colourable device*

- The merger would facilitate the consolidation of the shareholding of the promoters in Unichem Labs, bringing in long-term stability and transparency.
- The scheme does not envisage any arrangement, which is illegal, unlawful, etc.

<sup>2</sup> McDowell and Co. Ltd. v. Commercial Tax Officer [1977] 154 ITR 148 (SC)

<sup>3</sup> Groupe Industrial Marcel Dassault, *In re* [AAR No. 846 and 847 of 2009]

<sup>4</sup> Union of India v. Azadi Bachao Andolan [2004] 10 SCC 1 (SC)

<sup>5</sup> Wood Polymer Ltd., *In re* [1977] 47 Comp. Cases 597 (Guj)

- Reliance was placed on the Supreme Court rulings in the cases of Azadi Bachao Andolan and Vodafone<sup>6</sup>.
- The majority of the judges in the case of McDowell did not agree with the view of Justice Chinnappa Reddy, as discussed in the Vodafone decision.
- The decision of the AAR is not binding on the High Court and the decision in Wood Polymer Ltd. is no longer good in law, in light of the above judicial precedents.
- The promoters of Unichem Labs do not envisage a divestment of stake pursuant to the scheme and adopted only one of the available methods for reorganisation.
- Unichem Labs cannot be in fault if the objective is to be achieved through one of the alternate options available.
- Excerpt of the Supreme Court decision in the case of Azadi Bachao Andolan “*We are unable to agree with the submission that an act which is otherwise valid in law can be treated as non est merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests, as perceived by the respondents.*”
- In the case of Ambalal Sarabhai Enterprises<sup>8</sup>, the Gujarat High Court sanctioned the scheme, despite the fact that the transaction incidentally led to reduction in tax costs, after the Wood Polymer Ltd. decision.
- The income-tax authorities are not required to be heard while sanctioning a scheme under sections 391 to 391 of the Companies Act, 1956, by placing reliance on the judgement of the Division Bench of Bombay High Court in the case of Sterlite Industries (India) Ltd<sup>9</sup>.

#### ***Contention against including income-tax department as a party***

- The income-tax department does not have a right to intervene in the proceedings under sections 391 to 394 of the Companies Act, 1956<sup>7</sup>.

#### **High Court Ruling**

The High Court held that:

- The object of the scheme is legitimate. It provides long-term stability and transparency. Furthermore, it is permissible under the law and is not a colourable device to avoid any tax.
- Every transaction or arrangement permissible under the law having an impact of reducing the tax burden of the assessee is not to be treated as a tax avoidance device, relying on the Azadi Bachao Andolan decision.

#### **Conclusion**

- A transaction should not be held as a colourable device, provided it is within the framework of the law, unless undertaken with the sole objective of tax avoidance.
- Every action/inaction of a person which results in reduction of tax liability cannot be treated as tax avoidance, irrespective of the genuineness of the transaction.

<sup>6</sup> Vodafone International Holdings v. Union of India [2012] 341 ITR 1 (SC)

<sup>7</sup> Jindal Iron & Steel Company Ltd. v. ACIT [Company Application No. 123 of 2004 connected with Company Petition No. 76 of 2004]

<sup>8</sup> UOI v. Ambalal Sarabhai Enterprises [1984] 147 ITR 294 (Guj)

<sup>9</sup> SEBI v. Sterlite Industries (India) Ltd. [2003] 45 SCL 475(Bombay)

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<p><b>Ahmedabad</b> President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000</p>	<p><b>Bangalore</b> 6th Floor, Millenia Tower 'D' 1 &amp; 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000</p>	<p><b>Bhubaneswar</b> IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296</p>	<p><b>Chennai</b> PwC Center, 2nd Floor 32, Khader Nawaz Khan Road Nungambakkam Chennai 600 006 Phone +91-44 4228 5000</p>	<p><b>Hyderabad</b> #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600</p>
<p><b>Kolkata</b> South City Pinnacle, 4th Floor, Plot – XI/1, Block EP, Sector V Salt Lake Electronic Complex Bidhan Nagar Kolkata 700 091 Phone +91-33 4404 6000 / 44048225</p>	<p><b>Mumbai</b> PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000</p>	<p><b>Gurgaon</b> Building No. 10, Tower - C 17th &amp; 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000</p>	<p><b>Pune</b> GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444</p>	<p>For more information contact us at, <a href="mailto:pwctr.knowledgemanagement@in.pwc.com">pwctr.knowledgemanagement@in.pwc.com</a></p>

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