THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 14.08.2014

\+ **W.P.(C) 2033/2013**

DIRECTOR OF INCOME TAX (INTERNATIONAL TAX) ..... Petitioner

versus

COPAL RESEARCH LIMITED, MAURITIUS ..... Respondent

AND

\+ **W.P.(C) 2470/2013**

DIRECTOR OF INCOME TAX (INTERNATIONAL TAX) ..... Petitioner

versus

COPAL MARKET RESEARCH LIMITED, MAURITIUS ..... Respondent

AND

\+ **W.P.(C) 2590/2013**

DIRECTOR OF INCOME TAX (INTERNATIONAL TAX) ..... Petitioner

versus

MOODY'S GROUP LIMITED, CYPRUS ..... Respondent

AND

\+ **W.P.(C) 2597/2013**

DIRECTOR OF INCOME TAX (INTERNATIONAL TAX) ..... Petitioner

versus

MOODY'S ANALYTICS, USA ..... Respondent

Advocates who appeared in this case:

For the Petitioners	:	Mr. Balbir Singh, Sr. Standing Counsel with Mr. Arjun Harkauli, Jr. Standing Counsel, Ms. Monica Benjamin and Mr. Abhishek Singh Baghel.
For the Respondents	:	Mr. S. Ganesh, Sr. Adv. with Mr. Satyen Sethi, Mr. Prakash Kumar and Mr. Arta Trana Panda.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J

1. These writ petitions have been filed by the Revenue challenging a common ruling dated 31.07.2012 (hereinafter referred to as the 'impugned ruling') passed by the Authority for Advance Ruling (hereinafter referred to as 'AAR').

2. By the impugned ruling, the AAR held that the capital gains arising out of the sale of shares of an Indian Company - Copal Research India Private Limited, sold by a company incorporated in Mauritius (Copal Research Limited) to a Cyprus company (M/s Moody's Group Cyprus Ltd.) and sale of shares of a US company (Exevo Inc.) sold by the Mauritius Company (Copal Market Research Limited) to another US company (Moody's Analytics, Inc.) were not liable to tax, in India, in the hands of the seller companies. Consequently, the purchasing companies - M/s Moody's Group Cyprus Ltd. and Moody's Analytics, Inc.- had no obligation to withhold tax under Section 195 of the Income Tax Act, 1961

(hereinafter referred to as the 'Act') from the consideration payable to the sellers – the Mauritian companies.

3. The details of various companies involved in the present writ petition are:-

i. Copal Research Limited ('CRL') - a company incorporated on 17.03.2004 under the laws of Mauritius.
ii. Copal Research India Private Limited ('CRIL') - an Indian company incorporated on 31.12.2002.
iii. Copal Market Research Limited ('CMRL') - a company incorporated on 01.04.2008 under the laws of Mauritius.
iv. Copal Partners Limited ('Copal-Jersey') - a company incorporated in Jersey on 21.07.2006.
v. Exevo India Private Limited ('Exevo-India') - an Indian company incorporated on 22.03.2002.
vi. Exevo Inc. ('Exevo-US') - a company incorporated on 24.07.2002 in United States of America.
vii. Moody's Group Cyprus Ltd. ('Moody-Cyprus') - a company incorporated in Cyprus.
viii. Moody's Analytics, Inc. ('Moody-USA') - a company incorporated in United States of America.
ix. Moody's Group UK Ltd. ('Moody-UK') - a company incorporated in United Kingdom in 2007.

CRL, CRIL, CMRL and Copal-Jersey are hereinafter collectively referred to as the 'Copal Group'. Moody-Cyprus, Moody-USA and Moody-UK are

hereinafter collectively referred to as the ‘Moody Group’. Exevo-India and Exevo-USA are hereinafter collectively referred to as the ‘Exevo Group’.

4. The facts necessary for considering the present petitions relate to three transactions pertaining to sale of shares of the constituents of Copal Group to the constituents of the Moody Group. The tax incidence in respect of two transactions - sale of shares of CRIL by CRL (hereinafter also referred to Transaction-I or the first transaction) and sale of shares of Exevo-US by CMRL (hereinafter also referred to as Transaction-II or the second transaction) - were the subject matter of applications filed before the AAR.

5. The first transaction entails sale of shares of CRIL by CRL to Moody-Cyprus: CRL entered into a Share Purchase Agreement dated 03.11.2011 (hereinafter referred to as the ‘SPA-I’) with Moody-Cyprus whereby CRL sold its entire 100% holding in CRIL to Moody-Cyprus. The sale consideration under the said SPA-I for the transfer of shares comprised of two components: Fixed sum of USD 31,406,740 payable in lump-sum (referred to as initial consideration in the SPA-I) and Deferred consideration in the form of an 'Earn-out' payable in one full and final installment as per Clause 5 of SPA-I read with Schedule 5 thereto. It is relevant to note that Copal-Jersey acquired 100% shares of CRL on 18.10.2006 and CRL is a wholly owned subsidiary of Copal-Jersey. Out of the 1,24,424 shares of CRIL that were sold to Moody Cyprus 1,14,425 (constituting 92% of the entire shareholding of CRIL) were acquired by CRL on 10.08.2004, by way of subscription and the balance 9,999 shares

(constituting 8% of the subscribed and issued share capital) were purchased on 21.05.2010.

