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[2016] 67 taxmann.com 310 (Mumbai - Trib.)

IT/ILT : Transaction which is on capital account, and from which no income/potential income arises, cannot come within purview of Indian Transfer Pricing provisions

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[2016] 67 taxmann.com 310 (Mumbai - Trib.)

IN THE ITAT MUMBAI BENCH 'K'

Topsgrup Electronic Systems Ltd.

v.

Income-tax Officer- 8(3)(3), Mumbai*

JASON P. BOAZ, ACCOUNTANT MEMBER
AND AMIT SHUKLA, JUDICIAL MEMBER
IT APPEAL NO. 2115 (MUM.) OF 2015
[ASSESSMENT YEAR 2009-10]
FEBRUARY 19, 2016

Section 92B, read with sections 92C and 2(24), of the Income-tax Act, 1961 and rule 10B of the Income-tax Rules, 1962 - Transfer pricing - International transaction - Meaning of (Conditions precedent) - Whether income arising from international transaction is a condition precedent for computing ALP and such income should be chargeable to tax under Act; in absence of such income, benchmarking of an international transaction and computing ALP thereof would not be in order -Held, yes - Whether, consequently, if an international transaction is on capital account and does not result in income as defined under section 2(24), provisions of Chapter X of Act would not be applicable to such transaction - Held, yes - Whether 'any income arising from an international transaction shall be computed having regard to Arm's Length Price' implies that potential income, if any, should arise from impugned international transaction which is before Transfer Pricing Officer for consideration and not out of a hypothetical international transaction which may or may not take place in future - Held, yes - Whether irrespective of nature of transaction under comparability whether inbound share investment or outbound share investment, comparison has to be with comparables and not with what options or choices were available to assessee for earning income or maximizing returns; thus, what is made applicable for inbound share investment would be equally applicable to outbound share investments also - Held, yes - Whether in absence of thin capitalization rules, debt capital could not be re-characterized as equity capital - Held, yes [Paras 7 to 8] [In favour of assessee]

FACTS

- The assessee, a part of the Topsgrup, engaged in the business of providing security services was incorporated to manufacture security equipment. However, since this business stopped, it started out activity of an investment/holding company. In order to expand its security business

on a global scale, it proposed to invest in a private company ('Shield') engaged in the business of providing security services. The assessee's holding company ('TSL') entered into an agreement with its investors, and a certain sum invested for acquisition of 'Shield'. Out of this amount of 'TSL' invested/subscribed to 12,46,010 shares of the assessee of face value of Rs. 10 plus premium of Rs. 990. The assessee invested in shares of Tops BV at the rate of Euro 2663.38 per share. It was further contended that above transactions, being on capital account, it did not result in any income nor was there any scope of earning any potential income arising out of this transaction. Thus, the aforesaid transaction was beyond TP regulations.

- The TPO observed that the AE (*viz*. Tops BV) got the huge premium due to its special relation with the assessee and the assessee had failed to establish that the AE was capable of raising funds, either by way of loan or share capital, on a standalone basis by itself. In the absence of this share premium, the AE would have had to take loans from the assessee or on open market which would entail it to pay huge interest costs. The AE, thus, got the funds by way of the above transfer by the assessee without being charged any interest thereon. Thus, according to the TPO, the premium was nothing but a loan given by the assessee to its AE (*viz*. Tops BV) in the garb of share premium.
- The TPO made addition on account of excess consideration paid and a further adjustment/addition being notional interest computed at the rate of 15 per cent on the aforesaid sum.
- Commissioner (Appeals) dismissed assessee's appeal.
- On appeal : the assessee submitted that, in the absence of income arising out of an international transaction, TP provisions did not apply and a transaction of investment in share capital could not be re-characterized as a loan.

HELD

As regards assessee's submission that in absence of income arising from an international transaction, TP provisions do not apply

- Income arising from the international transaction is a condition precedent for computing the ALP and such income should be chargeable to tax under the Act; in the absence of such income, benchmarking of an international transaction and computing ALP thereof would not be in order. Consequently, if an international transaction is on capital account and does not result in income as defined under section 2(24), the provisions of Chapter X of the Act would not be applicable to such transaction. [Para 7]
- The department was not able to establish that any income arose out of the assessee's transaction, *i.e.* of investment in the shares of its wholly owned subsidiary; however, they contended that there is a scope for effect on potential income arising from subsequent sale of these shares. [Para 7.1]
- The assessee pointed out that this averment made by the department was a new contention and line of argument that does not emanate from the points considered by the TPO/AO/CIT(A) in their orders and, therefore, in the light of the decision of the Special Bench of the Tribunal in the case of *Mahindra & Mahindra Ltd.* v. *Dy. CIT* [2009] 313 ITR (AT) 263 (Mum) (SB) this new argument/issue is not to be considered. There is force in the argument of the assessee on this issue. [Para 7.1.1]
- In any case the concept of potential income has been dealt with by the Bombay High Court in the case of *Vodafone India Services Pvt. Ltd.* v. *Union of India* [2014] 368 ITR 1/[2015] 228 Taxman 25/[2014] 50 taxmann.com 300 (Bom.) (Vodafone IV). [Para 7.1.2]
- It is self evident from the said decision that, potential income arising from a capital transaction

may be considered under Transfer Pricing provisions if it arises from out of the impugned transaction. The situations in which a capital transaction may have an impact on potential income are provided in said decision by way of instances such as interest on loan given or received or depreciation, *etc.* [Para 7.1.2]

- Further, a plain reading of section 92(1) which specifies that 'any income arising from an international transaction shall be computed having regard to the Arm's Length Price' implies that the potential income, if any, should arise from the impugned international transaction which is before the Transfer Pricing Officer for consideration and not out of a hypothetical international transaction which may or may not take place in future. Except for making a claim in this regard the Department was not able to establish that any income or potential income arose from the impugned transaction of the assessee's investment in acquiring the share capital of its wholly owned subsidiary. [Para 7.1.3]

- In respect of the contention of the Department that the decision of *Vodafone India Services (P.) Ltd.* (*supra*) was not applicable to the case on hand as it dealt with an inbound transaction and not an outbound transaction, the assessee submitted that the said decision had observed that it would be applicable to both inbound and outbound transaction. [Para 7.1.4]

- In these circumstances, the impugned transaction cannot be brought within the ambit of Indian Transfer Pricing provisions merely on the presumption that it may impact profits arising out of a subsequent transaction which may or may not be an international transaction. [Para 7.1.5]

- The differentiation sought to be made by the revenue between inbound investment in shares and outbound investment in shares for applicability of T.P provisions does not, find any support therein. It would also be appropriate in this regard to refer to Rules10B and 10C which indicate factors that ought to be taken into account for selection of the comparables, which necessarily include the contractual terms of the transaction and how the risks, benefits and responsibilities are to be decided. The conditions prevailing in the market in which the respective parties to the transactions operate, including the geographical location and the size of the markets, the laws and the Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition are all material and relevant aspects. If one keeps the aforesaid aspects in mind, it would be delusive to accept and agree that Transfer Pricing provisions/Rules cannot be different for inbound and outbound investment in shares. Such reasoning is not what Chapter X of the Act and Rules mandate or prescribe. The aforesaid provisions, do not make any such distinction. [Para 7.1.7]

- Therefore, irrespective of nature as to whether transaction under comparability is inbound share investment or outbound share investment, comparision has to be with comparables and not with what options or choices were available to assessee for carning income or maximizing return. Thus, what is made applicable for inbound share investment would be equally applicable to outbound share investments also. The parameters to be applied cannot be different for outbound investment and inbound investments. Therefore, the argument that different parameters would apply for inbound and outbound investments does not have any basis that emanate from the Transfer Pricing Rules.

- Thus, impugned transaction cannot come within perview of Indian transfer pricing provisions since the said transaction is on capital account from which no income/potential income. [Para 8.1.1]

Issue whether Transfer Pricing adjustments can yet be made if the impugned transaction of investment in equity share capital is re-characterized as a loan transaction and notional interest income is imputed to it and whether such a re-characterization is permissible under the existing legal provisions.

- In this regard, it must be stated that even assuming that such a re-characterization of the investment in equity share capital as a loan is permissible, the addition of that part of the equity

capital re-characterized as loan would not be possible, as the said loan cannot, by any stretch of imagination, be considered income of the assessee. The Department on being queried was not able to controvert this view. Hence, even if re-characterization is possible, the only addition permissible would be that of notional income in respect of the re-characterized loan. Therefore, in any event, the addition of Rs.124 crores being part of the investment in equity share capital, re-characterized as loan, stands deleted. [Para 8.1.2]

As regards question as to whether re-characterization of investment in equity share capital into loan is permissible under the Act.

- The assessee has placed material evidence on record to establish the *bona fide* of the impugned transaction. The assessee's balance sheet reflects the investment made as investment in equity shares which is also correspondingly reflected in the balance sheet of the investee company. The details of investment in equity shares were informed and submitted to the Reserve Bank of India. Further, even the agreement entered into between TSL (the holding company) and its investors provides for the proposed structure for acquisition of the Target company *i.e.* Shields Guarding Company, UK, wherein the assessee was to incorporate a wholly owned subsidiary in the Netherlands as an intermediate holding company. Therefore, even on the merits of the case, there is no reason to hold that the impugned transaction was in fact in the nature of a loan advanced and not an investment in share capital. The only ground taken by the Transfer Pricing Officer for recharacterization of the loan was that the value at which the investment was made was far in excess of the book value as determined under Schedule III of the Wealth Tax Act. Since shares are not covered under the definition of assets, there was no merit in applying the erstwhile Wealth Tax Valuation Rules to determine the Arm's Length Price of equity shares. [Para 8.3.1]

- In this view of the matter, it is held that the addition of notional interest on the share capital re-characterized as loan is not tenable. [Para 8.3.5]

- In view of said finding that there is no income/potential income arising to the assessee out of the impugned international transaction of investment in acquiring shares in its subsidiary, the same would not fall within the purview of Indian Transfer Pricing provisions. [Para 9.1.2]

- In the light of the facts and circumstances of the case as discussed above, the addition of made by the Transfer Pricing Officer/CIT(A) on account of alleged excess consideration paid and (ii) addition on account of notional interest computed at the rate of 15 per cent on the sum sought to be re-characterized as a loan was deleted. [Para 9.1.3]

CASE REVIEW

Vijai Electricals Ltd. v. *Addl. CIT* [2013] 60 SOT 77 (URO)/36 taxmann.com 386 (Hyd.); *Hill Country Properties Ltd.* v. *Addl. CIT* [2014] 48 taxmann.com 94 (Hyd.) (para 7.1.5); *DIT (International Taxations)* v. *Besix Kier Dahbol SA* [2012] 210 Taxman 151 (Mag.)/26 taxmann.com 169 (Bom.) (para 8.3.2); *Aegis Ltd.* v. *Addl. CIT* [IT Appeal No. 1213 (Mum) of 2014, dated 27-7-2015]; *Parle Biscuits (P.) Ltd.* v. *Dy. CIT* [2014] 46 taxmann.com 11 (Mum.); *Mylan Laboratories Ltd.* v. *Addl. CIT* [2014] 46 taxmann.com 76 (Hyd. - Trib.); *Prithvi Information Solutions Ltd.* v. *Asstt. CIT* [2014] 49 taxmann.com 176 (Hyd. - Trib) and *Tooltech Global Engineering (P.) Ltd.* v. *Dy. CIT* [2014] 51 taxmann.com 336 (Pune - Trib) (para 8.3.2) *followed*.

