Indian court sends Vodafone transfer pricing case to dispute resolution panel

(Please note that this article is from an independent third-party tax news provider and the views expressed do not necessarily reflect those of Deloitte).

The Bombay High Court on 29 November 2013 directed Vodafone India Services Pvt. Ltd. (Vodafone India) to submit its objections over an INR 13 billion (about $209 million) transfer pricing adjustment to the tax department's dispute resolution panel and strongly criticised the tax authority's handling of the case.

According to a judgment from a division bench comprising Chief Justice Mohit Shah and Justice M.S. Sanklecha, Vodafone India had filed a writ petition on 24 April challenging the adjustment, which is connected to an August 2008 transaction. (For prior coverage, see Vodafone to challenge Indian transfer pricing order.)

In that transaction, Vodafone India issued 289,224 shares to its Mauritius-based holding company, Vodafone TeleServices (India) Holdings Ltd., at a face value of INR 10 (about $0.16), each at a premium of INR 8,591 (about $138) per share, for a total consideration of INR 2.46 billion (about $39.5 million).

When Vodafone India filed its return for assessment year 2009-2010 in September 2009, it reported the arrangement as an international transaction, claiming that transfer pricing provisions under Chapter X of India's Income Tax Act, 1961, did not apply because the transaction did not give rise to income.

The assessing officer handling the return referred the matter to a transfer pricing officer without addressing Vodafone India's claim. The transfer pricing officer then determined that Vodafone India had undervalued the shares and reassessed the arm's-length price at INR 53,775 (about $863) per share, resulting in the massive readjustment.

The transfer pricing officer also decided that the amount resulting from the difference between the arm's-length price and the issue price constituted a loan from Vodafone India to the holding company. The officer said Vodafone India should have received interest from that loan and proposed levying an interest rate of 13.5%.

Vodafone India then filed its writ petition with the High Court, arguing that the share infusion was a capital transaction and therefore not taxable as income. Thus, the transfer pricing officer was acting beyond his jurisdiction in making the adjustment, it said. The company also filed objections on the merits of the adjustment with the tax department's dispute resolution panel.

According to Tanya Mehra of Phoenix Legal in New Delhi, Vodafone India also argued that there was a breach of justice because neither the assessing officer nor the transfer pricing officer gave Vodafone India the chance to present its case on the fundamental question of whether transfer pricing laws applied to the transaction. It further argued that the dispute resolution panel does not offer the company an alternative remedy because the panel cannot quash a draft assessment order by an assessing officer and that the panel is unable to produce an unbiased opinion on the issue of jurisdiction because one of its members is the director of income tax.

In its decision, the court did not address the merits of the case, but disposed of Vodafone India's writ petition, directing the company to file its objections about jurisdiction, as well as on substantive issues, with the dispute resolution panel within two weeks.

The court also ordered the panel to dispose of the objections within two months from the date the objections are filed by Vodafone India and clarified that if the panel's order is patently illegal, the company can approach the court under the writ jurisdiction, according to S.P. Singh of Deloitte Haskins & Sells in Gurgaon, who spoke to *Tax Analysts* in a personal capacity.

He said the decision regarding the tax authorities' ability to tax capital infusion was heavily anticipated as an indicator for the outcomes of similar transfer pricing cases that are at different stages of dispute.

"The basic question raised by the company was whether the tax law confers jurisdiction to a tax authority to treat a transaction on the capital account as a revenue transaction," he said. "Obviously, the company was expecting that at the stage of writ itself, the High Court will set aside the order of the tax authorities, holding the transaction as a nontaxable event."

Although the court declined to rule on substantive issues, it made several significant observations, Singh said.

One such observation was that if a taxpayer objects to the applicability of transfer pricing laws to a transaction, the assessing officer should give the taxpayer an opportunity to make its case before referring the matter to a transfer pricing officer to determine an arm's-length price.

The court also strongly criticised the tax department, saying that no government has the right to cause misery to and harass the taxpayer while collecting taxes.

"The court admitted that the taxpayer has reasons to feel harassed by the stands taken by the [transfer pricing officer] and the assessing officer on the question of jurisdiction," Singh said. "They observed, 'We hope the revenue will be more sensitive to the just demands of the assessee and not treat the assessee as an adversary who has to be taxed, no matter what.'"

The fact that the judges had such acerbic words for the tax department may have compelling implications for similar transfer pricing cases, such as that of Shell India. The Royal Dutch Shell PLC subsidiary in February received a transfer pricing adjustment of INR 152 billion (about $2.44 billion) from the tax department, which alleged that the company grossly undervalued an equity share transfer to its Dutch parent. (For prior coverage, see Indian authorities issue substantial transfer pricing adjustment against Shell.)

"This is a significant judgment, as it makes strong observations against the income tax authorities which may result in them being more transparent and less arbitrary while passing adverse assessment orders," Mehra said. "From the information available in public domain, Shell's writ petition on similar grounds is likely to be heard by the Bombay High Court in the coming week, and this judgment may have a bearing on its outcome."

However, it remains to be seen how significant the court's ruling will ultimately be, since the court did not delve into the merits of the case. Singh speculated that the court is waiting for lower-level courts to give their opinions before issuing its own.

"Though there are strong reasons to argue that share infusion is in the nature of capital transaction, not liable to be covered by the ambit of transfer pricing regulations, the final word on this issue is yet to be heard," he said. "It will be interesting to watch the developments."

Vodafone did not immediately return *Tax Analysts'* request for comment.