6. The relevant facts with respect to Transaction-II are: CRL acquired 100% shares of CMRL on 01.04.2008. Thereafter, CMRL acquired 100% shares of Exevo-USA. Exevo-USA holds 100% of the shareholding (10,06,550 shares) of Exevo-India. Subsequently, CMRL entered into a Share Purchase Agreement dated 03.11.2011 (hereinafter referred to as the 'SPA-II') with Moody-USA whereby CMRL sold all the shares of Exevo-USA to Moody-USA. The effect of the said transaction was that the control of the Indian Company (Exevo-India), which was a wholly owned subsidiary of Exevo-USA, was also indirectly transferred to Moody-USA (an American Company). The sale consideration under the said SPA-II comprised of two components being a fixed sum of USD 11,176,000 payable in lump-sum (referred to as initial consideration in the SPA-II) and deferred consideration in the form of an 'Earn-out' payable in one full and final installment as per Clause 5 of the SPA-II read with Schedule 5 thereto.

7. Copal-Jersey was, at the material time, the ultimate holding company of the Copal Group and its certain shareholders (other than banks and financial institutions) held approximately 67% of the issued and paid up capital of the company (the said shareholders are hereinafter referred to as the 'Copal Group Shareholders'). Banks and other Financial Institutions held the balance 33% shares (approx.) of Copal-Jersey. Copal Group Shareholders entered into a Share Purchase Agreement dated 04.11.2011 (hereinafter referred to as the 'SPA-III') with Moody-UK for sale of approximately 67% of the shares of Copal-Jersey to Moody-UK for an

aggregate consideration of USD 93,509,220 (this transaction is hereinafter also referred to as 'Transaction-III').

8. Four applications were filed before the AAR under section 245R of the Act in respect of the two transactions - Transaction-I and Transaction-II. Moody-USA and CMRL filed applications with respect to Transaction-II being AAR No.1186/2011 and AAR No.1189/2011 respectively. It was contended by the said applicants that in view of the India-Mauritius Double Taxation Avoidance Agreement (DTAA) read with section 90(2) of the Act, gains arising in the hands of CMRL from Transaction-II were not taxable under the Act and, consequently, Moody-USA was not required to withhold any tax. An advance ruling to the said effect was sought from the AAR. Applications seeking a similar ruling with respect to Transaction-I were filed by Moody-Cyprus and CRL being AAR 1187/2011 and AAR 1188/2011 respectively.

9. The AAR admitted the applications for consideration and framed the following questions in AAR No.1186/2011:-

> *"1) Whether on facts and in law, the applicant is justified in its view that capital gains arising on the sale of shares of Exevo Inc., US ('Exevo Inc') by Copal Market Research Ltd. ("CMRL") to the applicant would not be chargeable to tax in India in the hands of CMRL?*
>
> *2) Whether on facts and in law, the Applicant is justified in its view that the full value of consideration receivable by CMRL for the sale of shares of Exevo Inc. to the applicant shall be the total consideration including the 'Earn-Out' consideration for the purposes of computing 'Capital Gains'?*

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3) *If the 'Earn-Out' consideration is to be treated as business profits, whether such profits would be taxable in India under the Act in the absence of any 'Business Connection' of CMRL in India?*

4) *If the answer to question no. 3 above is in the affirmative, whether the 'Earn-Out' consideration would be chargeable to tax in the assessment year relevant to the previous year in which transfer took place or the year in which Earn-Out consideration is received by CMRL?*

5) *If the 'Earn-Out' consideration is to be treated as other income, whether such income would be taxable under the Act by virtue of any income having accrued or arisen to CMRL in India through or from:*

   i. *Any property in India; or*

   ii. *Any asset or source in India?*

6) *If the answer to question no. 5, is in the affirmative, whether the `Earn-Out' consideration would be chargeable to tax in the assessment year relevant to the previous year in which transfer took place or the year in which Earn-Out is received by CMRL?*

7) *Whether on the stated facts, the Applicant, being a foreign company and in absence of a place of business in India, would be subject to tax under the provisions to Section 115JB of the Act?*

8) *Whether on the facts and in law, the Applicant is required to withhold tax under section 195 of the Act on the income chargeable to tax in India in the hands of CMRL from sale of shares in Exevo Inc. to the Applicant?*

9) *If the answer to question 8 is in the affirmative, then, whether the Applicant would be liable to interest under section 201(1A) of the Act?"*

10. The AAR framed the following questions in AAR No.1188/2011:-

"1) Whether on facts and in law, the applicant is justified in its view that capital gains, if any, arising on the sale of shares of Copal Research India Private Limited ('CRIPL) by the applicant to Moody's Group Cyprus Ltd. (Moody's) will not be chargeable to tax in India in the hands of the applicant, as per the provisions of paragraph 4 of Article 13 of the Double Taxation Avoidance Agreement entered into between India and Mauritius ('the DTAA'/'the Treaty')?

2) Whether on facts and in law, the Applicant is justified in its view that the full value of consideration receivable by the Applicant for the sale of shares of CRIPL to Moody's shall be the total consideration including the 'Earn-Out' consideration for the purposes of computing 'Capital Gains'?

