LOOKING "THROUGH" TO A "COMMERCIAL RATIONALE": REVIEWING THE GAAR IMPLICATIONS OF DIT V. COPAL RESEARCH AND OTHERS

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Abstract

The author has used the wider constitutional context of Article 16(4) of the Indian constitution read with the text of the 117th Constitutional Amendment in order to argue against the proposed current system of reservation in promotion vis. the public services in India. While it is true that questions of structural inequality can certainly be effectively dealt by reservation in the services, the sanctity of the seniority system in the services and its wider need for a smooth operational bureaucracy cannot be ignored. It is therefore the endeavor of the author to explain why the proposed regime is likely to harm the internal structures of the bureaucracy and especially with regard to the public nature of the services. It is in this light that the author will strive to demonstrate the impending need to revise the guidelines for

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the implementation of this scheme and its legal vagaries. The ultimate objective of the author therefore, is to propose an alternate model of reservation, at least at a constitutional level.

I. INTRODUCTION

"*Taxes are what we pay for civilized nations*"[1]

One of the founding attributes of the Indian foreign investment market structure in the post liberalization period is an inherent state of policy flux, marked by a significantly grey area of law, between explicit tax mitigation measures allowed by the law in force and the willful breach of statutory tax impositions.[2] While it continues to remain a seemingly daunting policy challenge to cull out *that* very thin line between tax *"planning"* and tax *"evasion",* the Indian scenario surrounding the liability of capital gains tax in the context of indirect transfers has remained in a state of tussle between the law making authorities and the judicial interpretation\examination of international transactions.[3] While on one hand, the application of the *"look at"* test in the matter between *Vodafone International Holdings B.V v. Union of India*[4] marked the validity of avoidance arrangements so long as a holistic viewing of the entire transaction qualified it to not be a mere sham or a colorable exercise,[5] the judgment saw a sharp

[1]Oliver Wendell Holmes Jr, in the case of Compania General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87 (1927).
[2]Sanja Sanghvi, *Resolution of Vodafone tax case must to protect India's image*, BUSINESS TODAY, Mar., 2014.
[3]Wei Cui, *Taxing Indirect Transfers: Improving an Instrument for stemming Tax and Legal Base Erosion*, 33 VA. TAX REV. (2014).
[4]Vodafone International Holdings B.V v. Union of India, (2012) 6 SCC 613.
[5]*Id.*

knee jerk reaction from the legislature, retaliating through the introduction of the retrospective amendment to Section 9 of the Income Tax Act.[6] As a result of the addition of Explanation 5[7] to Section 9(1)(i) of the Act, a capital asset being any share of interest in a company registered or incorporated outside India, would always be deemed to have been situated in India, so long as it derived either directly, or indirectly a *"substantial*" amount of its value from assets situated within the territory of India.[8] Naturally, this legislative move triggered massive concerns of uncertainty and pessimism from the international investor community, who were caught unaware in the web of retrospective tax liabilities, although they were *prima facie* not guilty of using colorable devices, designed to avoid taxes.[9]

By deconstructing the judicial pronouncement in the recent judgment of the Delhi High Court in the matter between *DIT V. Copal Research and Others*[10], the objective of the author is twofold: First, to examine the implications of this judicial reasoning on the *"main purpose test"*[11] envisaged by the currently dormant GAAR provisions, contained in Chapter 10 A of the Act and to examine the likely consequences of this pronouncement on the pending special leave petition in the Supreme Court of India in the matter between *Sanofi Holdings vs. Department of Revenue*[12] and second, to analyze the impact of this judgment on the scope of *"badges of indicia*" test in the draft GAAR. The author argues that the rare judicial analysis carried out by the Court in deciding the validity of the *"commercial*

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[6]See The Finance Act, 2012, No. 23, Acts of Parliament, 2012, (India).
[7]Income Tax Act, 1961, No. 43, Acts of Parliament, 1961, (India), § 9(1)(i).
[8]*Id*.
[9]See A. Henderson, The Case for Indirect Taxation, 58 ECON. J. 232 (1948).
[10]DIT v. Copal Research and Others, (2014) 270 CTR (DEL) 223.
[11]The "main purpose test" is contained within the text of § 96, Income Tax Act 1961 (draft GAAR).
[12]Sanofi Holdings v. Department of Revenue, (2013) 257 CTR (AP) 401.