CASES REFERRED TO

Vodafone India Services (P.) Ltd. v. *Union of India* [2014] 368 ITR 1/[2015] 228 Taxman 25/[2014] 50 taxmann.com 300 (Bom.) (para 5.5), *Shell India Markets (P.) Ltd.* v. *Asstt. CIT* [2014] 369 ITR 516/[2015] 228 Taxman 99/[2014] 51 taxmann.com 519 (Bom.) (para 5.5), *Vijai Electricals Ltd.* v. *Addl. CIT* [2013] 60 SOT 77 (URO)/36 taxmann.com 386 (Hyd.) (para 5.5), *Hill Country Properties Ltd.* v. *Addl. CIT* [2014] 48 taxmann.com 94 (Hyd.) (para 5.5), *Equinox Business Parks*

(P.) Ltd. v. *Union of India* [2015] 230 Taxman 191/55 taxmann.com 222 (Bom.) (para 6.1.2), *S.G. Asia Holdings (India) (P.) Ltd.* v. *Dy. CIT* [2015] 229 Taxman 452/54 taxmann.com 376 (Bom.) (para 6.1.2), *DIT (International Taxation)* v. *Besix Kier Dahbol SA* [2012] 210 Taxman 151 (Mag.)/26 taxmann.com 169 (Bom.) (para 6.2.1), *Aegis Ltd.* v. *Addl. CIT* [IT Appeal No. 1213 (Mum.) of 2014, dated 27-7-2015] (para 6.2.1), *Parle Biscuits (P.) Ltd.* v. *Dy. CIT* [2014] 46 taxmann.com 11 (Mum.) (para 6.2.1), *Mylan Laboratories Ltd.* v. *Addl. CIT* [2014] 46 taxmann.com 76 (Hyd. - Trib.) (para 6.2.1), *Allcargo Global Logistics Ltd.* v. *Asstt. CIT* [2014] 150 ITD 651/47 taxmann.com 188 (Mum.) (para 6.2.1), *Prithvi Information Solutions Ltd.* v. *Asstt. CIT* [2014] 49 taxmann.com 176 (Hyd. - Trib) (para 6.2.1), *Tooltech Global Engg. (P.) Ltd.* v. *Dy. CIT* [2014] 51 taxmann.com 336 (Pune) (para 6.2.1), *Vodafone India Services (P.) Ltd.* v. *Union of India* [2014] 361 ITR 531/221 Taxman 116/[2013] 39 taxmann.com 201 (Bom.) (para 6.3.1), *PMP Auto Components* v. *Dy. CIT* [2014] 50 taxmann.com 272/66 SOT 42 (URO) (Mum.) (para 6.3.1), *Mahindra & Mahindra Ltd.* v. *Dy. CIT* [2009] 313 ITR (AT) 263 (Mum.) (SB) (para 6.4), *CIT* v. *EKL Appliances Ltd.* [2012] 24 taxmann.com 199/209 Taxman 200/345 ITR 241 (Delhi) (para 6.5), *Ascendas (India) (P.) Ltd.* v. *Dy. CIT* [2013] 33 taxmann.com 295/143 ITD 208 (Chennai) (para 6.5.2) and *Dana Corporation,* In re [2010] 321 ITR 178/186 Taxman 187 (AAR - New Delhi) (para 6.5.6).

S.M. Lala *for the Appellant.* **Mukesh Kumar Shah** *for the Respondent.*

ORDER

Jason P. Boaz, Accountant Member - This appeal by the assessee is directed against the order of the CIT(A)- 58, Mumbai dated 02.01.2015 for A.Y. 2009-10.

2. The facts of the case, briefly, are as under: —

2.1 The assessee company, a wholly owned subsidiary of the Tops Securities Ltd. (TSL) is engaged in the business of providing security services. For A.Y. 2009-10, the assessee filed its return of income on 23.09.2009 declaring total income of Rs.3,65,280/-. The case was selected for scrutiny. The Assessing Officer ('AO') made a reference under section 92CA of the Income Tax Act, 1961 (in short 'the Act') to the Transfer Pricing Officer ('TPO') for determining the arms length price ('ALP') of the reported international transactions entered into by the assessee with its Associated Enterprises ('AE'), after obtaining the approval of the Commissioner of Income Tax - 8, Mumbai. The TPO passed an order under section 92CA of the Act dated 31.12.2012 proposing an adjustment of Rs.142,80,14,163/- towards the ALP of the international transactions the assessee entered into with its AE in the period relevant to A.Y. 2009-10, which are as under: —

(i)	Loan to THBV	Rs. 1,366/-
(*ii*)	Subscription to Share Capital to AE	Rs.1,42,80,12,797/-
		Rs.1,42,80,14,163/-

The AO completed the assessment for A.Y. 2009-10 under section 143(3) r.w.s. 144C of the Act vide order dated 09.05.2013.

2.2 Aggrieved by the order of assessment for A.Y. 2009-10 dated 09.05.2013, the assessee preferred an appeal before the CIT(A)-58, Mumbai. The learned CIT(A) dismissed assessee's appeal vide order dated 02.01.2015.

3. Aggrieved by the order of the CIT(A)-58, Mumbai dated 02.01.2015 for A.Y. 2009-10, the assessee has preferred this appeal before the Tribunal raising the following grounds: —

> "1. The learned Commissioner of Income Tax (Appeals) erred in facts and law in not holding the reference made by the learned Assessing Officer u/s. 92CA(1) as being without jurisdiction and bad in law, and as a consequence of which the order passed u/s. 143(3) r.w.s. 144C is also erroneous, suffers from legal infirmity and is thus bad in law.

2. (*a*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in sustaining the action of the learned Assessing Officer! Transfer Pricing Officer in making an addition of Rs. 1,366/- by benchmarking the interest on loan to Associated Enterprises at Prime Lending Rate of 12% pa plus 3% markup towards risk factors—as against 13% p.a. offered by the appellant.

(*b*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in not appreciating that the 13% p.a. offered on the foreign currency (Euro) loan given to the Associated Enterprise, being wholly owned subsidiary, is more than the average Prime Lending Rate g 12% p.a. and even the LIBOR rate of 5.54% p.a., pursuant to which no adjustment in Arm's Length Price is warranted.

3.(*a*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in sustaining the action of the learned Assessing Officer/Transfer Pricing Officer in making an addition of Rs. 1,24,17,50,258/-, by way of adjustment on account of re- characterisation of the investment in shares issued at premium by wholly owned subsidiary outside India as interest free loan given to the Associated Enterprise.

(*b*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in not appreciating the commercial expediency of the investment transaction and that there is no charge on application of funds by the appellant.

(*c*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in appreciating that no addition could be made under any provisions of the Income-tax Act, 1961 in respect of investments made out of own explained funds in absence of any specific charging provisions for making such an addition.

(*d*) The learned Commissioner of Income Tax (Appeals) erred in fact and law in appreciating that the no adjustment can made by the Transfer Pricing Officer by re-characterising a part of investment into loan without application of any of the prescribed methods for determination of arms-length price and that the adjustment made by the learned Transfer Pricing Officer without applying any of the prescribed methods is therefore bad-in-law.

(*e*) The learned Commissioner of Income Tax (Appeals) erred in fact and law in appreciating that the value of investment in the Associated Enterprise, being wholly owned subsidiary, was made based on the value of underlying assets to be acquired by the said Associated Enterprise.

4. (*a*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in appreciating that no notional interest can be brought to charge by re-characterisation of investment, by holding a part of it to be loan.

(*b*) The learned Commissioner of Income Tax (Appeals) erred in facts and law in sustaining the action of the learned Assessing Officer/ Transfer Pricing Officer in making an adjustment of Rs. 18,62,62,539 as notional interest income @ 15% p.a. without adopting any of the prescribed method for deriving at Arm's length rate and not appreciating that there is no charging provision in the Income-tax Act, 1961 to bring to charge such notional interest.

5. The Appellant prays that:—

i. The reference made u/s.92CA and consequentially the order passed u/s. 143(3) r.w.s 144C be treated as being without jurisdiction, invalid and bad in law;

ii. Addition of interest of Rs. 1,366/- by adoption of PLR @ 15% p.a. be deleted and the adjustment made by the appellant be upheld;

iii. Addition of Rs. I,24,17,50,258/- on account of re-characterisation of share capital into interest-free loan be deleted;

iv. Addition of notional interest of Rs. 18,62,62,539/- @ 15% on construing share

investment as interest-free loan be deleted;

v. Any other relief, as may be deemed fit in the matter, be granted.

6. The grounds of appeal raised are without prejudice to one another.

7. The appellant craves leave to add, amend, alter or delete any or all the grounds of appeal."

4. Grounds at Sr. Nos. 1, 2, 5, 6 and 7

4.1 At the outset, the learned A.R. for the assessee submitted that the grounds at Sr. Nos. 1 and 2 (for smallness of the amount involved) are not being pressed in this appeal. Since these grounds are not pressed, they are rendered infructuous and are accordingly dismissed as infructuous.

4.2 The grounds at Sr. Nos. 6 and 7 are general in nature and therefore no separate adjudication is called for thereon.

4.3 Ground No. 5 is the prayer of the assessee in this appeal. This ground will automatically get addressed when this appeal is disposed off.

Grounds at S.Nos. 3(a) to (e) and 4(a) & (b) - Transfer Pricing Issues

5. The facts of the case on these issues as emanate from the record are, briefly, as under: —

5.1 The assessee, a part of the Topsgrup, engaged in the business of providing security services was incorporated to manufacture security equipment. However, since this business stopped, it is carrying on the activity of an investment/holding company. In order to expand its security business on a global scale, the Topsgrup proposed to invest in Shield Guarding Company Ltd., U.K. ('Shield'), a private company engaged in the business of providing security services. Towards this end, the assessee's holding company 'TSL' entered into an agreement dated 18.07.2007 with its investors, viz. India Advantage Fund & Indivision who jointly invested Rs.140 crores for acquisition of 'Shield'. Out of this amount of Rs.140 crores, 'TSL' invested/subscribed to 12,46,010 shares of the assessee of face value of Rs.10/- plus premium of Rs.990/-; resulting in investment of Rs.124,60,14,673/-).

5.2 The money of Rs.124,60,14,673/- received by the assessee from 'TSL' was invested by acquiring 7200 shares @ Euro 2,663.38 per share during the period under consideration (i.e. A.Y. 2009-10) in Tops BV Netherlands, a wholly owned subsidiary, which was to be an intermediate holding company to acquire 'Shield'. The money received by Tops BV Netherlands was further invested towards acquisition of 'Shield'. The structure of the Topsgrup group of companies for acquisition of 'Shield' is given as under: —

- TSL is the Holding Company;
- TESL, the assessee, is a wholly owned subsidiary of TSL;
- Tops BV is a 100% subsidiary of the assessee'
- Tops UK is a 100% subsidiary of Tops BV;
- 'Shield' is the target for acquisition.

5.3 It has been submitted by the assessee that while the investment in acquisition of shares of 'Tops BV' formed part of the notes in Form 3CEB, the same was not benchmarked as the assessee was of the view that the subscription to equity capital did not have any bearing on profitability, TP regulations were not applicable. It was further submitted that the recharacterization of this transaction as a loan was not permissible, as this was not in accordance with the provisions of the Act.

5.4 It is seen from the TPO's order under section 92CA(3) of the Act, where he has held that as per the amended provisions of section 92CA(2), transactions of capital financing have all along been

international transactions. The TPO observed that the AE (viz. Tops BV) got the huge premium due to its special relation with the assessee and the assessee had failed to establish that the AE was capable of raising funds, either by way of loan or share capital, on a standalone basis by itself. In the absence of this share premium, the AE would have had to take loans from the assessee or on open market which would entail it to pay huge interest costs. The AE thus got the funds by way of the above transfer by the assessee without being charged any interest thereon. Thus, according to the TPO, the premium was nothing but a loan given by the assessee to its AE (vis. Tops BV) in the garb of share premium. The TPO then proceeded to compute the book value per share on the basis of Schedule III of the Wealth Tax Act, 1957 and accordingly made an addition of Rs.124,17,50,258/-. In doing so, the TPO considered the number of shares at 72000 instead of 7200, the share premium at Euro 266.3 as against Euro 2663 and book value at Euro 0.428 instead of Euro 4.28. The TPO made a further adjustment/ addition of Rs.18,62,62,539/- being notional interest computed @15% on the aforesaid sum of Rs.124,17,50,258/-.