3) If the 'Earn-Out' consideration is to be treated as business profits, whether such profits shall be taxable in India as per the provisions of Article 7 read with Article 5 of DTAA?

4) If the answer to question no. 3 above is in the affirmative, whether the Earn-Out would be chargeable to tax in the assessment year relevant to the previous year in which transfer took place of or the year in which Earn-Out is received by the Applicant?

5) If the 'Earn-out' consideration is to be treated as Other Income, whether such income shall be taxable in India as per the provisions of Article 22 of the DTAA?

6) If the answer to question 5 above is in the affirmative, whether the Earn-Out would be chargeable to tax in the assessment year relevant to the previous year in which transfer took place or the year in which Earn-Out is received by the Applicant?

> *7) Whether on the stated facts, the Applicant, being a foreign company and in absence of a place of business or a Permanent Establishment ('PE') in India, would be subject to tax under the provisions of section 115JB of the Act?*
>
> *8) Whether on the stated facts and in law, Moody's Group Cyprus Ltd. another non-resident is required to withhold tax under section 195 of the Act on the income chargeable to tax in India in the hands of the applicant from the sale of shares?"*

11. The AAR adopted the questions framed in AAR No.1186/2011 in AAR No.1189/2011, which were also answered in terms of the ruling in AAR 1186/2011. Similarly, the questions framed in AAR No.1188/2011 were adopted by the Authority in AAR No.1187/2011 and answered accordingly. The AAR passed a common order in all the four applications and by the impugned ruling held that the capital gains arising out of the said transaction were not liable to tax in India in the hands of the respondents. The AAR further ruled that the Earn-Out consideration would also be a part of the consideration receivable by the respondents. The AAR held that there was no obligation on Moody-USA and Moody-Cyprus to withhold tax under Section 195 of the Act. Aggrieved by the impugned ruling, the Revenue has filed the present writ petitions.

12. The learned counsel appearing for the Revenue has submitted that the transactions for sale of shares of Exevo-USA and CRIL must not be viewed in isolation but in conjunction with the sale of shares of Copal-Jersey to Moody-UK as contemplated under SPA-III dated 04.11.2011. And, all the transactions i.e. Transaction-I, Transaction-II and Transaction-III were an integral part of a single transaction. It was argued that the

commercial understanding between Copal Group Shareholders and Moody-UK was to structurally transfer the entire businesses and interest of the Copal Group to the Moody Group and the same was effectuated by the three transactions (Transaction-I, Transaction-II and Transaction-III). It was stated that Copal Group Shareholders held approximately 67% shareholding of Copal-Jersey and Banks and Financial Institutions held the balance shares constituting approximately 33% of the share capital of Copal-Jersey. Given the shareholding structure of the Copal Group, the transfer of shares of Copal-Jersey by the Copal Group Shareholders would consummate the transfer of the entire Copal Group i.e. the businesses and the downstream subsidiaries of Copal-Jersey, to the Moody Group. This, it was contended, was the real transaction between the Copal Group Shareholders and Moody-UK.

13. It was submitted that the sale and purchase agreements read together indicate that, structurally, the entire Copal Group was transferred to the Moody Group. It was argued that but for the separate sale transactions in respect of shares of CRIL and Exevo-US (i.e SPA-I and SPA-II) executed one day prior to the sale of shares of Copal-Jersey (i.e SPA-III), the gains arising from sale of shares of Copal-Jersey in the hands of Copal Group Shareholders would be taxable under the Act, as the shares of Copal-Jersey would derive their value substantially on account of the value of the assets situated in India namely shares of Exevo-India and CRIL. It was reasoned that by virtue of Section 9(1)(i) of the Act read with Explanation 5 thereto, the capital gains arising in the hands of the Copal Group Shareholders (who were non-residents) would be taxable under the Act as the said gains would

be deemed to accrue and arise in India. It was submitted that in order to avoid this incidence of tax, the transaction of sale of the businesses and interests of the Copal Group to the Moody Group was structured in a manner so as to include two separate transactions for sale of shares of CRIL held by CRL to Moody-Cyprus and shares of Exevo-USA to Moody-USA. Sellers in both these transactions, namely, CRL and CMRL were companies incorporated in Mauritius and the tax chargeable on gains arising from sale of shares in the hands of the Mauritius entities could be avoided by virtue of India-Mauritius Double Taxation Avoidance Agreement. It was submitted that in the given circumstances, the transactions in question, namely, sale of shares of CRIL and Exevo-US, were interspersed and as such were transactions structured *prima facie* for avoidance of tax.

14. The learned counsel for the assessee had objected to the contentions of the revenue and submitted that the same were neither raised before the AAR nor pleaded in the writ petition. He further submitted that the shares of CRIL and shares of Exevo-USA were sold to Moody Group as they insisted on acquiring 100% shareholding of these companies. However, with respect to shares of Copal-Jersey only 67% of its shares were sold to a separate entity of the Moody Group. That transaction, thus, ought to be considered as a transaction independent of Transaction-I and Transaction-II.

