

RICHTER HOLDINGS LTD vs. ASSISTANT DIRECTOR OF INCOME TAX (MANU/KA/0193/2011)



HIGH COURT OF KARNATAKA

Decided on 24.03.2011

RATIO DECIDENDI

In case a non-resident company claims that purchase of shares of an Indian company from another non-resident company does not amount to transfer of capital asset, it may be necessary to lift corporate veil to look into real nature of transaction to ascertain vital facts.

FACTUAL MATRIX

1. Richter Holdings Ltd (Petitioner) is a company incorporated in Cyprus, it holds 60% of the shares in Finsider International Company Ltd (Finsider) registered in United Kingdom (UK). The petitioner and West Globe Ltd. a company incorporated under the laws of Mauritius purchased the remaining shares in Finsider from another company registered in UK called Early Guard Limited. Finsider was holding 51% shares of Sesa Goa Ltd. an Indian Company.
2. The Tax department issued a show cause notice to Petitioner alleging that the Petitioner had indirectly acquired 51% in Sesa Goa Ltd and was therefore, liable to deduct tax at source before making payment to Early Guard Limited.

PETITIONER'S CONTENTIONS

1. The Petitioner contended that the transfer of share in non-resident company from one non-resident company to another non-resident company does not amount to acquisition of immovable property by controlling the management and it is only an incident of ownership of the shares in a company which flows out of the holding of shares.

2. The controlling interest is not an identifiable or distinct capital asset independent of the holding of shares and the nature of the transaction has to be ascertained from the covenants of the contracts and from the surrounding circumstances.
3. The transaction is only an acquisition of shares and does not amount to acquisition of immovable property. As such, the question of treating the same as capital gain and to deduct income from capital gains does not arise. Therefore, the notice issued by the tax department is not tenable in law.

TAX DEPARTMENT'S CONTENTIONS

1. The shares held by Finsider in Sesa Goa Ltd constitutes a capital asset as per section 2 (14) of the Income Tax Act, 1961 (Act). As such, the purchase of shares of Finsider by Petitioner amounted to a transfer of a capital asset of 51% shares of Sesa Goa Ltd.
2. As per section 195 of the Act, the Petitioner is liable to deduct tax at source in respect of payment made for purchase of capital asset

JUDGEMENT

The High Court of Karnataka held that the Petitioner should reply to show cause notice issued by the Tax department and urge all their contentions before it. The High Court also emphasized that the fact finding authority (Tax Department) may lift the corporate veil to look into the real nature of the transaction to ascertain the vital facts.

CONCLUSION

The High Court was of the view that at this stage only the show cause notice is under challenge. Therefore, the High Court has not gone into the merits of the contentions raised by both the Parties. The High Court directed the petitioner to appear before the Tax Department and urge all the contentions which were raised before the High Court.

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However, the High Court without going into the merits of the contentions held that the Tax Department can lift the corporate veil to look into the real nature of the deal. This has a number of implications. First, the *Richter Holding Case* arguably provides an additional ground to the tax authorities to tax indirect transfers. Second, it is not clear from the judgment itself whether the tax authorities advanced the argument regarding lifting the corporate veil and, if so, how it was countered by Richter Holding. Third, the Karnataka High Court appears to have readily permitted lifting the corporate veil without at all alluding to the jurisprudence on the subject-matter.

Keeping in view the approach of the Tax department and present ruling of the High Court, the transaction relating to acquisition of shares of an Indian company by a non-resident company is required to be suitably structured to reduce the tax liability.