rationale" in the transaction in question, through the implicit application of the New Zealand model of assessment in such circumstances (as was observed in the cases of *Challenge Corporation; Accent Management Ltd. vs. Inland Revenue* and *Peterson vs. Commissioner of Inland Revenue),*[13] significantly limits the territory of Section 96 of the Act, which seeks to cast the taxation net on international acquisitions that are structured in and routed through international subsidiaries.[14] The argument of the author is centered on the fact that there exists scope of abuse through subjective interpretation by the Revenue, given the fact that phrases such as *"main purpose"* are left undefined within the text of the law. The author further argues that the espoused judicial rationale shall also have a conclusive impact on the matters *sub judice* in similar contexts, *Sanofi* being one of them.[15] The third and final leg of the author's analysis will be to prove that the *"bona fide"* test contained in Section 96 of the Act (one of the requirements of the *"tainted elements* test"[16]) will be significantly controlled by this judicial pronouncement considering that the Court has read *commercial substance* and *bona fide means* (the use of the Double Taxation Avoidance Agreement[17] primarily) into one mode of examination.

[13]See Challenge Corporation, Accent Management Ltd. vs. Inland Revenue, (2007) BCL 728 (CA).
[14]Income Tax Act, 1961, No. 43, Acts of Parliament, 1961, (India) § 96.
[15]*Id*.
[16]Income Tax Act, 1961, No. 43, Acts of Parliament, 1961, (India), § 96 (1) (a-d).
[17]The India-Mauritius Double Taxation Avoidance Arrangement.

II. BRIEF STATEMENT OF FACTS

The present dispute arises from a complex factual matrix[18] involving the Moody Group Limited (hereinafter referred to as "**Moody-UK**") which is a company incorporated in the United Kingdom and Copal Partners Ltd, Jersey (hereinafter referred to as "**CPL Jersey**"), (which held 100% shares in Copal Research Ltd, Mauritius [CRL Mauritius]). Now, CRL Mauritius held 100% of the shares in its subsidiaries Copal Research India Pvt Ltd, India (CRIL India) and Copal Market Research Ltd, Mauritius (CMRL Mauritius). CMRL Mauritius held 100% shares in Exevo Inc, USA (Exevo USA) and Exevo USA held 100% shares in Exevo India Pvt Ltd, India (Exevo India).[19]

The transactions in question involved Three Share-Purchase Agreements (SPA's) which facilitated the sale of shares of the units of Copal Group to the units of the Moody Group wherein Moody-UK aimed at acquiring the 67% share ownership of the Copal Group in CPL Jersey and its 100% share-ownership in CRIL India and Exevo USA.[20]

SPA-I - CRL Mauritius sold its entire 100% shareholding in CRIL India to Moody's Group Cyprus Ltd. (Moody-Cyprus). SPA-II – CMRL Mauritius sold its entire shareholding in Exevo USA to

[18]The factual matrix has been provided from the text of the Judgment.
[19]Ernst and Young, *India's Delhi High Court rules 50% as benchmark to evaluate "substantial value" on taxation of indirect transfers*, GLOBAL TAX ALERT, http://docplayer.net/143759180-Global-tax-alert-india-s-delhi-high-court-rules-50-as-benchmark-to-evaluate-substantial-value-on-taxation-of-indirect-transfers.html.
[20]Director of Income Tax v. Copal Research Limited, (2014) 270 CTR (Del) 223, at ¶4.

Moody's Analytics Inc. (Moody-USA). SPA-III - Sale of approximately 67% of the shares of Copal-Jersey to Moody-UK.[21]

An application was filed with the Authority for Advance Rulings (hereinafter referred to as "**AAR**") arguing that the transactions involved the overseas entities carrying out an indirect transfer of the share ownership of the Indian Entities, thereby attracting the scope of Section 9 of the IT Act, which discusses the taxability of income accruing or arising directly or indirectly from the transfer of a capital asset situated in India.[22] With the AAR ruling in favour of the assessee, the Revenue Authority filed a writ petition before the Delhi High Court challenging the decision.[23]