15. Before proceeding to consider the rival submissions, it would be necessary to refer to Clause (iii) of Proviso to Section 245R(2) of the Act which reads as under:-

*"**245R. Procedure on receipt of application.—***

(1) xxxx xxxx xxxx xxxx

(2) The Authority may, after examining the application and the records called for, by order, either allow or reject the application:

Provided that the Authority shall not allow the application where the question raised in the application,-

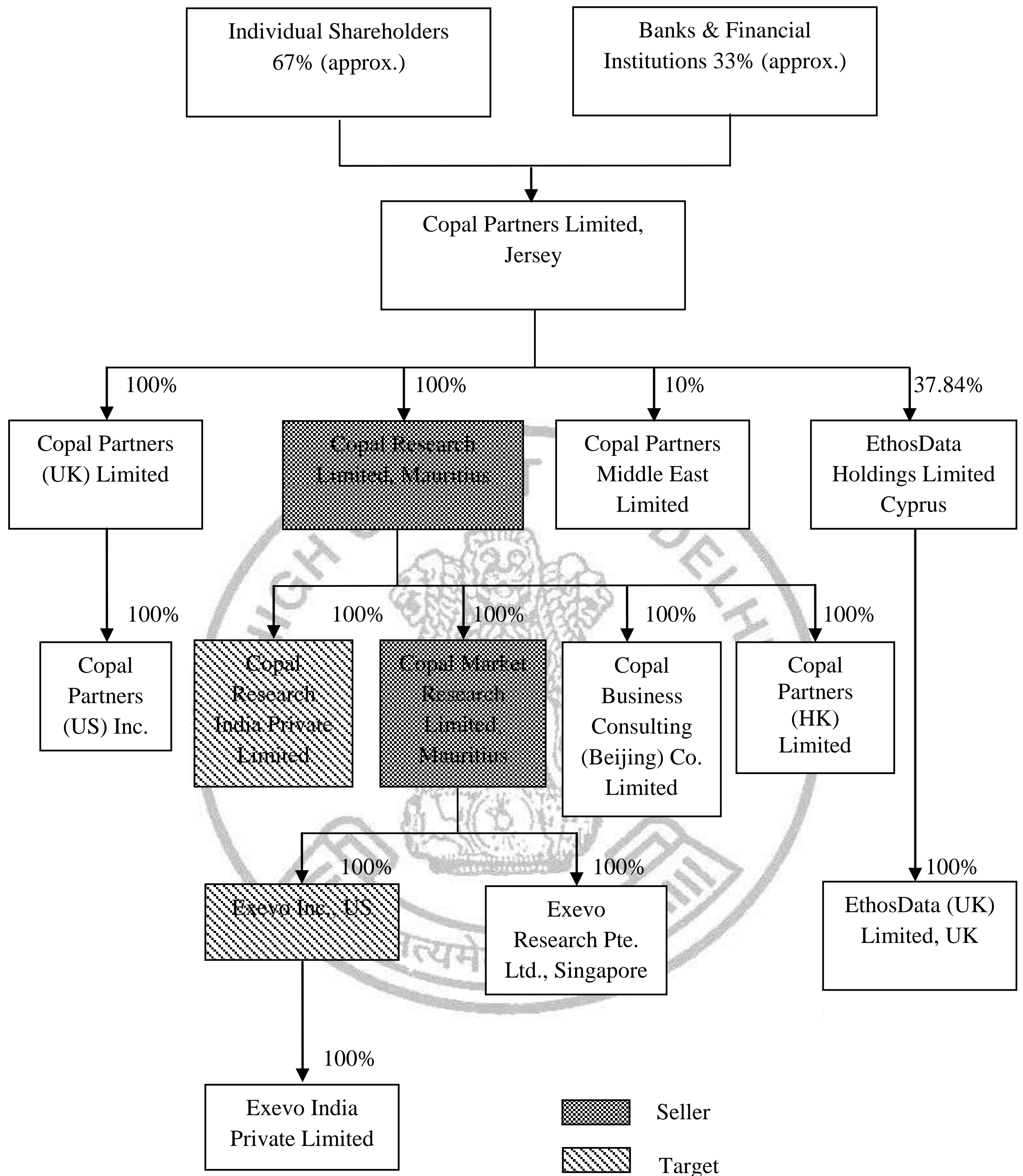
(i) xxxx xxxx xxxx xxxx

(ii) xxxx xxxx xxxx xxxx

(iii) relates to a transaction or issue which is designed prima facie for the avoidance of income-tax except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of section 245N or in the case of an applicant falling in sub-clause (iiia) of clause (b) of section 245N:"

16. The principal questions for consideration are whether the two transactions in question - for sale and purchase of CRIL shares and Exevo-USA shares (SPA-I and SPA-II) are designed *prima facie* for avoidance of income tax under the Act and whether the applications in respect of the said transactions were liable to be disallowed by the AAR in terms of Clause (iii) of Proviso to Section 245R(2) of the Act.

