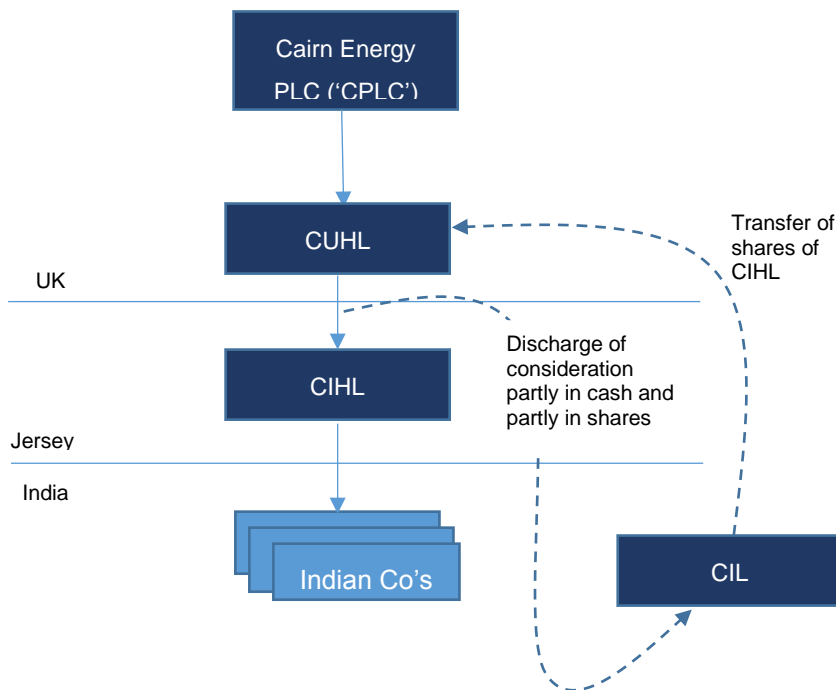


Delhi ITAT rules on taxability of indirect transfers

The Income-tax Appellate Tribunal ('ITAT') in the case of Cairn UK Holdings Ltd ('CUHL') held that the internal reorganisation carried out by the assessee Group in order to consolidate its Indian operations was liable to tax in India under the indirect transfer provisions. Briefly, the transaction, amongst other steps, involved a transfer of shares of Cairn India Holdings Ltd ('CIHL'), a Jersey based company, to Cairn India Ltd ('CIL') by CUHL. CIHL was a holding company of 9 operating subsidiaries based in India.

The transaction is depicted below:





Key Conclusions:

On the validity of retrospective amendment to bring indirect transfers to tax

- The ITAT held that it was not the right forum to challenge the validity of retrospective amendment.

On the pendency of international arbitration

- The ITAT rejected the plea to have the matter adjourned on account of the pendency of arbitration under the bilateral investment treaty. The ITAT was of the view that keeping the issue unnecessarily pending for a very long time was not warranted.

On the taxability of the transaction

- On merits, the ITAT held that the contention of the assessee that the transaction was merely an *internal reorganisation* and hence should not be subject to capital gains tax was not correct. This is because the value of the holdings of the assessee in CIL had been unlocked due to an IPO and book building process. Thus, the entire mechanics cannot be termed as a mere "internal reorganisation".
- The ITAT also rejected the argument that no "real income" has accrued to the assessee as the entire transaction was entered within the Group without any involvement of a third party. To support its conclusion, the ITAT noted that the assessee itself had mentioned a note in its UK audited accounts that it had generated an exceptional gain of GBP 1.36 billion which is exempt from tax under Schedule 7AC of Taxation of Chargeable Gains Act, 1992.
- As far as question of computation of capital gains was concerned, the ITAT did not allow a cost step-up to CUHL at the time when it acquired shares of Indian Co's in exchange of issue of its own shares to CPLC. In other words, the Fair Market Value ('FMV') of shares of Indian Co's was not regarded as 'cost' in the hands of CUHL despite it being capable of being regarded as '*sale consideration*' in the hands of CPLC at the time of exchange (though not assessed as such by the tax authorities). Thus, only the face value of shares issued by CUHL to CPLC was determined to be the cost of acquisition in the hands of CUHL (instead of assessee's plea to regard FMV of shares of Indian Co's as the cost).

On levy of interest under section 234B / 234C

- The ITAT held that the assessee cannot be burdened with interest u/s 234A and 234B on tax liability arising out of a retrospective amendment.



Comments:

This decision upholds the preponderant view that indirect transfer provisions can also apply in cases involving intra-group reorganisation. While the observations of the ITAT on availability of cost-step up in the hands of transferor could be a subject matter of challenge before the High Court, the relief provided by the ITAT on non-levy of interest under section 234B and 234C is an important one. It is pertinent to note that this decision does not deal with the question of what constitutes “substantial” for the purposes of application of the indirect transfer provisions.



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