In order to outline the theoretical territory of the present discussion, one must necessarily examine the operation of both the look *"through"* and the look *"at"* test, in terms of the impact that these doctrines have had, on shaping the Indian scenario relating to income tax jurisprudence, especially in the context of international transfer taxation. By carrying out this examination, the author seeks to provide sufficient context in order to adequately comprehend the implications of such decisions in the years to come.[24]

III. REVENUE STRUCTURES IN THE INDIAN INDIRECT TRANSFER DEBATE: A FLITTERING JUDICIARY?

[21]*Id.* at ¶5-6.
[22]*Id.* at ¶7.
[23]*Id.* at ¶1.
[24]The reason as to why this outline has been provided, is to ensure that the subtle legal differences between the two approaches, as propounded by both the judiciary as well as the legislature is adequately provided to the reader.

As Lord Tomlin notes, in the landmark 1936 case of the IRC V. the Duke of Westminster, "*every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax*".[25] The operation of the Westminster Principle, as the ratio decidendi of this case is popularly known as, allowed the assesses in question, to structure their financial arrangements in a manner that would minimize their tax liability, so long as the structuring was within the boundaries of the black letter law (emphasis added).[26] The primary criticism for the often used legal justification of the Westminster paradigm was that the statements of Tomlin, when he states that "*this so called doctrine of the substance seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable*",[27] do not confer a positive legal right on the assessee individual or corporation the explicit right to design avoidance mechanisms , but only speak about "*denying the right of the Revenue to artificially maximize the burden of tax on an individual*".[28]

While on one hand, several tax experts, including Ben Saunders,[29] argue that the use of this principle as a legal justification to avoid tax was void on the grounds that the statements of Lord Tomlin were read

[25]IRC v. the Duke of Westminster, (1935) ALL E.R (259) (House of Lords).
[26]J. Tiley, *Tax Avoidance: A Change in the Rules*, 41 CAMBRIDGE L. J. (1982).
[27]Copal Research, *supra* note 22.
[28]*Id.*; See Richard Murphy, *Tax Research United Kingdom, The Duke of Westminster is Dead*, Aug. 10, 2012, https://www.taxresearch.org.uk/Blog/2012/08/10/the-duke-of-westminster-is-dead-long-live-the-duke-of-westminster/.
[29]*Id.*

out of context, the principle was followed as good law, until 1982 when the matter between *W.T Ramsay Ltd. v. I.R.C*[30] was examined before the House of Lords and led to the subsequent clarification to the Westminster Principle. This particular case, dealing with the question of the design of intermediary financial structures to willfully create a tax avoidance scheme, significantly contributed to the reduction of formalism in fiscal matters, as was later reiterated by Lord Steyn and Lord Cooke in the matter between *IRC v. McGuckian (1997)*.[31]

With the operation of what was a purposive interpretation of any commercial arrangement, it was in the opinion of the House of Lords that *"it is the task of the Court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions intended to operate as such, it is the series or combination which may be regarded"*.[32] As a result of such a line of judicial thinking, a significant impact was caused on several commercial arrangements, operating through the self-cancellation of transactions which had very little actual commercial or business rationale, apart from the overarching intention of tax avoidance. In fact, the judicial response to the Ramsay principle, as was observed subsequently in the matters of *IRC v. Burmah Shell* (1982),[33] as well as *Furniss vs. Dawson* (1984),[34] provided the Revenue with adequate scope to cast the taxation net on financial arrangements which had no real commercial substance. [35]

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[30]W.T Ramsay Ltd. v. I.R.C, (1982) AC 300 (House of Lords).
[31]IRC v. McGuckian, (1997) I W.L.R 991.
[32]Copal Research, *supra* note 22.
[33]IRC v. Burmah Shell, (1982) STC 30.
[34]Furniss v. Dawson, (1984) AC 474.
[35]Mihir Desai, *Foreign Direct Investment in a World of Multiple Taxes*, 88 J. PUBLIC ECON. (2004).