17. Before proceeding to address the rival contentions, it would be relevant to examine the shareholding/investment structure and the inter-relation between the various entities of the Copal Group. This could be understood by a chart demonstrating the structure of the Copal Group of companies, which is reproduced below:-



18. A bare perusal of the above structure indicates that sale of 67% of the shares of Copal-Jersey by Copal Group Shareholders to Moody-UK would result in the Moody Group acquiring 67% indirect economic interest in

CRL and CMRL (being the wholly owned downstream subsidiaries of Copal-Jersey) and this would obviously include interest in any consideration paid by Moody-Cyprus and Moody-USA to CRL and CMRL respectively for acquiring shares of CRIL and Exevo-US as contemplated under SPA-I and SPA-II. This obviously would be illogical as on one hand the concerned entities of Moody Group would pay for assets of CRL and CMRL (Transaction –I and Transaction-II) and on the other hand another entity of the Moody Group would pay to re-acquire a significant part of the consideration paid a day earlier (Transaction-III). This was explained by the learned counsel for the respondents. He stated that the consideration paid by Moody-USA to CMRL was distributed by CMRL as dividend to CRL. CRL distributed the funds received as dividend and consideration for sale of shares of CRIL to Copal-Jersey, which in turn distributed the amounts received as dividends to its shareholders.

19. It follows from the above that the transactions of 03.11.2011 (i.e. SPA-I and SPA-II) resulted in Copal Group Shareholders receiving (i) dividend constituting 67% of the fixed consideration paid by Moody-Cyprus and Moody-USA for acquisition of the shares of CRIL and Exevo-US respectively; and (ii) sale consideration for the shares of Copal-Jersey. The banks and the financial institutions which held shares in Copal-Jersey also participated in the dividends that were distributed from the funds received from the sale proceeds of the sales of CRIL and Exevo-US. It would be obvious that this could not have been commercially achieved if the overall transaction had been structured in the manner as suggested by the Revenue i.e. by simplicitor sale of shares of Copal-Jersey. Thus, even if

it is assumed that the transactions for sale of shares of CRIL and Exevo-US as well as the sale of 67% shares of Copal-Jersey are considered as a singular transaction which essentially entails exit by the shareholders of Copal-Jersey, commercially, the structure of transfer as suggested by the Revenue would not be an alternative to the transactions in question; First of all, for the reason that the Moody Group would not acquire 100% direct control over CRIL and Exevo-US but only an indirect 67% economic interest therein and secondly, the banks and financial institutions holding 33% shares in Copal-Jersey would not have received their share of the consideration from sale of shares of CRIL and Exevo-US.

20. The respondents explained that there is a commercial rationale for the sale of shares of CRIL and Exevo-US as those companies represented holding interest in Indian companies and Moody's had insisted on acquiring the entire 100% capital of those companies. Accordingly, the transfer of those shares took place at the Mauritian level and not by sale of shares of the upstream holding company/companies at the Jersey level. Sale of shares of the ultimate holding company i.e. Copal-Jersey could be effected only to the extent of 67% of the shareholding which was held by the Copal Group Shareholders as the balance 33% was held by banks and financial institutions and their shares were not being acquired by Moody-UK. There is no material to indicate that this commercial transaction was not bonafide.

21. Thus, in our view, the contention of the Revenue that the transaction as presently structured has been done only for the purposes of avoiding tax and as an alternative to sale of shares by shareholders of Copal-Jersey (which would not be as tax friendly) is not sustainable as the transaction

structured in the manner as suggested by the Revenue i.e. sale of shares of Copal-Jersey alone, would not achieve the same commercial results and thus, could not be considered as a real transaction which has been structured differently to avoid an incidence of tax.

22. In view of our conclusion that the commercial transaction as structured could not be structured at the Jersey level and the sale of shares of Exevo-US and CRIL at Mauritius level cannot be stated to be without any commercial reason but only to avoid tax, it is not necessary to examine whether the gains arising in the hands of the Copal Group Shareholders from sale of shares of Copal-Jersey would be exigible to tax assuming that the shares of Exevo-US and CRIL had not been transacted at the Mauritius level.

23. However, as the edifice of the arguments advanced by the Revenue is based on the substratal assumption that the gains arising from sale of shares of Copal-Jersey would be subject to tax, if shares of Exevo-US and CRIL had not been sold by CRL and CMRL, we consider it appropriate to consider the this contention.

24. In our view, the aforesaid contention of the Revenue also cannot be accepted for the reason that even if the sale of shares by the Copal Group Shareholders to Moody-UK has been structured in the manner as suggested by the Revenue, there would be no incidence of tax. According to the Revenue, the real transaction is sale of shares by shareholders of Copal-Jersey to Moody-UK. This would mean that shareholders holding 67% of the equity in Copal-Jersey namely the Copal Group Shareholders would

transfer their shares to Moody-UK without there being any sale of shares by CRL and CMRL of their equity holdings in CRIL and Exevo-US respectively.

25. The consideration payable by Moody-UK to Copal Group Shareholders for their 67% shareholding was agreed as USD 93,509,220. This consideration obviously does not include the fixed value of the shares of CRIL or Exevo-India as 100% economic interest of those companies was acquired by the Moody Group one day prior to the sale and purchase of shares of Copal-Jersey and the fixed consideration thereof had been distributed as dividends. If the sale and purchase transactions under SPA-I and SPA-II had not been executed and only 67% shares of Copal-Jersey would have been acquired by Moody-UK then the value of the Copal-Jersey shares would also include the value of shares of CRIL and Exevo-US. In other words, 67% of USD 42,582,740 (being the aggregate of the fixed consideration payable for the shares of CRIL and Exevo-US), would represent the value of shares of Copal-Jersey held by Copal Group Shareholders, which was derived from assets situated in India. Thus, while the value of the said shares derived from assets situated outside India was USD 93,509,220, the value of Sale Shares derived from assets situated in India would be USD 28,530,435.8 (67% of the fixed consideration). The Earn-Out consideration payable is ignored as the same was contemplated to be paid after sale of Copal-Jersey shares and, thus, would not add to the value of the said shares.