5.5 On appeal before the learned CIT(A), the assessee placed reliance on the following judicial decisions in support of the propositions put forth that, (i) TP provisions would not be applicable to capital transactions due to the absence of the income element therein; and (ii) recharacterisation of investment into loan was not possible: —

(*i*) Vodafone India Services (P.) Ltd. v. Union of India [2014] 368 ITR 1/[2015] 228 Taxman 25/[2014] 50 taxmann.com 300 (Bom.)

(*ii*) *Shell India Markets (P.) Ltd.* v. *Asstt. CIT* [2014] 369 ITR 516/[2015] 228 Taxman 99/[2014] 51 taxmann.com 519 (Bom.)

(*iii*) *Vijai Electricals Ltd.* v. *Addl. CIT* [2013] 60 SOT 77 (URO)/36 taxmann.com 386 (Hyd.)

(*iv*) *Hill Country Properties Ltd.* v. *Addl. CIT* [2014] 48 taxmann.com 94 (Hyd.).

The learned CIT(A) was of the view that the ratio of the Hon'ble Bombay High Court judgements do not apply to the assessee in the case on hand as they pertained to inbound transactions i.e. where the assessee received the amount on issue of shares, whereas the transaction of the assessee in the case on hand pertained to an outbound transaction.

6. Before us, the learned A.R. for the assessee put forth submissions, arguments and contentions on this issue on two propositions as under:—

(*i*) That in the absence of income arising out of an international transaction, TP provisions do not apply; and

(*ii*) That a transaction of investment in share capital could not be re- characterized as a loan.

6.1.1 The assessee's first submission is that in the absence of income arising from an international transaction, TP provisions do not apply. It was submitted that the assessee invested /subscribed to 7200 shares of Tops BV @ Euro 2663.38 per share (Euro 10 plus share premium - Euro 2653.38). It was further contended that as is evident from the above transactions, being on capital account, it did not result in any income nor was there any scope of earning any potential income arising out of this transaction. Thus, it was submitted that the aforesaid transaction is beyond TP regulations. Chapter X of the Act, dealing with TP provisions, commences with section 92(1) of the Act which provides that "Any income arising from an international transaction shall be computed having regard to the arms length price". In this regard it was submitted that the income arising from an international transaction is a condition precedent for the benchmarking of an international transaction. Therefore, firstly, there should be income; and secondly, income should arise from the international transaction. In the absence of these two conditions, the TP provisions do not apply.

6.1.2 The subject matter of dispute is with regard to the investment by the assessee in acquiring the shares in Tops VB, Netherlands. It was submitted by the assessee that while this transaction is admittedly an international transaction under section 92B of the Act, however no income has arisen

out of this transaction. Therefore, the learned A.R. for the assessee submitted that in the absence of income, this transaction is not required to be benchmarked and the same is beyond the scope of TP provisions in India. In this context, the learned A.R. for the assessee placed reliance on the following judicial pronouncements:—

(*i*) *Vodafone India Services (P.) Ltd.* (*supra*), particular reference was drawn to the findings in the order at the following paragraphs:—

"24. A plain reading of section 92(1) of the Act very clearly brings out that income arising from a International Transaction is a condition precedent for application of Chapter X of the Act ….

25. …… The word income for the purpose of the Act has a full understood meaning as defined in Section 2(24) of the Act. This even when the definition in Section 2(24) of the Act is an inclusive definition. It cannot be disputed that income will not in its normal meaning include capital receipts unless it is so specified, as in Section 2(24)(vi) of the Act. In such a case, Capital Gains chargeable to tax under Section 45 of the Act are, defined to be income. The amounts received on issue of share capital including the premium are undoubtedly on capital account. Share premium have been made taxable by a legal fiction under section 56(2)(viib) or the Act and the same is enumerated as Income in Section 2(24)(xvi) of the Act. However, what is bought into the ambit of income is the premium received from a resident in excess of the fair market value of the shares. In this case what is being sought to be taxed is capital not received from a non-resident i.e. premium allegedly not received on application of ALP. Therefore absent express legislation, no amount received, accrued or arising on capital account transaction can be subjected to tax as Income. This is settled by the decision of this Court in *Cadell Weaving Mill Co.* v. *CIT* 249 ITR 265 was upheld by the Apex Court in *CIT* v. *D.P. Sandu Bros, Chember (P) Ltd.* 273 ITR 1. …..

42. ….. As pointed out above, the issue of shares at a premium is on Capital Account and gives rise to no income. The submission on behalf the revenue that the shortfall in ALP as computed for the purposes of Chapter X of the Act gives rise to income is misplaced. The ALP is meant to determine the real value of the transaction entered into between AEs. It is a re-computation exercise to be carried out only when income arises in case of an International Transaction between AEs. It does not warrant re-computation of a consideration taken/given on capital account. .

49. …… Thus no, occasion to apply Chapter X of the Act can arise in such a case."

(*ii*) *Shell India Markets (P) Ltd.* (*supra*) wherein it was held at para 12 thereof that

" …….. the jurisdiction to apply Chapter X of the Act would occasion only when income arises out of International Transaction and such income is chargeable to tax under the Act. …… "

(*iii*) *Equinox Business Parks (P) Ltd.* v. *Union of India* [2015] 230 Taxman 191/55 taxmann.com 222 (Bom.) wherein at para 8 thereof it was observed that:—

"8. ……….

3.4. We find that the issue under consideration of applying Transfer Pricing Provisions on 'issue of shares' has been decided in favour of the assessee by the Hon'ble Bombay High Court in the case of M/s Vodafone India Services Private Limited in Writ Petition number 871 of 2014 dated 10th October 2014. ……..

Therefore, such capital account transaction not falling within a statutory exception cannot be brought to tax. Even income arising from international Transaction between

AE must satisfy the test of income under the Act and must find its home in one of the above heads i.e. charging provisions. There is no charging section in Chapter X of the act. Only if there is income which is chargeable to tax under the normal provisions of the act, then alone chapter X of the act could be invoked. Further, since there is no income arising from the transaction of issue of shares, the provisions of chapter X would not apply. …………"

(*iv*) *S.G. Asia Holdings (India) (P) Ltd.* v. *Dy. CIT* [2015] 229 Taxman 452/54 taxmann.com 376 (Bom.), wherein the Hon'ble Court followed the decision in the case of *Vodafone India Services P. Ltd.* (*supra*).

6.1.3 Ld. Counsel further submitted that though the aforesaid judgements pertain to inbound transactions, i.e. receipt of share capital and share premium on account of issue of shares, but they are applicable in the instant case of the assessee also which is for an outbound investment in the equity share capital of its subsidiary. It was argued by him that in the decision of *Vodafone India Services P. Ltd.* (*supra*), at para 42 thereof, the Hon'ble Bombay High Court laid down the ratio that the ALP in transaction between AEs is to be determined under TP provisions only in the event of occurrence of income. It is a re-computation exercise to be carried out only when income arises in case of an international transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account. It was submitted that in view of the above, the ratio laid down therein by the Hon'ble Court is applicable to both inbound and outbound transactions.

6.1.4 The learned A.R. for the assessee submitted that in any event the provisions of section 56(2)(viia) and 56(2)(viib) of the Act do not bring to tax transactions such as payment of excess premium or shortfall in receipt of share premium. It was argued that the case of the assessee does not fall under section 56(2)(viia) as the consideration paid for the shares is alleged to be excessive as compared to the fair market value which is the opposite scenario of what section 56(2)(viia) envisages. It is argued that the same also does not fall within the ambit of the provisions of section 56(2)(viib) of the Act as this section covers the issue of shares, whereas the assessee has made an investment in shares. It is contended that in the above circumstances, Indian TP provisions are not applicable either to Vodafone India Services P. Ltd. or to the assessee.

6.1.5 The learned A.R. for the assessee further submits that without prejudice to the assessee's above submissions, the ITAT, Hyderabad Bench in the following cases, covering the issue of outbound investment in equity shares of an AE, has held that since no income arises from investment in equity share capital, the said transactions are beyond the scope of Indian TP provisions:—

(*i*) Vijai Electrical Ltd. (*supra*).

(*ii*) Hill Country Properties Ltd. (*supra*).

In respect of the decision in the case of *Vijai Electricals Ltd.* (*supra*), the learned A.R. for the assessee submits that the CIT noticed that during the year under consideration, the assessee had invested certain amounts in its subsidiaries outside India. The learned CIT in revision proceedings under section 263 of the Act was of the view that these are international transactions as per section 92B of the Act. Since the AO had completed the assessment without referring those transactions to the TPO for determination of the ALP thereof, the CIT passed an order under section 263 setting aside the assessment. It is submitted that the Tribunal observed from the records that the assessee company had invested amounts in the share capital of subsidiaries outside India and was the view that since these transactions were not in the nature of transactions referred to under section 92B of the Act, TP provisions were not applicable. The relevant portions of the Tribunal's order, brought to the notice of the Bench, at paras 8 to 10 thereof is extracted hereunder:—

'8. The learned counsel relied upon the decision in the case of Dana Corporation RE, 321 ITR 178 (AAR) wherein it has been held as follows:

"Section 92 is not an independent charging provision. The expression 'income arising' in the opening words of section 92 postulates that income has arisen under the substantive charging provisions of the Act. If by application of the provisions of section 45 read with section 48, which are integrally connected one with the other, income cannot be said to arise, section 92 does not come to the aid of the Revenue even though it is an international transaction. Section 92 obviously is not intended to bring in a new head of income or to charge tax on income which is not otherwise chargeable under the Act."

9. The learned counsel also relied upon the decision in the case of *Amiantit International Holding Ltd.*, 322 ITR 678 (AAR) wherein it was held that in a case where income was not chargeable at all transfer pricing provisions of section 92-B(i) of the IT Act would not apply.

9.1 The learned DR, on the other hand relied upon the decision ITAT Mumbai Bench "B" in the case of *Board of Control for Cricket in India* v. *DIT (Exemption)*, [2005] 96 ITD 263 (Mum) wherein it was held that 'the said order did not show that the AO had considered or applied his mind to the factual and legal aspects of the case. It was a stereotyped order which simply accepted what the assessee stated in its application without proper examination of the factual and legal aspects of the case. An order may be rendered erroneous due to error in approach, error in computation, error in applying the relevant law or facts or error in selecting a principle which would not govern the fact situation. Likewise, arbitrary exercise of quasi-judicial power without due consideration of the relevant aspects of the case would also render the resultant order erroneous within the meaning of 7 ITA NO. 842/Hyd/2012 M/s Vijai Electricals Ltd. section 263. In this view of the matter, the submissions of the assessee that the order passed by the AO u/s 195(2) was not erroneous within the meaning of section 263 could not be upheld. The said order was an erroneous order capable of being revised u/s 195(2) provided other conditions of section 263 were also fulfilled.' The learned DR also relied upon in the case of *CIT* v. *Sri Mahasastha Pictures*, [2003] 263 ITR 304/127 Taxman 162 (Mad.).

10. We have considered the rival submissions, perused the record and have gone through the orders of the authorities below as well as decisions cited. In our opinion, the amount representing 2118.84 is towards investment in share capital of the subsidiaries outside India as the transactions are not in the nature of transactions referred to section 92-B of the IT Act and the transfer pricing provisions are not applicable as there is no income. Accordingly, we set aside the order passed by the CIT u/s 263 and that of the AO is restored and the grounds raised by the assessee in this regard are allowed.'