The judicial trend in India is one that followed a similar line of precedent, as did the United Kingdom. In the pre-Ramsay era, the Supreme Court endorsed the Westminster principle, as was observed in the 1968 decision of the court in the matter between *CIT v. A Raman*[36], whereby the Court held that "*avoidance of tax liability by so arranging commercial affairs that the charge of tax is distributed is not prohibited*", and the 1940 case of *Bank of Chettinad v. CIT,*[37] whereby the High Court at Bombay resorted to the opinion of Lord Cairns in the matter between *Partington vs. Attorney General*[38] (1869) to say that "*if the person sought to be taxed, comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be*".[39]

In the 1986 Supreme Court decision however, in the matter between *McDowell and Co. Ltd. vs. Commercial Tax Officer*[40], the legality of colorable devices to avoid the payment of taxes was held to be nil. The Court, relying heavily on the line of reasoning adopted in the matter between *C.I.T (Gujarat) vs. B.M Kharwar*,[41] reiterated that the *" if the parties have chosen to conceal by a device, the true legal relation resulting from the transaction, it is open to the taxing authorities to unravel the device. But the legal effect of the transaction cannot be displaced by probing into the substance of the transaction"*[42]. The legal position which emerges from the case is that

[36]CIT v. A Raman, (1968) 67 ITR 11 (SC).
[37]Bank of Chettinad v. CIT, (1940) 8 ITR 522 (SC).
[38]Partington v. Attorney General, (1869) LR 4 HL 100.
[39]Desai, *supra* note 35.
[40]McDowell and Co. Ltd. v. Commercial Tax Officer, (1986) 154 ITR 148 SC.
[41]C.I.T (Gujarat) v. B.M Kharwar, (1969) AIR 812.
[42]Partington, *supra* note 38.

unless the assessee had resorted to colorable devices to avoid the tax in question, the taxation net could not be cast on him/her (the Court observes that "*tax planning is legitimate provided that it is within the framework of the law. It is the duty of every citizen to pay the taxes honestly without resorting to subterfuges*". [43]

While the concurring opinion of Justice Chinappa Reddy expounded further on the *"dubious methods"*[44] often resorted to by taxpayers in the opinion of the Court, the general theme which emerges from his concurring opinion is that obtaining a tax benefit was impermissible unless it was explicitly bestowed by the law on the assessee. In fact, the words of the Judge, when he says that *"our normal meticulous methods of statutory construction tend to lead us astray by concentrating too much on verbal niceties and paying too little attention to the provision as a whole"*,[45] provide sufficient basis for a model of taxability examination which required the purposive interpretation of the statute, using not just the golden rule of interpretation, but also the mischief rule. [46]While one could possibly contend that the position of the Judge in this matter is not explicit by virtue of him stating that *"there is no equity in a tax"*,[47] (which naturally also implies the absence of equity from the point of view of the tax collector), a simpler position emerges when he goes to the extent of asking if *"the Ghost of Westminster should be allowed to rear its head in India"*. [48]

[43]*Id.*
[44]*Id.*; See the separate and concurring opinion of Reddy, J. at 38.
[45]*Id.*
[46]The mischief rule of legal interpretation involves the examination of the real intent of the lawmakers or law framers in a given set of facts and circumstances.
[47]Partington, *supra* note 38.
[48]*Id.*

IV. FROM MCDOWELL TO AZADI: CLARIFYING THE INDIAN POSITION ON "SUSPECT JURISDICTIONS" AND THE "GHOST OF WESTMINSTER"

As a result of the *McDowell* opinion, the discretionary authority granted to the Revenue expanded significantly, resulting in the incorporation of the judgment within the tax policies of the Government. The position of law in operation, therefore, was largely unsettled for a period of time before the validity of Circular 789 of the Central Board of Direct Taxes, issued on April 13, 2000, came into examination in the case of *Azadi Bachao Andolan vs. Union of India*.[49] There were two pivotal issues which were addressed in this case and which served as a clarification to the prevailing uncertainty about the demilitarization of the Revenue's aggressive taxation policies. Firstly, the Court, relying heavily on the line of examination followed by the Calcutta High Court in the matter between *CIT vs. Davy Ashmore*,[50] reiterated the stance of the Court where it had upheld the validity of Government Circular No. 333 of 1982. This circular, which stated that *"the correct legal position is that where a specific provision is made in the Double Taxation Avoidance Agreement, these provisions will prevail over the general provisions in the Income Tax Act, 1961"*,[51] provided a much needed judicial response to the concerns of the international business community, and their capital gains liability, especially in what the Chinese Revenue Authorities call *"suspect jurisdictions"*[52].