26. It is apparent from the above that only a fraction of the value of shares of Copal-Jersey was derived indirectly from the value of the shares

of CRIL and Exevo-India. The question, thus, arises is whether the sale of shares of an overseas company which derives only a minor part of its value from the assets located in India could be deemed to be situated in India by virtue of Explanation 5 to Section 9(1)(i) of the Act. This question can be answered by reference to the express language of Section 9(1)(i) of the Act as well as by applying the principle that income sought to be taxed under the Act must have a territorial nexus with India. By virtue of Section 9(1)(i) of the Act all income arising from transfer of a capital asset situated in India would be deemed to accrue or arise in India and would thus be exigible to tax under the Act. A share of a company incorporated outside India is not an asset which is situated in India and, but for Explanation 5 to Section 9(1)(i) of the Act, the gains arising out of any transaction of sale and purchase of a share of an overseas company between non-residents would not be taxable in India. This would be true even if the entire value of the shares of an overseas company was derived from the value of assets situated in India. This issue arose in the case of ***Vodafone International Holdings BV v. Union of India and Anr.***: **(2012) 6 SCC 613** and the Supreme Court held that the transaction of sale and purchase of a share of an overseas company between two non-residents would fall outside the ambit of Section 9(1)(i) of the Act. Subsequently, Section 9(1) was amended by virtue of Finance Act, 2012 by introduction of Explanations 4 & 5 to Section 9(1)(i) of the Act, which read as under:-

> *"Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*

Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India;"

27. The notes to clauses explained the introduction of the Explanations 4 and 5 to Section 9(1)(i) of the Act as being clarificatory. A plain reading of Explanation 5 also indicates that the given reason for its introduction was for removal of any doubts. In other words, the language of the said legislative amendment suggests that it was always the intention of the legislature that an asset which derives its value from assets in India should be considered as one which is situated in India. The clear object of Section 9(1)(i) of the Act is *inter alia* to cast the net of tax also on income which arises from transfer of assets in India irrespective of the residential status of the recipient of the income. Since the assets are situated in India, the entire income arising from their transfer could be said to arise in India. Explanation 5 introduced a legal fiction for the limited purpose of imputing that assets which substantially derive their value from assets situated in India would also be deemed to be situated in India.

28. It is trite law that a legal fiction must be restricted to the purpose for which it was enacted. The object of Explanation 5 was not to extend the scope of Section 9(1)(i) of the Act to income, which had no territorial nexus with India, but to tax income that had a nexus with India, irrespective of whether the same was reflected in a sale of an asset situated outside India. Viewed from this standpoint there would be no justification to read

Explanation 5 to provide recourse to section 9(1)(i) for taxing income which arises from transfer of assets overseas and which do not derive bulk of their value from assets in India. In this view, the expression “substantially” occurring in Explanation 5 would necessarily have to be read as synonymous to “ principally”, “mainly” or at least “majority”. Explanation 5 having been stated to be clarificatory must be read restrictively and at best to cover situations where in substance the assets in India are transacted by transacting in shares of overseas holding companies and not to transactions where assets situated overseas are transacted which also derive some value on account of assets situated in India. In our view, there can be no recourse to Explanation 5 to enlarge the scope of Section 9(1) of the Act so as to cast the net of tax on gains or income that may arise from transfer of an asset situated outside India, which derives bulk of its value from assets outside India.

29. It is also relevant to refer to the draft report submitted by the expert committee appointed by the Prime Minister in 2012 to report on the retrospective amendment relating to indirect transfer of assets (Shome Committee). The said Committee had, in its draft report, considered the import of the expression ‘substantially’ as used in Explanation 5 to Section 9(1)(i) of the Act. The Committee considered the submissions of stakeholders that the expression ‘substantially’ did not have any fixed meaning and was vague. After analysis, the Committee noted that it was necessary to pin down a definition of the said expression and for that purpose, there were no reason to depart from the Direct Tax Code Bill, 2010 (DTC) that had been put in the public domain. Under the DTC, gains

from the sale of assets situated overseas, which derived more than 50% of their value from assets situated in India, were liable to be taxed in India. The Shome Committee in its draft report recommended as under:-

> *"The word "substantially" used in Explanation 5 should be defined as a threshold of 50 per cent of the total value derived from assets of the company or entity. In other words, a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value from the assets located in India being more than 50% of the global assets of such company or entity. This has been explained through the above illustration."*

30. In addition to the above, the 'United Nations Model Double Taxation Convention between Developed and Developing Countries' and the 'OECD Model Tax Convention on Income and on Capital' may also be referred to since the said conventions deal with a regime whereunder the right to tax capital gains can be fairly and reasonably apportioned between contracting States. Since the models propose a regime which is generally accepted in respect of indirect transfers, the same, although not binding on Indian authorities, would certainly have a persuasive value in interpreting the expression 'substantially' in a reasonable manner and in its contextual perspective. The 'United Nations Model Double Taxation Convention between Developed and Developing Countries' and the 'OECD Model Tax Convention on Income and on Capital' provide that the taxation rights in case of sale of shares are ceded to the country where the underlying assets are situated only if more than 50% of the value of such shares is derived from such property.