The learned A.R. for the assessee also drew the attention of the Bench to the findings of the ITAT, Hyderabad Bench in the case of *Hill Country Properties Ltd.* (*supra*) wherein at paras 70.1, 72 and 72.1 it was held as under:—

'70.1 Assessee objecting to the proposed addition before DRP contended that the investment of the said amount was by way of share application money and is not an international transaction and has the approval of the RBI as being share application money and has been sent through banking channels. It is further contended that it is in the nature of equity in the hands of subsidiary and that there is no provision in the Act empowering the TPO to re-characterize an investment in the form of equity as a debt. DRP held that this contention cannot be accepted and the TPO has already considered all the objections at Para-8 of the TP order. ……..

70.2 ………..

…………….

70.5 ………….

71. ………….

72. We have heard both the parties, perused the record and have gone through the orders of the authorities below. Similar issue came up for consideration before this Tribunal in the case of

Vijai Electricals Ltd. v. *Addl. CIT* [2013] 60 SOT 77/36 taxmann.com 386 (Hyd) wherein it has been held as follows:

"10. We have considered the rival submissions, perused the record and have gone through the orders of the authorities as well as decisions cited. In our opinion, the amount representing Rs.2118.84 crores is towards investment in share capital of the subsidiaries outside India as the transactions are not in the nature of transactions referred to section 92-B of the IT Act and the transfer pricing provisions are not applicable as there is no income. Accordingly, we set aside the order passed by the CIT u/s 263 and that of the AO is restored and the grounds raised by the assessee in this regard are allowed.'

72.1 In view of the above, in our opinion impugned transaction cannot be considered u/s 92CA of the I.T. Act and accordingly, this ground is allowed."

The learned A.R. for the assessee submits that in view of the findings rendered by the ITAT, Hyderabad Bench in the aforesaid cases (*supra*) on similar facts as those in the case on hand, as the international transactions of investing/subscribing in the equity capital of a foreign subsidiary does not result in any income, the same is outside the purview of Indian T.P. regulations.

6.2 The assessee's second line of argument is that a transaction of investment in share capital cannot be re-characterised as a loan. The learned A.R. for the assessee submits that the Balance Sheet of the assessee for this relevant period (placed at pages 29 and 34 of the Paper Book) clearly shows that the investment made was in equity shares of the subsidiary, which is correspondingly reflected in the Balance Sheet of the subsidiary investee company (at pages 292 and 296 of the Paper Book). It is further submitted that the details of investment in equity shares were submitted and duly approved by the RBI. Even the agreement entered into between TSL (Holding company) and its investors clearly provides for the proposed structure for the acquisition of the Target company whereby the assessee was to set up a wholly owned subsidiary in the Netherlands as an intermediary company.

6.2.1 Alternatively, without prejudice to the above contentions, the learned A.R. for the assessee submits that the TPO/CIT(A) is not empowered to re-characterise the investment made by the assessee in Tops BV, Netherlands into an interest free loan and consequent thereto to make an addition of the said alleged loan and make a further addition of notional interest income therefrom which was not earned by the assessee. It was argued that the Act does not permit re-characterisation of equity into loan or for that matter loan to equity. It was also contended that the TPO cannot question the commercial expediency of the transaction. In support of the above proposition put forth, the learned A.R. for the assessee placed reliance on the following judicial pronouncements, referring to the relevant portions thereof:—

(*i*) *DIT (International Taxation)* v. *Besix Kier Dahbol SA* [2012] 210 Taxman 151 (Mag.)/26 taxmann.com 169 (Bom.)

(*ii*) *Aegis Ltd.* v. *Addl. CIT* [IT Appeal No. 1213 (Mum.) of 2014, dated 27-7-2015]

(*iii*) *Parle Biscuits (P.) Ltd.* v. *Dy. CIT* [2014] 46 taxmann.com 11 (Mum.)

(*iv*) *Mylan Laboratories Ltd.* v. *Addl. CIT* [2014] 46 taxmann.com 76 (Hyd. - Trib.)

(*v*) *Allcargo Global Logistics Ltd.* v. *Asstt. CIT* [2014] 150 ITD 651/47 taxmann.com 188 (Mum.)

(*vi*) *Prithvi Information Solutions Ltd. v .Asstt. CIT* [2014] 49 taxmann.com 176 (Hyd. - Trib)

(*vii*) *Tooltech Global Engg. (P.) Ltd.* v. *Dy. CIT* [2014] 51 taxmann.com 336 (Pune)

6.2.2 The learned A.R. for the assessee drew the attention of the Bench to the relevant portions of the decisions cited (supra) which are extracted hereunder:—

(*i*) *Besix Kier Dahbol SA* (*supra*) In this case the question before the court was:—

"(*i*) Whether on the facts and circumstances of the case and in law the Tribunal was right in holding that in the absence of any specific thin capitalization rules in India, the Assessing Officer cannot disallow the interest payment on debt capital after having observed the abnormal thin capitalization ratio of 248:1?"

In this regard it was submitted that the Hon'ble Court held as under at paras 4 to 8 of its order:—

"(4) The respondent-assessee is a company incorporated under the laws of Belgium. The sole business of the respondent-assessee is to carry out the project of construction of fuel jetty near Dabhol in India.

The respondent-assessee had fully paid capital of 25.00 lacs (Belgium Francs) divided into 2500 shares of 1000 Belgium Francs each. This equity capital was divided in the ratio of 60:40 between the two joint venture partners N V Besix SA, Belgium and Kier International (Investment) Limited of U.K. The respondent assessee also borrowed from its shareholders in the same ratio as the equity share holding amount of Rs.57.09 crores from N.A. Basix SA and Rs.37.01 crores from Kier International Investment Limited. In the circumstances, the respondent had equity capital of Rs. 38.00 lacs and debt capital of Rs.9410 lacs. Thus, debt equity ratio worked out is to 248:1.

(5) The respondent assessee paid interest of Rs. 5.73 crores on the aforesaid borrowing of Rs.57.09 crores and Rs.37.01 crores from NV Basix SA and Kier International (Investments) Limited respectively. However, the Assessing Officer disallowed the payment of interest in view of the Reserve Bank of India's approval letter dated 3/11/1998 granting approval to the assessee to do business in India. The approval letter dated 03/11/1998 specifically provided that India Branch Office will not borrow or lend from/to any person in India without specific permission of the Reserve bank of India. The Assessing officer further observed that in view of India Belgium Double Taxation Avoidance Agreement interest on monies paid by the Head Office to the branches was not allowable as a deduction.

(6) In appeal, the Commissioner of Income Tax (Appeals) by an order dated 29/3/2007 upheld the order of the Assessing officer and disallowed the deduction on account of interest of Rs.5.73 crores paid to Joint Venture Partners. The Commissioner of Income Tax (Appeals) held that Article 7(3)(b) of the Double Taxation Avoidance Agreement forbids allowance of any interest paid to the head office by permanent establishment in India as a deduction. Further, the payment of interest also directly violates the conditions imposed by RBI in its letter dated 3/11/1998. Therefore, the order of the Assessing Officer was upheld.

(7) However, the Tribunal allowed the respondent-assessee's appeal. During the course of the proceedings before the Tribunal the revenue contended that the borrowings on which the interest has been claimed as a deduction are in fact capital of the assessee and brought only under the nomenclature of loan for tax consideration. It was the case of the appellant-revenue before the Tribunal that debt capital is required to be re-characterized as equity capital. However, the Tribunal held that in India as the law stands there were no rules with regard to thin capitalization so as to consider debt as an equity. It is only in the proposed Direct Tax Code Bill of 2010 that as a part of the General Anti Avoidance Rules it is proposed to introduce a provision by which a arrangement may be declared as an impermissible avoidance arrangement and may be determined by recharactersing any equity into debt or vice versa.

(8) We find no fault with the above observations of the Tribunal. There were at the

relevant time and even today no thin capitalization rules in force. Consequently, the interest payment on debt capital cannot be disallowed. In view of the above, the question (i) raises no substantial question of law and is therefore, dismissed."

(*ii*) *Aegis Ltd.* (*supra*) : It is submitted that the relevant findings in this case at para 27 is as under:—

"27. We have heard the rival submissions and also perused the relevant findings in this regard in the impugned orders. The assessee has subscribed to redeemable preference shares of its AE, Essar Services, Mauritius and has also redeemed some of these shares at par. The TPO has redeemed some of these shares at par. The TPO has re-characterized the said transaction of subscription of shares into advancing of unsecured loan by terming it as an exceptional circumstance and has charged/imputed interest, on the reasoning that in an uncontrolled third party situation, interest would have been charged. We are unable to appreciate such an approach of TPO and under what circumstances, leave above any exceptional circumstances, a transaction of subscription of shares can be re-characterized as Loan transaction. The TPO /Assessing Officer cannot disregarded any apparent transaction and substitute it, without any material of exception circumstance highlighting that assessee has tried to conceal the real transaction or some sham transaction has been unearthed. The TPO cannot question the commercial expediency of the transaction entered into by the assessee unless there are evidence and circumstances to doubt. Here it is a case of investment in shares and it cannot be given different colour so as to expand the scope of transfer pricing adjustments by re-characterizing it as interest free loan. Now, whether in a third party scenario, if an independent enterprise subscribes to a share, can it be characterize as loan. If not, then this transaction also cannot be inferred as loan. The contention of the Ld. Counsel is also supported by the Hon'ble jurisdictional High Court in the case of Dexiskier Dhboal SA, ITA No. 776 of 2011 order dated 30th August, 2012 and by various other decisions, as cited by him. The Co-ordinate Benches of the Tribunal have been consistently holding that subscription of shares cannot be characterizes as loan and therefore no interest should be imputed by treating it as a loan. Accordingly, on this ground alone, we delete the adjustment of interest made by the Assessing Officer. Thus, ground no. 14 is treated as allowed."

(*iii*) *Parle Biscuits (P.) Ltd.* (*supra*) - TP]: It is submitted that the relevant findings at para 11 thereof are as under:—

'11. At the time of hearing before us, the contention raised by the ld. Counsel for the assessee is that the clear transactions involving payment of share application money cannot be treated as international transactions of loans given by the assessee company to its AE merely because there was a delay in allotment of shares. It is observed that this contention of the ld. Counsel for the assessee is duly supported by the latest decision of Delhi Bench of this Tribunal in the case of *Bharati Airtel Ltd.* v. *ACIT* rendered vide its order dated 11-3-2014 passed in ITA No. 5816/Del/2012 wherein a similar issue has been decided by the Tribunal in favour of the assessee vide para 47 which reads as under:—

"47. We find that in the present case the TPO has not disputed that the impugned transactions were in the nature of payments for share application money, and thus, of capital contributions. The TPO has not made any adjustment with regard to the ALP of the capital contribution. He has, however r, treated these transactions partly as of an interest free loan, for the period between the dates of payment till the date on which shares were actually allotted, and partly as capital contribution, i.e. after the subscribed shares were allotted by the subsidiaries in which capital contributions were made. No doubt, if these transactions are treated as in the nature of lending or borrowing, the transactions can be subjected to ALP adjustments, and the ALP so computed can be the

basis of computing taxable business profits of the assessee, but the core issue before us is whether such a deeming fiction is envisaged under the scheme of the transfer pricing legislation or on the facts of this case. We do not find so. We do not find any provision in law enabling such deeming fiction. What is before us is a transaction of capital 9 ITA 9010/M/10 subscription, its character as such is not in dispute and yet it has been treated as partly of the nature of interest free loan on the ground that there has been a delay in allotment of shares. On facts of this case also, there is no finding about what is the reasonable and permissible time period for allotment of shares, and even if one was to assume that there was an unreasonable delay in allotment of shares, the capital contribution could have, at best, been treated as an interest free loan for such a period of 'inordinate delay' and not the entire period between the date of making the payment and date of allotment of shares. Even if ALP determination was to be done in respect of such deemed interest free loan on allotment of shares under the CUP method, as has been claimed to have been done in this case, it was to be done on the basis as to what would have been interest payable to an unrelated share applicant if, despite having made the payment of share application money, the applicant is not allotted the shares. That aspect of the matter is determined by the relevant statute. This situation is not in pari materia with an interest free loan on commercial basis between the share applicant and the company to which capital contribution is being made. On these facts, it was unreasonable and inappropriate to treat the transaction as partly in the nature of interest free loan to the AE. Since the TPO has not brought on record anything to show that an unrelated share applicant was to be paid any interest for the period between making the share application payment and allotment of shares, the very foundation of impugned ALP adjustment is devoid of legally sustainable merits."