[49]Union of India v. Azadi Bachao Andolan & Anr., (2004) 10 SCC 1.
[50]CIT vs. Davy Ashmore, (1991) 190 ITR 626 Calcutta.
[51]*Id*.
[52]Chu, *supra* note 3.

As a result of this opinion, the earlier position of the Karnataka High Court in the case of *CIT v. R.M Muthaiah* was also explained to fit the income tax concerns which plague the Indian foreign investment structure at present[53]. As per the facts of this particular case, the question before the court was the over-riding nature of the Double Taxation Agreement entered into between the governments of India and Malaysia, with respect to the taxing power of the Income Tax Act, 1961. The response of the Court was one that was primarily investor friendly, stating that *"the agreement would take away the power of the Indian government to levy tax on the income in respect of certain categories as referred to in certain articles in the Agreement".* [54]In addition to the abovementioned case, mention is also found of the decision of the Federal Court of Australia in the matter between *Commissioner of Taxation vs. Lamesa Holdings,*[55] where the investigation was centered on the taxability of a Netherlands Company under the Australian Income Tax Act, which sold the shares in an Australian Company and was directed to pay taxes on the profits so earned. On further examination into the rule of law envisaged by Article 13 (Alienation of Property) of the DTAA, the Company was held not liable to pay tax within the Australian jurisdiction.[56]

In addition to this clarification that was much needed within the contextual framework of the prevailing uncertainty, the Court went on to observe its second most important holding in the case, when it upholds the Westminster principle, stating categorically that "*the reliance on Furniss, Ramsay and Burmah Oil by the respondents in support of their submission is to no avail*", although it had managed

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[53]CIT vs. R.M Muthaiah, (1993) 202 ITR 508 Karnataka.
[54]*Id.*
[55]See JOHN TILEY & GLEN L., ADVANCED TOPICS IN REVENUE LAW (Hart Publishing, 2013).
[56]*Id.*

to create "*a temporary turbulence*."[57] The final statements of the Court in which it says that despite having *"anxiously scanned"* the *McDowell* decision, it found no real legal basis for holding it as legally sound, sealed the validity of the Westminster Principle in India, with the Court saying that *"unless abrogated by an act of Parliament, we think that this legal principle would continue to hold good"*. [58]

V. LAYING OUT THE OPERATIONAL FRAMEWORK FOR THE INDIAN GAAR: "LOOK AT OR LOOK THROUGH"?

The *Azadi* decision was generally received well by the foreign investor community, especially in the context of those business giants which found it increasingly difficult to cope with the logistical and statutorily complex compliance structures in countries such as India or China.[59] However, although the Supreme Court decided to propound the spirit of a holistic judgment of complex international financial structures through the *"look at"* approach in the Vodafone tax dispute, the tussle between the judiciary and the legislature viz. indirect transfers continues to plague the minds of the international business community even today. Therefore, both *Azadi* and *Vodafone* mandated that unless the transaction in question was a sham when viewed holistically, the Revenue would have to allow such avoidance arrangements.[60] With the Revenue seeking to enforce the *"look*

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[57]Azadi, *supra* note 49.
[58]*Id.*
[59]Matthews George, *Use of the Corporate Vehicle for Tax Planning*, NUJS LAW REVIEW (2010); See K.R Girish, *Controlled Foreign Corporations-Is India Ready for this Tax Regime?* THE HINDU, Apr. 16, 2007.
[60]*Id.*

through" approach (and thereby cast a wider tax net) through the currently dormant GAAR Provisions, contained in Chapter 10 A of the Income Tax Act, the present case of *DIT v. Copal Research and Others*, raises complex difficulties for the full-fledged operation of the provisions of the GAAR in India.[61]

VI. THE "COLORABLE EXERCISE" SCRUTINY: IDENTIFYING THE "COMMERCIAL RATIONALE"

The High Court at Delhi, while examining the three Share Purchase Agreements in question, carries out a fairly detailed and articulate *"sham transaction/colorable exercise"* scrutiny, in order to ascertain whether or not the separate execution of the share purchase agreements, was designed specifically for the purposes of tax avoidance or whether there was sufficient business motive behind *that* particular structuring of the transaction. The liberal and investor friendly interpretation of the Court is well reflected when it observes that the simpliciter sales of Copal Jersey to the Moody Group would result in the Moody Group acquiring only 67% of the shares of both CRIL as well as Exevo U.S.A, which was contrary to the original business plan of acquiring 100% shareholding in the abovementioned Companies[62]. If one were to follow the fallacious reasoning of the Revenue, several problems would arise. First, 33% of the shares in Copal Jersey were held by banks and financial institutions and the simpliciter sales of these shares to the Moody Group would therefore