31. Paragraph (4) of Article 13 of the United Nations Model Double Taxation Convention between Developed and Developing Countries provides that a Contracting State is allowed to tax a gain on alienation of shares of a company or on alienation of interests in other entities the property of which consists principally of immovable property situated in that State. For this purpose, the term 'principally' in relation to the ownership of an immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by such company, partnership, trust or estate. It is also relevant to note that India has signed a treaty with Korea incorporating this clause. The relevant portion of Article 13 of the said UN Convention is quoted below:-

"Article 13

CAPITAL GAINS

xxxx xxxx xxxx xxxx

4. Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:

(1) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.

(2) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of

> *the aggregate value of all assets owned by the company, partnership, trust or estate."*

32. The 'OECD Model Tax Convention on Income and on Capital' provides a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation. Article 13 of the said Convention deals with the taxes on capital gains. Article 13(1) provides that the gains derived by a resident of a Contracting State from the alienation of immovable property situated in another Contracting State may be taxed in that other State. Article 13(4) of the said Convention provides that the *'gains derived by a resident of a Contracting State from the alienation of shares or comparable interests deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.'*

33. In view of the above, gains arising from sale of a share of a company incorporated overseas, which derives less than 50% of its value from assets situated in India would certainly not be taxable under section 9(1)(i) of the Act read with Explanation 5 thereto.

34. Thus, in the present case, even if the transaction had been structured in the manner as suggested on behalf of the Revenue, the gains arising to the shareholders of Copal-Jersey from sale of their shares in Copal-Jersey to Moody UK would not be taxable under Section 9(1)(i) of the Act, as their value could not be stated to be derived substantially from assets in India. In this view, the contention of the Revenue that the entire transaction of sale of Copal-Jersey shares has been structured in a manner so as to

include the sale of shares in CRIL and Exevo-US by the Mauritian companies only to avoid the incidence of tax and take benefit of the DTAA is *ex facie* flawed.

35. The learned counsel for the Revenue has contended that the entire structure of investments to hold the companies in India had been evolved only with the object of avoiding tax and intermediary companies in Mauritius had been incorporated only with a view to avoid tax in the event of a future sale. In our view, this contention is also devoid of any merit. The investment structure evolved over a period of time and it also cannot be ignored that 92% of the share capital of the CRIL was subscribed by CRL.

36. It has been contended on behalf of the Revenue that Rishi Khosla is the prime mover of the Copal Group. It is stated that he alongwith one Jeol Perlman left their earlier employment and promoted Copal-Jersey and are in *defacto* control and management of the entire Copal Group. It is contended that other companies/subsidiaries of the Copal Group are only shell companies. It is further alleged that CRL and CMRL are not operative since their revenues are generated from within the Copal Group. It is, therefore, urged that since Rishi Khosla is a resident of the United Kingdom, the situs of CRL and CMRL ought to be taken as United Kingdom - from where the affairs of the Copal Group, including CRL and CMRL are alleged to be conducted - and not Mauritius. The learned counsel for the Revenue had submitted that Rishi Khosla had also varied the terms of the transactions. According to him, the same indicated that management of the companies was synonymous with Rishi Khosla.

37. The learned counsel for the respondents contested these contentions urged by the petitioner. It was stated that the companies were managed by their respective Board of Directors. It is also disputed that CRL and CMRL were not operative companies. It is stated that both CRL and CMRL held category-I Global Business Licenses (GBL) w.e.f. 18.03.2004 and 03.04.2008 respectively. CRL received substantial revenues from provision of services relating to business of financial research and CMRL also received revenues from provision of services relating to business of market research. The financial statements of both the said companies indicated that the companies had received substantial revenues. The respondent also disputed the contentions that CRL and CMRL were shell companies and asserted that the said companies were companies with substance. In the alternative, it was submitted that the India-Mauritius Double Taxation Avoidance Agreement did not include a Limitation of Benefits (LOB) clause and thus, it was not open for the revenue to contend that the said companies should be denied the treaty benefit with India.

38. In our view, the CRL and CMRL cannot be stated to be shell companies so as to ignore their corporate identities. Even according to the revenue, the companies are generating revenue from intra-group services. The fact that a company may render services to its related enterprise would not render the company to be non-existent or give reasons for lifting its corporate veil. The financial statements placed on record indicate that CRL and CMRL have been generating revenues and we also have no reason to doubt the statement that CRL and CMRL have been providing services in relation to business of financial research and market research respectively.