Respectfully following the decision of the Tribunal in the case of Bharati Airtel (supra) on a similar issue, we delete the addition made by the A.O./TPO and sustained by the ld. CIT(A) on account of T.P. adjustment to the extent it is in relation to the transactions involving share application money given by the assessee company to its AE which was treated as in the nature of loans given by the assessee to its AE till the date of issue of shares.'

(*iv*) Mylan Laboratories Ltd. (*supra*) : It is submitted that the relevant findings at para 6.2 thereof are as under:—

"6.2 The co-ordinate Bench in the case of *Prithvi Information Solutions Ltd.* v. *ACIT* [34 ITR (Trib) 429 (ITAT, Hyd)] (*supra*), has considered similar issue wherein assessee also made investments towards equity and shares have been allotted. The facts are similar to assessee's case Vide para 12, the co-ordinate Bench considering various orders passed by the co-ordinate Benches referred to in the order held that the investments are in the nature of equity then, they cannot be treated as 'loans and advances'. Since in this case, the investments are in the nature of equity and shares have been allotted after a period of four months, we are of the opinion that TPO cannot reclssify the amount as 'loans and advances'. Moreover, we have considered the appeal in AY. 2008-09 vide orders dt. 10-01-2014, wherein it is noticed that TPO has not made any adjustment from 1st April 2007 to the period of allotment. Therefore, keeping that factor also in mind, we are of the opinion that adjustment proposed by the TPO as confirmed by the DRP is not warranted. We direct the same to be deleted. Ground is allowed."

(*v*) *Allcargo Global Logistics Ltd.* (*supra*) : It was submitted that in this case the company had paid a certain sum to its AE as share application money which remained unutilized for a certain period. TP adjustment was made in the hands of the assessee on account of interest chargeable on amount of share application money, treating the same as loan due to non-allotment of shares. At para 7 thereof it was held as under:—

"7. As the issue involved in ground No. 2 of the present appeals as well as all the material facts relevant thereto are similar to the case of *Bharti Airtel Limited* (*supra*) decided by the Tribunal, we respectfully follow the said decision of the co-ordinate Bench of this Tribunal and delete the addition made by the A.O./TPO and sustained by the ld. CIT(A) by way of TP adjustment on account of interest chargeable on the amount of share application money paid by the assessee and lying unutilized with its AE treating the same as the transaction of loan. Ground No. 2 of the assessee's appeals for both the years under consideration is accordingly allowed."

(*vi*) *Prithvi Information Solutions Ltd.* (*supra*) : The learned A.R. for the assessee submits that in this case, it was held that investments in the nature of equity cannot be treated as loans and advances and hence cannot be brought within the purview of 'international transactions' as defined in section 92B of the Act.

(*vii*) *Tooltech Global Engineering (P.) Ltd.* (*supra*) : It is submitted by the learned A.R. for the assessee that in this case at para 12 of the order it has been held as under:—

"12. In so far as the amount of Rs.9,91,39,000/- (i.e. Rs.66,87,000/- + Rs.9,24,52,000/-) advanced during the year is concerned, the treatment given by the assessee is in the nature of 'share application money'. The aforesaid amount of share application money is outstanding as the investee company has not issued shares to the assessee till the close of the previous year under consideration. The nature of the aforesaid transaction is share application money, and clearly it is not in the nature of a lending or borrowing. The TPO has treated such transaction in the nature of interest-free loan primarily for the reason that till the close of the previous year under consideration no shares have been actually allotted to the assessee. Accordingly, arm's length price adjustment has been made on account of interest element on such amount. In our considered opinion, the action of the TPO in changing the characteristic of the transaction of payment of share application money as an interest- free loan is unwarranted and beyond his jurisdiction which carrying out the transfer pricing proceedings. There is no provision of law which enables the TPO to change the character of a transaction while subjecting it to the process of determination of arm's length price. The TPO was required to benchmark such transactions against a similarly placed transaction and not deem the transaction to be a lending or borrowing transaction. No doubt, a transaction of advancing loans is within the purview of transfer pricing mechanism and the arm's length price computed thereof is includible in the assessable income of the assessee. So however, where the character of payment is towards share application money, thereby reflecting a capital investment, and the same not having been disputed by the TPO, such a transaction cannot be subject to an arm's length price adjustment under the plea of it being a transaction of lending or borrowing. Therefore, in our view, the TPO was not justified in treating the aforesaid transaction as being an interest- free lending transaction entered with the associated enterprise. Moreover, it is also not the case of the TPO that in a comparable transaction of share application money amongst unrelated parties, the transaction would have entailed charging of interest for ITA No.273/PN/2014 A.Y. : 2009-10 8 the period between payment of share application and the date of allotment of shares. Therefore, in our considered opinion, the approach of the authorities below in the context of the aforesaid amount of Rs.9,91,39,000/- by treating it to be a transaction in the nature of interest-free lending transaction per se, and subjecting it to an arm's length price adjustment is erroneous and unwarranted. Accordingly, we direct the Assessing Officer to delete the addition to the said extent."

6.2.3 In the light of the above submissions, the learned A.R. for the assessee contended that the following conclusions are required to be drawn:—

(*i*) That the TPO/CIT(A) cannot re-characterize the investment in equity shares in Tops BV, Netherlands into a loan and therefore the addition of loans and notional interest thereon

cannot be made.

(*ii*) Without prejudice to the above, even if the said transaction was to be characterized as a loan, the TPO could not have considered the principal part of the loan so re-characterized amounting to Rs.124,17,50,258/- as income of the assessee. This was a capital outflow of the assessee and could not be considered as income under any provisions of the Act.

(*iii*) Alternatively and without prejudice to the above, it is submitted that in any event since the international transaction has taken place in foreign exchange, the rate for computing notional interest cannot exceed the LIBOR of 5.514% (page 45 of the Paper Book).

6.3 The learned D.R. for Revenue was heard in this matter. In respect of the alleged excess consideration paid over and above the Wealth Tax value adopted by the TPO being re-characterized as a loan, the learned D.R. was not able to explain as to how the alleged excess consideration of Rs.124,17,50,250/-, which was in the nature of a capital payment, could be considered as income in the hands of the assessee as has done by the TPO (at page 7 of his order). The learned D.R. was unable to explain/justify the basis of the TPO's action as to how the principal amount of Capital Investment/loan could be taxed under the provisions of the Act.

6.3.1 The learned D.R., however, referring to the decision of the Hon'ble Bombay High Court in the case of *Vodafone India Services (P.) Ltd.* v. *Union of India* [2014] 361 ITR 531/221 Taxman 116/[2013] 39 taxmann.com 201 (Vodafone III), contended that the term 'income' includes potential income and in this regard referred to para 32 thereof. It was contended that potential income could arise/be affected by the investment made by the assessee in the share capital of Tops BV, Netherlands, i.e. the subsidiary, in the event of future sale of shares under the head 'Income from Capital Gains'. The contention of the learned D.R. was that the assessee may sell the shares it holds in Tops BV, at a future date for a price lower than the cost at which they had been acquired resulting in long term/short term capital loss, thereby impacting the income of the assessee in subsequent years. It was also contended by the learned D.R. that the assessee could enter into a future transaction for sale of the said shares it held in Tops BV, Netherlands to a Non-AE as a result of which the sale of shares would not come within the purview of TP regulations and thereby defeating the purpose of Chapter X of the Act. The learned D.R. placed reliance on the case of *PMP Auto Components* v. *Dy. CIT* [2014] 50 taxmann.com 272/66 SOT 42 (Mum.) on the grounds that payment towards share application money was to be benchmarked to determine the ALP of the transaction by considering the application money as a loan and the delay in allotment of shares as the period of loan.

6.4 In rejoinder to the submissions of the learned D.R., the learned A.R. for the assessee argued that as per the decision of the Special Bench of the ITAT, Mumbai in the case of *Mahindra & Mahindra Ltd.* v. *Dy. CIT* [2009] 313 ITR (AT) 263 (Mum.) (SB), the learned D.R. cannot raise any point other than those considered by the AO and the learned CIT(A) and in this context drew the attention of the Bench to para 19.6 of the order of the Special Bench wherein it was held:—

> "19.6 ...... The Departmental Representative has no jurisdiction to go beyond the order passed by the AO. He cannot raise any point different from that considered by the AO or CIT(A). His scope of arguments is confined to supporting or defending the impugned order. He cannot set up an altogether different case. If the Departmental Representative is allowed to take up a new contention de hors the view taken by the AO that would mean the Department Representative (six - Departmental Representative) stepping into the shoes of the CIT exercising jurisdiction under s. 263. We, therefore, do not permit the learned Departmental Representative to transgress the boundaries of his arguments. ..... "

6.4.1 It was contended by the learned A.R. for the assessee that the concept of potential income arising out of international transaction was not considered in the orders of the TPO/AO or CIT(A) inspite of the assessee's submission that the transaction of investment in the share capital of its subsidiary, Tops BV, Netherlands, did not require benchmarking as no income arose from the transaction. Neither the AO nor the learned CIT(A) held that TP regulations were applicable in

view of there being a possibility of potential income. The learned A.R. for the assessee urged that since the contentions of the learned D.R. were in addition to the findings of the TPO/CIT(A) and in the light of the decision of the ITAT Special Bench in *Mahindra & Mahindra* (*supra*), they cannot and are not to be considered.

6.4.2 The learned A.R. for the assessee submits, that without prejudice to the above, with respect to the reliance placed by the learned D.R. on Vodafone III, the findings therein were dealt with by the subsequent decision of the Hon'ble Bombay High Court in *Vodafone India Services (P.) Ltd.* (*supra*), i.e. Vodafone IV), wherein it was held that:—

> "31. Similarly, the reliance by the Revenue upon the definition of International Taxation in the sub clause (c) and (e) of Explanation (i) to Section 92B of the Act to conclude that Income has to be given a broader meaning to include notional income, as otherwise Chapter X of the Act would be rendered otiose is farfetched. The issue of shares at a premium does not exhaust the universe of applicability of Chapter X of the Act. There are transactions which would otherwise qualify to be covered by the definition of International Transaction. The transaction on capital account or on account of restructuring would become taxable to the extent it impacts income i.e. under reporting of interest or over reporting of interest paid or claiming of depreciation etc. It is that income which is to be adjusted to the ALP price. It is only a tax on capital receipts. This aspect appears to have been completed lost sight of the impugned order.
>
> 42. It was contended by the Revenue that in any event the charge would be found in Section 56(1) of the Act. Section 56 of the Act does provide that income of every kind which is not excluded from the total income is chargeable under the head income from other sources. However, before Section 56 of the Act can be applied, there must be income which arises. As pointed out above, the issue of shares at a premium is on Capital Account and gives rise to no income. The submission on behalf of the revenue that the shortfall in the ALP as computed for the purposes of Chapter X of the Act give rise to income is misplaced. The ALP is meant to determine the real value of the transaction entered into between AEs. It is a re-computation exercise to be carried out only when income arises in case of an International transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account. It permits re- computation of Income arising out of a Capital Account Transaction, such as interest paid/received on loans taken/given, depreciation taken on machinery, etc. All the above would be cases of income being affected due to a transaction on capital account. This is not the Revenue's case here. Therefore, although Section 56(1) of the Act would permit including within its head, all income not otherwise excluded, it does not provide for a charge to tax on Capital Account Transaction of issue of shares as is specifically provided for in Section 45 or Section 56(2)(viib) of the Act and included within the definition of income in Section 2(24) of the Act."