[61]Income Tax Act, 1961, No. 43, Acts of Parliament, 1961, (India), Chapter 10A.
[62]The argument that was accepted by the Court is that original business plan of acquiring complete interest in the downstream subsidiaries in India would not be possible through the U.S route, since interest of only 67% vested with the Copal Group shareholders. The rest 33% was held by banks and other financial institutions.

be to a maximum extent of only 67%[63]. Therefore, the only way for the Moody Group to acquire a 100% shareholding in CRIL and Exevo U.S.A (and therefore Exevo India) was through the execution of separate share purchase agreements, structured through the Mauritius route, since the selling Company was incorporated in Mauritius.

In fact, the suspicion raised by the Revenue surrounding the timing of these transactions, was also put to rest when the Court observes that the distribution of upstream dividend to the shareholders of CRIL and Exevo U.S.A wouldn't have been possible if separate agreements were not executed before the final share purchase transaction[64]. On the question of the timing of these transactions therefore, the Court upheld the validity of the actions of the assessees, contrary to the Revenue's contentions that SPA-1 and SPA-2 were executed one day prior to SPA-3 simply to (a) obtain the benefits of the Indo-Mauritius DTAA and therefore to avoid capital gains liability (b) that the entire transaction should be viewed in conjunction since the only real purpose of the transactions was a step by step transfer of interests to the Moody Group.

Secondly, by virtue of the application of both the Economic Substance Doctrine and the Step Transaction Doctrine (both implicitly borrowed from the American school of income tax jurisprudence and applied by the Court in this case[65]), the Court makes an examination of whether or not the Mauritius Companies were *"shell companies[66]"*, in order to determine the credibility of the Mauritius route and the Revenue's argument that the route was

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[63]See the full text of the judgment for a complete flowchart of the reasoning.
[64]From the text of the judgment.
[65]Philip Sancilio, *Clarifying the Notably Abstruse: Step Transactions, Economic Substance and the Tax Code*, COLUM. L. REV. (2013).
[66]A shell company is a vehicle for corporate transactions without individually having significant operations or assets.

resorted to only for purpose of obtaining a definite benefit under the India-Mauritius DTAA[67]. Having ascertained that both CRL as well as CMRL were operating financially through the provision of financial and market research services, with the aid of Category 1 Global Business Licenses, the Court held that there was sufficient evidence to retain the individual corporate identities of the entities in question (thereby satisfying the *"test of agency"* as stated in *New Horizon Ltd. v. Union of India* by the Supreme Court in 1995) Clearly, there was a definite *"commercial rationale"* behind the structure in question and the business objective that was sought to be obtained wouldn't have been possible through the route suggested by the Revenue. Further, as a result of the investment structure existing for a considerable period of time, the Revenue could not validly contend that the structure was devised solely for purposes of tax avoidance. [68]

VII. RESTRICTING THE TERRITORY OF ABUSIVE DISCRETION: EXAMINING SECTION 96 OF THE INCOME TAX ACT 1961

What is interesting to note, and what becomes pivotal to the Indian Revenue on multiple counts, is the manner of the examination of the Court, in applying what is primarily a New Zealand model of analysis. In addition to the general over-riding nature of Chapter 10 A, a closer examination of Section 96 (Impermissible Avoidance Arrangement) explains that an arrangement will be treated as impermissible if (a) the main purpose of the arrangement if to obtain a tax benefit and (b) the arrangement must fulfill one or more of the

[67]The India-Mauritius Double Taxation Avoidance Arrangement.
[68]Raman, *supra* note 36.

conditions laid down in Section 96(1) (a) to (d). Now, although the Draft guidelines specify that the burden of proof in both cases shall lie on the Revenue, the author contends that the subjective element within the text of Section 96 is fundamentally problematic for the investor community, for the reason explained below.