39. The next issue that needs to be addressed is whether CRL and CMRL should be considered as residents of UK on account of the alleged role of Rishi Khosla in its affairs. Undoubtedly, Rishi Khosla has a vital role to play in the affairs of the Copal Group. The respondents have placed on record the Business Advisory Agreement entered into with Rishi Khosla, which defines his role as an advisor. The 'Earn-Out' consideration payable is also based on a formula which is to be applied with reference to a "computation date" which is defined to mean the date when Rishi Khosla is disentitled to act as a Director. This also indicates that the role of Rishi Khosla in the affairs of the Copal Group would be significant and he cannot be stated to be playing a role of a mere agent employed for concluding the transactions as contemplated under various agreements (SPA-I, SPA-II and SPA-III). However, in our opinion, this by itself would not be sufficient to assume CRL and CMRL to be tax residents of United Kingdom. The AAR had considered this aspect and held that the Revenue was unable to show that the effective management of the companies was not where the Board of Directors of the companies situated. It was held that although Rishi Khosla may have played a role larger than that of a normal agent but circumstances did not warrant an inference that the control and management of the companies vested with him and not with the respective Board of Directors. The relevant findings of the AAR are as under:-

> *"11. Assuming that learned counsel for the Revenue is right in his submission the decision in Vodafone has modified the ratio of the decision in Azadi Bachao Andolan on the conclusiveness of a tax residency certificate, it cannot be said that it has been shown that the effective management of the companies is not from where their Board of Directors function.*

Normally, the management of a company vests in its Board of Directors as authorized by the General Body. The role of Rishi Khosla highlighted by the Revenue is in respect of the sale transactions undertaken and in pushing them through. It does not appear to be a role in connection with the running of the businesses of the companies concerned. It is not shown that the management of the companies in Mauritius in general, is not with a Board of Directors of those companies sitting in Mauritius and that the management and control is from United Kingdom of which Rishi Khosla is a resident. Even if one were to take the Business Advisory Agreement relied on by the applicants with a pinch of salt, it cannot be said that the role played by Rishi Khosla in these transactions establish that the management and control of the Mauritian companies is with Rishi Khosla. It is therefore not possible to accept the contention of learned counsel for the Revenue that by applying the place of management test, the seller companies could be held to be non-Mauritian companies.

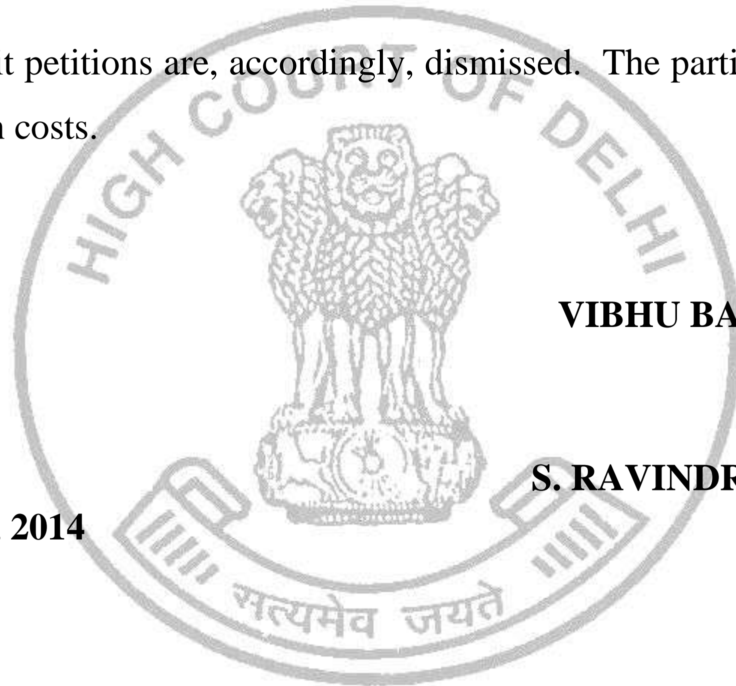
12. It was contended that Rishi Khosla has not acted in terms of the Board Resolution relied on and that he had varied the terms of the transaction at his pleasure and this demonstrates that he had dominion over the companies. He had in fact acted beyond the authority conferred on him by the resolution of the Board relied on. The Board Resolution was a sham put forward to achieve the object of avoidance of tax. Though there may be some substance in the argument that Rishi Khosla has not merely played the role of a normal agent, the circumstances relied on are not sufficient to warrant an inference that the control and management of the seller companies rested with Rishi Khosla and not with the Board of these companies.

13. There may be some substance in the argument of the learned counsel that this Authority has to consider only the negative, namely that the control of the companies is not in Mauritius and it is not necessary for this Authority to find positively that the control and management is with Rishi Khosla, before coming to a conclusion that the applicants are

not entitled to claim the benefit of the India Mauritius DTAC. But on the available facts, the presumption that the control and management of the companies rest with the Board of Directors cannot be said to have been rebutted by sufficient or cogent material. I overrule the arguments in this behalf."

40. We concur with the above quoted conclusion of the AAR. The material on record is insufficient to conclude that the corporate structure of CRL and CMRL should be ignored and the residence of Rishi Khosla be considered as the situs of the said companies.

41. The writ petitions are, accordingly, dismissed. The parties are left to bear their own costs.



VIBHU BAKHRU, J

S. RAVINDRA BHAT, J

AUGUST 14, 2014
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