6.4.3 The learned A.R. for the assessee argued that it was to be noted that the nature of potential income arising out of an international transaction was clarified to mean a potential impact of income arising out of the international transaction which was the subject matter of dispute and not a future independent transaction which was completely unrelated. In respect of this contention, the Bench pointed out to the learned D.R. for Revenue that the potential income envisaged in his arguments (supra) arose out of a possible subsequent transaction and not from the transaction which was the subject matter of dispute or that the TP provisions cover or provide such a charge of tax. The learned D.R. was unable to justify his contention.

6.5 In respect of the issue of re-characterization of investment in equity shares as a loan, the learned D.R. for Revenue additionally raised the following contentions:—

(*i*) that the assessee invested in the shares of its subsidiary Tops BV, Netherlands at a value which was abnormally high with respect to the book value of the subsidiary company determined as per Schedule III of the Wealth Tax Act, 1957

(*ii*) that this transaction of the assessee was aimed at ultimately building losses in the future. It was contended that the assessee, in the future, would sell the shares purchased in Tpos BV in the year under consideration, at a value substantially lower than the purchase price and accordingly claim a capital loss under the head 'Income from capital gains'

(*iii*) That the entire transaction was a manipulation and not bonafide. The learned DR contended that the investment in the shares of Tops BV was a bundled transaction actually consisting of two parts-investment in share capital (including premium) and a loan. In this context, the learned D.R. submitting that the re-characterization of investment was possible, placed reliance on the decision of the Hon'ble Delhi High Court in the case of *CIT* v. *EKL Appliances Ltd.* [2012] 24 taxmann.com 199/209 Taxman 200/345 ITR 241 (Del) and Article 9 of the OECD guidelines drawing the attention of the Bench to para 16 of the order:—

"16. ……………………………………………………………………………………

"1.36 …………………………………………………………………………………..

1.37 ………………… The first circumstance arises where the economic substance of a transaction differs from its form. ……… The second circumstance arises where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price ………"

(*iv*) that there was no proof that the investment made by the assessee in Tops BV, Netherlands, was actually in the nature of investment in share capital and not actually a loan in the garb of share capital.

6.5.1 In rejoinder to the above contentions of the learned D.R., the learned A.R. for the assessee submitted that the learned D.R. cannot raise or be permitted to raise any point different from those considered by the AO/ CIT(A). In this context he drew the attention of the Bench to para 2.1 of the judgement in the case of *Mahindra & Mahindra Ltd.* (*supra*).

6.5.1A The learned A.R. for the assessee contended that the learned D.R. was wrong in concluding that the valuation of shares was excessive by relying on the valuation adopted by the TPO, i.e. the net asset value or book value of shares based on historic costs, as per Schedule III of the Wealth Tax Act, 1957. The learned A.R. for the assessee submitted that equity shares in a company are not covered under the depreciation of assets provided for in section 2(ea) of the Wealth Tax Act w.e.f. 1993. The learned A.R. for the assessee contends that it is therefore apparent that the provisions of Wealth Tax Act are inapplicable to equity shares held by an assessee and consequently, the valuation rules therein are also inapplicable.

6.5.2 The learned A.R. for the assessee submitted, without prejudice to the contention that TP regulations are not applicable to the capital transaction of investment in purchase of shares in its subsidiary Tops BV, Netherlands, TP provisions seek to determine the ALP, defined under section 92F(ii) of the Act to mean a price which is applied or sought to be applied in a transaction between persons other than AEs in uncontrolled condition, viz. the fair market value. It is contended that under no circumstances can the net asset value of an unquoted share computed on the basis of its book value be considered as its fair market value as done by the TPO [i.e. @ Euro 7,704 / 1800 shares = 4.28 Euro per share]. It is submitted that the assessee and its wholly owned subsidiaries were mere holding companies, the entire amount of share capital and premium would belong to the assessee and therefore the value of the investment would be based on the value of the Target company, i.e. Shields Guarding Company, UK, which was in the nature of an underlying asset with respect to the valuation of Tops BV, Netherlands, the assessee submitted before the authorities below the valuation report of the ultimate target for acquisition, Shields Guarding Company, UK,

which was carried out by a SEBI registered company on the basis of Discounted Cash Flow Method and Earning's Multiple Method, which are widely accepted methods for valuation of shares of unlisted companies, and in this context cited the decision of the Chennai ITAT in the case of *Ascendas (India) (P.) Ltd.* v. *Dy. CIT* [2013] 33 taxmann.com 295/143 ITD 208 wherein it was held that fixing of the enterprise value on discounted value of future projects or cash flow method was a method used worldwide for the purpose of determining the fair market value of shares. It is submitted that the target, Shields Guarding Company, U.K., was actively engaged and fully operational in providing security services, which was not a capital intensive business and therefore the net asset value was not a suitable method for valuing the said company as mentioned in the valuation report. It is also submitted that the authorities below have not rendered any adverse finding in respect of the valuation report.

6.5.3 The learned A.R. for the assessee also drew the attention of the Bench to the fact that during the financial year ending 31.03.2014, the assessee had sold a part of the shares acquired in Tops BV, Netherlands at a profit of Rs.4,71,86,529/- as is evident from Note 13 of the financial statement for the year ended 31.03.2015, placed at page 148(c) of the assessee's Paper Book. This fact, the learned A.R. for the assessee submits, refutes the contention of the learned D.R. that the purchase cost of shares in Tops BV, Netherland were inflated to claim losses in subsequent years.

6.5.4 The learned A.R. for the assessee submits that the TPO/learned CIT(A) in their orders have not rendered any finding that the said transaction was in fact a sham transaction. The validity of the agreements entered into by the assessee and the valuation report in this regard have not been disputed. The learned CIT(A)/TPO have merely relied on the valuation as per Wealth Tax Act to conclude that the investment made by the assessee in the shares of Tops BV, Netherlands was excessive and was therefore in the nature of a loan. It is contended that the entire valuation as per Wealth Tax Act fails due to its not being applicable to equity shares and therefore the very basis (i.e. Wealth Tax Act valuation) on which re-characterization of the transaction as a loan was done was flawed from the beginning. It was also pointed out that the assessee during the financial year ended 31.03.2014 has sold a part of the shares acquired at Tops BV, Netherlands at a profit/gain of Rs.4,71,86,529/-. Consequently, the reliance placed by the learned D.R. on *EKL Appliance Ltd.* (*supra*) fails. Further, there are no thin capitalization rules in the country and in the light of the discussion of the Hon'ble Bombay High Court in the case of *Besix Kier Dabhol SA* (*supra*) re-characterization of equity into debt and vice versa is not permissible.

6.5.5 With respect to the contention of the learned D.R. that there was no proof that the investment made by the assessee in Tops BV, Netherlands was actually in the nature of investment in share capital , the learned A.R. for the assessee submitted that the said investment has been duly reflected as investment in shares of Tops BV in the Balance Sheet of the assessee for the relevant period (placed at pages 29 & 34 of assessee's Paper Book). It was also submitted that the Balance Sheet of Tops BV, Netherlands has disclosed the said transaction as an increase in share capital and share premium (at pages 292 and 296 of the Paper Book). Therefore, the learned A.R. for the assessee contends that, the fact that the investment was in the nature of investment in share capital of Tops BV is clearly supported by the financials of the assessee and the investee company, i.e. Tops BV, Netherlands. It was also submitted that the assessee has observed the relevant compliances with RBI for the reporting of this investment in equity shares.

6.5.6 The learned D.R.'s response to the judicial pronouncements relied on by the assessee alongwith the assessee's rebuttal is briefly summarized hereunder:—

S.No.	Case Law	Proposition relied on by the assessee	Response by DR	Rebuttal by assessee
1	*Basix Kier Dahbol SA* (*supra*)	Investment in shares cannot be given a different colour so as to expand the	The DR did not deal with these four judgements	Not applicable as the DR did not deal with the judgements in his arguments.
2	*Aegis Ltd.*			

	(*supra*)	scope of Transfer Pricing adjustments by re-characterising it as in interest free loan	relied on by the assessee.	
3	*Parle Biscuits (P.) Ltd.* (*supra*)			
4	*Mylan Laboratories Ltd.* (*supra*)			
5	*Vijai Electrical Ltd.*	Transfer Pricing provisions are not applicable to investment in share capital of the subsidiaries outside India as there is no income arising from the said transaction.	The DR contended that the said judgement was not applicable to the case of the assessee it dealt with section 263 of the Act and did not deal with the proposition that in the absence of income, transfer pricing provisions would not apply.	The contention of the DR is misplaced as the judgement in Paras 8 & 9, consider the rulings of *Dana Corpn.,* In re [2010] 321 ITR 178 /186 Taxman 187 (AAR-New Delhi), which state that without the presence of income, the provisions of transfer pricing would not apply. Considering the said judgements, the Tribunal decided that Transfer Pricing provisions are not applicable to investment in share capital of the subsidiaries outside India as there is no income arising from the said transaction.
6	*Hill Country Properties Ltd.* (*supra*)	Amount representing investment in share capital of subsidiaries outside India was not in the nature of transaction referred to in Section 92B and thus transfer pricing provisions were not applicable to such transaction	The DR contended that the judgement dealt with share application money paid to the overseas AE and therefore inapplicable	In this judgement reliance was placed on *Vijai Electricals Ltd.* (*supra*) to hold that in the absence of income, TP provisions do not apply Further, share application money is closer to loan than share capital as pending allotment there is scope to refund the share application money (as in the case of loan). In the assessee's case, the investment is in share capital which was recorded so in the books of both the assessee and the investee company, therefore making it non-refundable. In fact, the case of the assessee, dealing with share capital investment as opposed to share application money is on a much stronger footing. Therefore the contention of the DR fails. Further, it is pertinent to note that the DR has relied on *PMP Auto Components* (*supra*), wherein the subject matter of dispute was share

				application money and a delay in period of allotment.
7	*Prithvi Information Solutions Ltd.* (*supra*)	Investments in nature of equity, cannot be treated as loans and advances and hence cannot be brought within purview of international transactions as defined under section 92B	The DR contended that the said judgment was not applicable to the case of the assessee as it dealt with whether a delay in share application money could be treated as a loan	It is pertinent to note that in the said judgement does not deal with a delay in allotment of shares. The share application was inadvertently reported as a loan by the auditors. Prithvi had filed a revised audit report and furnished the allotment certificates to prove that it was actually investment in share capital. This can be noted from Tribunal's findings on Para 10 of the order. [PB/204] Share application money is closer to a loan than share capital as pending allotment there is scope to refund the share application money (as in the case of loan). In the assessee's case, the investment is in share capital which was recorded so in the books of both the assessee and the investee company, therefore making it non- refundable. In fact, the case of the assessee dealing with share capital investment as opposed to share application money, is on a much stronger footing. Therefore the contention of the DR fails. Further, it is pertinent to note that the DR has relied on *PMP Auto Components* (*supra*), wherein the subject matter of dispute was share application money and a delay in period of allotment
8	*Tooltech Global Engineering (P.) Ltd.* (*supra*)	Payments made to its AE towards share application money, thereby reflecting capital investment, which was undisputed by the TPO, could not be subject to ALP adjustment under the plea of it being a transaction of lending of borrowing	The DR contended that the said judgment was not applicable to the case of the assessee as it dealt with whether a delay in share application money could be treated as a loan. Further in the case of Allcargo	Share application money is closer to a loan than share capital as pending allotment there is scope to refund the share application money (as in case of loan). In the assessee's case the investment is in share capital which was recorded so in the books of both the assessee and the investee company, therefore making it non-refundable. In fact, the case of the assessee dealing with share capital investment as opposed to share application money, is on a much stronger footing. Therefore the contention of the DR fails. The contention that Allcargo is inapplicable as it was a case of re-opening of assessment is invalid as
9	*Allcargo Global*			