If the provisions of Section 96 are interpreted subjectively, there is always a possibility of the commercially motivated assessee also being dragged into the ambit of the GAAR, by virtue of the fact that (a) the meaning of *"main purpose"* can be very widely construed so as to lead to an abuse of discretion and (b) assuming that if an arrangement has both commercial as well as tax reasons, the GAAR must not be applicable, but which can very well happen by the current wording of Section 96, because of a very fine line between tax avoidance being the *main purpose* and the *ancillary purpose*. The High Court at Delhi in this case, implicitly applies the test of *"whether or not the transaction would have been entered into if not for the resultant tax benefit",* when it carries out the detailed analysis of the resultant business benefits from the simpliciter sale of shares of Copal Jersey.

By virtue of the Court observing that a 100% control couldn't be obtained by the Copal Group through a simpliciter sale of shares from Copal Jersey to the Moody Group, it becomes evident that although the capital gains tax liability through the Mauritius route was significantly low, the transaction would still have to be structured in the same manner for the 100 % control to exist. This particular mode of assessment, borrowed primarily from the two landmark New Zealand cases of *Challenge Corporation vs. Commissioner of Inland Revenue* (2007)[69] and *Peterson vs. Commissioner of Inland Revenue*

[69]Challenge Corporation vs. Commissioner of Inland Revenue, (2007) BCL 728 (C.A).

(2006)[70], significantly reduces the element of subjectivity in Section 96, which therefore reduces the scope of taxability and abused subjectivity by the Revenue. To put it simply, an inherent element of subjectivity exists within Section 96, especially because wide discretion is granted to the Revenue in ascertaining the *"main purpose"*[71] of the transaction. By adopting the jurisprudence emerging from New Zealand, and asking the question of whether the transaction would have been entered into *despite no tax advantage,* the Court in this case has reduced the scope of Section 96, by drastically reducing the subjective element. It is highly likely that this decision will tilt the balance in favour of *Sanofi Holdings*[72] in the pending Special Leave Petition in the Supreme Court, and shall restrict the scope of abusive discretion by the Revenue in future litigation.

Now, consider a situation where the Revenue seeks to cast the taxation net on the assessee, on the grounds that the transaction in question was structured through the Cayman Islands (very low capital gains tax). Irrespective of whether or not there was a valid commercial motive otherwise, the Revenue could still hold the assessee liable because it could possibly prove that the means used (the Cayman Islands route) was not *"bona fide"*[73] (read: designed to avoid tax), because of Section 96(1)(d). Now, the Court, by virtue of holding that the business motive existed independently of the Mauritius route and that the Mauritius route was a credible route from a commercial viewpoint, we may infer that a subsidiary arrangement structure was itself a part and parcel of having a valid *"commercial rationale"*. Therefore, even in a case where the Revenue sought to enforce the *bona fide* test as divorced from the *commercial rationale* test, it shall probably not be able to do so, considering that the

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[70]Peterson v. Commissioner of Inland Revenue, (2005) 22 NZ TC 19098 (PC).
[71]Income Tax Act, 1961, No. 43, Acts of Parliament, 1961, (India), § 96.
[72]Challenge, *supra* note 13.
[73]Income Tax Act, 1961, No. 43, Acts of Parliament, 1961, (India), § 96(1)(d).

purpose and the means of the particular transaction have been clubbed into only one model of examination, that is the *commercial rationale test*. As a result of this higher threshold, the taxing scope of the Revenue will significantly decrease, since using an international subsidiary route is also a part of having a *"commercial rationale"*.

VIII. CONCLUDING REMARKS: TOWARDS AN INVESTOR-FRIENDLY PARADIGM?

While the usage of corporate vehicles for purposes of tax planning shall carry sufficient uncertainty until the full-fledged operation of the GAAR provisions, judicial intervention in restricting the scope of abusive discretion marks an important liberal and pro-investor stand by the Courts in this country. The often used artificial distinctions used by the Revenue for purposes of a wider tax net, often prove detrimental to the interests of the country, especially in an inbound foreign investment market like India. The author, through the two primary submissions welcomes the decision of the High Court at Delhi, and contends that the well-reasoned decision shall give the Indian income tax jurisprudence a new face in the current legislative context of the GAAR. The method of examination adopted by the Court in the present instance is a reflection of the judicial intention of giving international transactions extra space within the regulated Indian market conditions and is an excellent sign for the inbound foreign investment market in India.