	Logistics Ltd. (*supra*)		Global Logistics, the DR contended that it was a case of re-opening of assessment under section 147 of the Act and therefore inapplicable.	the Tribunal has dealt with the case of merits and not on whether the re-opening was sustainable in law [PB/227] Further, it is pertinent to note that the DR has relied on *PMP Auto Components* (*supra*), wherein the subject matter of dispute was share application money and a delay in period of allotment.
10	*Vodafone India Services (P.) Ltd.* (*supra*)	A plain reading of Section 92(1) of the Act very clearly bring out that income arising from an international transaction is a condition precedent for application of Chapter X of the Act i.e. income arising from an International Transaction between AEs must satisfy the test of income under the Act and must find its home in one of the heads of income i.e. charging provisions In the absence of income arising out of the international transaction, Transfer Pricing Provisions are not applicable.	The DR contended that the judgements of the Bombay High Court were not applicable to the assessee as they dealt with inbound transactions which was different as compared to the transaction of the assessee i.e. outbound transaction.	The contention of the DR is misplaced as the High Court has clearly stated in Para 42 of *Vodafone India Services (P.) Ltd.* (*supra*) that the concept of no transfer pricing in the event of no income applies equally to inbound and outbound transactions. "42. ... It is a re-computation exercise to be carried out only when income arises in case of an international transaction between AEs. It does not warrant re-computation of a consideration received/ given on capital account. It permits re-computation of income arising out of a Capital Account transaction, such as interest paid/received on loans taken/given, depreciation taken on machinery etc. All the above would be case of income being affected due to a transaction on capital account ...." The rest of the decisions rely on the decision of Vodafone India Services and therefore the same holds good for all of the decisions.
11	*Shell India Markets (P.) Ltd.* (*supra*)			
12	*Equinox Business Parks (P) Ltd.* (*supra*)			
13	*S.G. Asia Holdings (India) (P) Ltd.* (*supra*)			

The learned A.R. for the assessee submitted that in the case of PMP Auto Components relied on by the learned D.R., the Coordinate Bench did not have the benefit of the judgements of the jurisdictional High Court in the case of *Besix Kier Dabhol SA* (*supra*), *Vodafone Services (P.) Ltd.* (*supra*), Coordinate Bench of ITAT, Mumbai judgements in the case of *Aegis Ltd.* (*supra*), *Parle Biscuits (P.) Ltd.* (*supra*) and of the ITAT, Hyderabad Bench in the case of *Vijay Electrical Ltd.* (*supra*) and *Hill Country Properties Ltd.* (*supra*). It was also contended that the investment of the assessee in the case on hand in equity share capital is on a stronger footing than dealing with share application money, which was the issue in *PMP Auto Components* (*supra*).

7. We have heard the rival contentions put forth by both the learned A.R. for the assessee and the learned D.R. for Revenue and perused and carefully considered the material on record; including the judicial pronouncements cited and relied on. Chapter X begins with section 92(i) of the Act

which states that "Any income arising from and international transaction shall be computed having regard to the arms length price." Evidently, therefore, income arising from the international transaction is a condition precedent for computing the ALP and such income should be chargeable to tax under the Act. In the absence of such income, benchmarking of an international transaction and computing ALP thereof would not be in order. Consequently, if an international transaction is on capital account and does not result in income as defined under section 2(24) of the Act, the provisions of Chapter X of the Act would not be applicable to such transaction. This proposition finds support in a number of judgements of the Hon'ble Bombay High Court viz. *Vodafone India Services* (*supra*), i.e. (Vodafone IV), *Shell India Markets (P) Ltd.* (*supra*), *Equinox Business Parks (P) Ltd.* (*supra*) and decisions of the ITAT, Hyderabad Bench in the case of *Vijay Electrical Ltd.* (*supra*) and Hill Country Properties Ltd. (*supra*).

7.1 Before us, the learned D.R. was not able to establish that any income arose out of the assessee's transaction, i.e. of investment in the shares of its wholly owned subsidiary, Tops BV, Netherlands. The learned D.R., however, contended that there is a scope for effect on potential income arising from subsequent sale of these shares and in this regard placed reliance on the decision of the Hon'ble Bombay High Court in the case of Vodafone India Services Ltd. (*supra*) ('Vodafone-III').

7.1.1 The learned A.R. for the assessee pointed out that this averment made by the learned D.R. was a new contention and line of argument that does not emanate from the points considered by the TPO/AO/CIT(A) in their orders and therefore in the light of the decision of the Special Bench of the Mumbai ITAT in the case of *Mahindra & Mahindra Ltd.* (*supra*) this new argument/issue is not to be considered. We find force in the argument of the learned A.R. for the assessee for the assessee on this issue.

7.1.2 In any case the concept of potential income has been dealt with by the Hon'ble Bombay High Court in the case of *Vodafone India Services (P.) Ltd.* (*supra*) (Vodafone IV) at para 31, 32 and 43 of its order as under:—

> "31. Similarly, the reliance by the revenue upon the definition of International Taxation in the sub-clause (c) and (e) of Explanation (i) to Section 92B of the Act to conclude that Income has to be given a broader meaning to include notional income, as otherwise Chapter X of the Act would be rendered otiose is far fetched. The issue of shares at a premium does not exhaust the universe of applicability of Chapter X of the Act. There are transactions which would otherwise qualify to be covered by the definition of International Transaction. The transaction on capital account or on account of restricting would become taxable to the extent it impacts income i.e. under reporting of interest over reporting of interest paid or claiming of depreciation etc. It is that income which is to be adjusted to teh ALP. It is …… tax on the capital receipts. This aspect appears to have been completely lost sight of in the impugned order."
>
> "32. The other basis in the impugned order is that as a consequence of under valuation of shares, there is an impact on potential income. The reasoning is that if the ALP were received, the Petitioner would be able to invest the same and earn income, proceeds on a mere surmise/assumption. This cannot be the basis of taxation. In any case, the entire exercise of charging to tax the amounts allegedly not received as share premium fails, as no tax is being charged on the amount received as share premium. Chapter X is invoked to ensure that the transaction is charged to tax only on working out the income after arriving at the ALP of the transaction. This is only to ensure that there is no manipulation of prices/ consideration between AEs. The entire consideration received would not be a subject-matter of taxation. It appears for the above reason that the learned Solicitor General did not seek to defend the conclusion in the impugned order on the basis of the reasons found therein, but sought to support the conclusion with new reasons".
>
> "43. It was contended by the revenue that income becomes taxable no sooner it accrues or arises or when it is deemed to accrue or arise and not only when it was received. It is

submitted that even though the Petitioner did not receive the ALP value/ consideration for the issue of its shares to its holding company, the difference between the ALP and the contract price is an income, as it arises even if not received and the same must be subjected to tax. There can be no dispute with the proposition that income under the Act is taxable when it accrues or arises or is received or when it is deemed to accrue, arise or received. The chargeability to tax is when right to receive an income becomes vested in the assessee. However, the issue under consideration is different viz. whether the amount said to accrue, arise or receive is at all income. The issue or shares to the holding company is a capital account transaction, therefore, has nothing to do with income. We thus do not find substance in the above submission."

As is self evident from the above, potential income arising from a capital transaction may be considered under Transfer Pricing provisions if it arises from out of the impugned transaction. The situations in which a capital transaction may have an impact on potential income are provided in para 31 of the decision in the case of *Vodafone India Services (P.) Ltd.* (*supra*) (extracted supra) by way of instances such as interest on loan given or received or depreciation, etc.

7.1.3 Further, a plain reading of section 92(1) of the Act which specifies that 'any income arising from an international transaction shall be computed having regard to the Arm's Length Price' implies that the potential income, if any, should arise from the impugned international transaction which is before the Transfer Pricing Officer for consideration and not out of a hypothetical international transaction which may or may not take place in future. Before us, except for making a claim in this regard the Ld. Departmental Representative was not able to establish that any income or potential income arose from the impugned transaction of the assessee's investment in acquiring the share capital of its wholly owned subsidiary, Tops BV, Netherlands.

7.1.4 In respect of the contention of the Ld. Departmental Representative that the decision of *Vodafone India Services (P.) Ltd.* (*supra*) was not applicable to the assessee in the case on hand as it dealt with an inbound transaction and not an outbound transaction, the Ld. Representative for the assessee for the assessee submitted that the decision of the Hon'ble High Court in the case of *Vodafone India Services P. Ltd.* (*supra*) had observed that it would be applicable to both inbound and outbound transaction at para 42 thereof which is extracted hereunder:—

"42. It was contended by the Revenue that in any event the charge would be found in Section 56(1) of the Act. Section 56 of the Act does provide that income of every kind which is not excluded from the total income is chargeable under the head income from other sources. However, before Section 56 of the Act can be applied, there must be income which arises. As pointed out above, the issue of shares at a premium is on Capital Account and gives rise to no income. The submission on behalf of the revenue that the shortfall in the ALP as computed for the purpose of Chapter X of the Act given rise to income is misplaced. The ALP is meant to determine the real value of the transaction entered into between AEs. It is a re-computation exercise to be carried out only when income arises in case of an International transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account. It permits re-computation of Income arising out of a Capital Account Transaction, such as interest paid/received on loans taken/given, depreciation taken on machinery etc. All the above would be cases of income being affected due to a transaction on capital account. This is not the revenue's case here. Therefore, although Section 56(1) of the Act would permit including within its head, all income not otherwise excluded, it does not provide for a charge to tax on Capital Account Transaction of issue of shares as is specifically provided for in Section 45 or Section 56(2) (viib) of the Act and included within the definition of income in Section 2(24) of the Act."

7.1.5 In these circumstances, we are of the view that the impugned transaction cannot be brought within the ambit of Indian Transfer Pricing provisions merely on the presumption that it may impact profits arising out of a subsequent transaction which may or may not be an international transaction. In coming to this view, we draw support from the decisions of the ITAT, Hyderabad

bench in the case of *Vijay Electricals Ltd.* (*supra*) and *Hill Country Properties Ltd.* (*supra*); which are cases of outbound investments, wherein prices at which the equity shares were acquired could have impacted the profits which may have arisen out of a subsequent transaction of the said shares. However, since no income arose from those transactions, it was held that the same would not fall within the ambit of Indian Transfer Pricing provisions. In the case of *Vijay Electricals Ltd.* (*supra*), the Tribunal in an appeal against order passed under section 263 of the Act held that Transfer Pricing provisions are not applicable to the transactions of investment in share capital since no income arises therefrom. Though in the case of *Hill Country Properties Ltd.*, (*supra*), the transaction was of share application money, the Tribunal followed the decision rendered in the case of *Vijai Electricals Ltd.* (*supra*).

7.1.6 The differentiation sought to be made by the Revenue between inbound investment in shares and outbound investment in shares for applicability of T.P provisions does not, in our considered view, find any support therein. It would also be appropriate in this regard to refer to Rules 10B and 10C of the Income Tax Rules, 1962 (in short' the Rules'). Rule 10B(2) reads as under:—

> "(2) For the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:
>
> (*a*) the specific characteristics of the property transferred or services provided in either transaction;
>
> (*b*) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
>
> (*c*) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
>
> (*d*) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail."

Equally important is sub-rule (3) to Rule 10B, which reads as under:—

> " (3) An uncontrolled transaction shall be comparable to an international transaction if
>
> (*i*) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
>
> (*ii*) reasonably accurate adjustments can be made to eliminate the material effects of such differences."

Similarly, Rule 10C(1) reads as under:—

> " 10C. (1) For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction [or specified domestic transaction], and which provides the most reliable measure of an arm's length price in relation to the international transaction [or the specified domestic transaction, as the case may be].
>
> (2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely:—
>
> (*a*) the nature and class of the international transaction [or the specified domestic transaction];

(*b*) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(*c*) the availability, coverage and reliability of data necessary for application of the method;

(*d*) the degree of comparability existing between the international transaction [or the specified domestic transaction] and the uncontrolled transaction and between the enterprises entering into such transactions;

(*e*) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(*f*) the nature, extent and reliability of assumptions required to be made in application of a method"

7.1.7 The aforesaid Rules indicate factors that ought to be taken into account for selection of the comparables, which necessarily include the contractual terms of the transaction and how the risks, benefits and responsibilities are to be decided. The conditions prevailing in the market in which the respective parties to the transactions operate, including the geographical location and the size of the markets, the laws and the Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition are all material and relevant aspects. If we keep the aforesaid aspects in mind, it would be delusive to accept and agree that Transfer Pricing provisions/Rules can be different for inbound and outbound investment in shares. Such reasoning is not what Chapter X of the Act and Rules mandate or prescribe. The aforesaid provisions, in our view, do not make any such distinction.

7.1.8 Therefore, whether the transaction under comparability is inbound share investment or outbound share investment, the comparison has to be with comparables and not with what options or choices were available to the assessee for earning income or maximizing returns. Thus, what is made applicable for inbound share investment would be equally applicable to outbound share investments also. The parameters to be applied cannot be different for outbound investment and inbound investments. Therefore, in our view, the argument that different parameters would apply for inbound and outbound investments does not have any basis that emanate from the Transfer Pricing Rules.

8.1.1 We have already held that the impugned transaction cannot come within the purview of Indian Transfer Pricing provisions since the said transaction is on capital account from which no income/ potential income arises. Another question for consideration is whether Transfer Pricing adjustments can yet to be made if the impugned transaction of investment in equity share capital is re-characterized as a loan transaction and notional interest income is imputed to it and whether such a re-characterization is permissible under the existing legal provisions.

8.1.2 In this regard, it must be stated that even assuming that such a re- characterization of the investment in equity share capital as a loan is permissible, the addition of that part of the equity capital re-characterized as loan would not be possible, as the said loan cannot, by any stretch of imagination, be considered income of the assessee. The Ld. Departmental Representative on being queried was not able to controvert this view. Hence, even if re-characterization is possible, the only addition permissible would that of notional income in respect of the re-characterized loan. Therefore, in any event, the addition of Rs.124 crores being part of the investment in equity share capital, re-characterized as loan, stands deleted. The only issue for our consideration that now survives is as to what the quantum of addition on account of notional interest if such re-characterization is permissible. Before answering this, it would be required to consider the question of whether re-characterization of investment in equity share capital into loan is permissible under the Act.

8.2.1 The Ld. Departmental Representative contended that the impugned transaction of investment in equity share capital was a bundled transaction, comprising of both investment in share capital alongwith a loan and was therefore, to be treated as a loan to the extent that the amount of investment exceeded the book value of investment computed as per Schedule III of the wealth Tax Act. The Ld. Departmental Representative contended that the transaction was in fact a manipulation wherein the assessee would take care of the inflated cost at the time of future sale. It was alleged that the impugned transaction was based on abnormally high premium resulting in a flight of capital from the country which was to be curtailed. Relying on the decision in the case of *EKL Appliances Ltd.* (*supra*) and Article -9 of the OECD guidelines, the Ld. Departmental Representative contends that the re-characterization of the impugned investment in share capital was possible.

8.3.1 From the details on record we find that the assessee has placed material evidence on record to establish the bona-fide of the impugned transaction. The assessee's balance sheet reflects the investment made as investment in equity shares which is also correspondingly reflected in the balance sheet of the investee company, Top BV Netherlands. The details of investment in equity shares were informed and submitted to the Reserve Bank of India. Further, even the agreement entered into between TSL (the holding company) and its investors provides for the proposed structure for acquisition of the Target company i.e. Shields Guarding Company, UK, wherein the assessee was to incorporate a wholly owned subsidiary in the Netherlands as an intermediate holding company. Therefore, even on the merits of the case, we find no reason to hold that the impugned transaction was in fact in the nature of a loan advanced and not an investment in share capital. The only ground taken by the Transfer Pricing Officer for re- characterization of the loan was that the value at which the investment was made was far in excess of the book value as determined under Schedule III of the Wealth Tax Act. In our view, since shares are not covered under the definition of assets, we find no merit in applying the erstwhile Wealth Tax Valuation Rules to determine the Arm's Length Price of equity shares.

8.3.2 In view of the aforesaid discussions, we agree with the contention of the Ld. Representative for the assessee that re-characterization of investment in share capital into loan is not possible under the Transfer Pricing provisions. In coming to this view, we draw support from the discussions of the Hon'ble Bombay High Court in the case of *Besix Kier Dabhol SA* (*supra*) and the orders of the various benches of the Tribunal in the following cases; (i) *Aegis Ltd.,* (*supra*) - Transfer Pricing]; (ii) *Parle Biscuits (P.) Ltd.* (*supra*) - Transfer Pricing] (iii) *Mylar Laboratories Ltd.,* (*supra*) - Transfer Pricing]; (iv) *Prithvi Information Solution* (*supra*) and (v) *Tooltech Global Engineering (P.) Ltd.* (*supra*).

8.3.3 In the case of *Besix Kier Dabhol SA* (*supra*), the Hon'ble Bombay High Court upheld the decision of the Co-ordinate bench wherein, it was held that in the absence of thin capitalization rules, debt capital could not be re- characterized as equity capital and vice-versa. The relevant portion at para- 7 and 8, thereof is extracted hereunder:—

> "7. However, the Tribunal allowed the respondent-assessee's appeal. During the course of the proceedings before the Tribunal the revenue contended that the borrowing on which the interest has been claimed as a deduction are in fact capital of the assessee and brought only under the nomenclature of loan for tax consideration. It was the case of the appellant-revenue before the Tribunal that debt capital is required to be re-characterized as equity capital. However, the Tribunal held that in India as the law stands there were no rules with regard to thin capitalization so as to consider debt as an equity. It is only in proposed Direct Tax Code Bill of 2010 that as a part of the General Anti Avoidance Rules it is proposed to introduce a provision by which a arrangement may be declared as an impermissible avoidance arrangement and may be determined by re-characterizing any equity into debt or *vice versa*.
>
> 8. We find no fault with the above observations of the Tribunal. There were at relevant time and even today no thin capitalization rules in force. Consequently, the interest payment on debt capital cannot be disallowed. In view of the above, the question (i) raises no substantial

question of law and is therefore, dismissed."

8.3.4 Further, in *Aegis Ltd.* (*supra*) to which one of us is party, the Co- ordinate bench relying on the aforesaid decision of the Hon'ble Bombay High Court in *Besix Kier Dabhol SA* (*supra*) at para 27 thereof held that the re-characterization of equity into loan as carried out by the Transfer Pricing Officer was not permissible. Para 27 of this order of the Co-ordinate bench is extracted hereunder:—

> "27. We have heard the rival submissions and also perused the relevant findings in this regard in the impugned orders. The assessee has subscribed to redeemable preference shares of its AE, Essar Services, Mauritius and has also redeemed some of these shares at par. The TPO has redeemed some of these shares at par. The TPO has re- characterized the said transaction of subscription of shares into advancing of unsecured loan by terming it as an exceptional circumstance and has charged/imputed interest, on the reasoning that in an uncontrolled third party situation, interest would have been charged. We are unable to appreciate such an approach of TPO and under what circumstances, leave above any exceptional circumstances, a transaction of subscription of shares can be re-characterized as Loan transaction. The TPO /Assessing Officer cannot disregarded any apparent transaction and substitute it, without any material of exception circumstance highlighting that assessee has tried to conceal the real transaction or some sham transaction has been unearthed. The TPO cannot question the commercial expediency of the transaction entered into by the assessee unless there are evidence and circumstances to doubt. Here it is a case of investment in shares and it cannot be given different colour so as to expand the scope of transfer pricing adjustments by re-characterizing it as interest free loan. Now,whether in a third party scenario, if an independent enterprise subscribes to a share, can it be characterize as loan. If not, then this transaction also cannot be inferred as loan. The contention of the Ld. Counsel is also supported by the Hon'ble jurisdictional High Court in the case of Dexiskier Dhboal SA, ITA No. 776 of 2011 order dated 30th August, 2012 and by various other decisions, as cited by him. The Co- ordinate Benches of the Tribunal have been consistently holding that subscription of shares cannot be characterizes as loan and therefore no interest should be imputed by treating it as a loan. Accordingly, on this ground alone, we delete the adjustment of interest made by the Assessing Officer. Thus, ground no. 14 is treated as allowed."

8.3.5 In the light of the above decisions (supra), we do not find merit in the contentions of the Ld. Departmental Representative in respect of re- characterizing of the investment in acquisition of equity shares undertaken by the assessee in Tops BV, Netherlands as a loan. In this view of the matter, we hold that the addition of notional interest on the share capital re-characterized as loan is not tenable. Consequently, we do not consider it necessary to deal with the alternate contention of the assessee that in case there is to be addition of notional interest, if any, it should be based in LIBOR rates. We, therefore, accordingly delete the addition of Rs.18,65,62,539/- made by the Assessing Officer on account of notional interest.

9.1.1 In view of our finding that there is no income/potential income arising to the assessee out of the impugned international transaction of investment in acquiring shares in its subsidiary TOPs BV, Netherlands, the same would not fall within the purview of Indian Transfer Pricing provisions. In coming to this view we drew support from the ratio laid down in the following judicial pronouncements:—

(*i*) *Vodafone India Services (P.) Ltd.* (*supra*) (Vodafone IV), wherein at para 42 it is mentioned that the ratio applies equally to inbound and outbound capital transactions;

(*ii*) *Shell India Markets (P.) Ltd.* (*supra*)

(*iii*) *Equinox Business Parks (P.) Ltd.* (*supra*)

(*iv*) *Vijay Electricals Ltd.*, (*supra*)

(*v*) *Hill Country Products Ltd.* (*supra*)

9.1.2 In the absence of provisions/Rules for re-characterization of investment in share capital into loan and vice-versa, we are of the considered view that the re-characterization of the impugned capital transaction into a loan as sought for by the Transfer Pricing Officer/CIT(A) is not tenable in law in view of the decision of the Hon'ble Bombay High Court in the case of *Besix Kier Dabhol SA* (*supra*), which was followed by the Co-ordinate Bench of this Tribunal in the case of *Aegis Ltd.* (*supra*) to which one of us is party.

9.1.3 In the light of the facts and circumstances of the case as discussed above, we delete (i) the addition of Rs.124,17,50,258/- made by the Transfer Pricing Officer/CIT(A) on account of alleged excess consideration paid and (ii) addition of Rs.18,62,62,539/- on account of notional interest computed @15% on the aforesaid sum of Rs.124,17,50,258/- sought to be re-characterized as a loan. In this view of the matter, the alternate plea of the assessee to reconsider the LIBOR rate for the purpose of computing the addition on account of notional interest becomes academic.

10. In the result, the assessee's appeal for assessment year 2009-10 is allowed as indicated above. Since the assessee's appeal for the assessment year 2009-10 stands disposed by this order, the Stay Application filed by the assessee in S.A.No.288/Mum/2015 is rendered infructuous and is accordingly dismissed.

pooja

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*In favour of assessee.