

## THERE'S NO SUCH THING AS A *SANOFI* CLAUSE...OR PERHAPS THERE IS

by Nikhil V. Mehta

Consider these simple facts: two French resident companies sell shares in another French company to a fourth French company. Let's call them GIMD, MA, ShanH and Sanofi respectively. Which country has the right to tax the capital gain made by the two French sellers? France or France?

In a recent *Vodafone*-style salvo from the Indian courts – this time the Andhra Pradesh High Court – we have a 100-page judgment telling us that India cannot interfere with France's exclusive right to tax the transaction.

Now, I have conveniently omitted one fact, without which the Indian nexus is even more inexplicable than in reality. ShanH is a holding company. What did it hold? 80% of the shares in SBL, an Indian company. So, the Indian tax authorities say, let's see how we can bring this transaction into the Indian tax net: the way to do so is to find ways of looking through ShanH and to say that the real transfers were of the shares in SBL.

I want to divert from *Sanofi* for a moment to think about the enormity of what the Indian tax authorities tried to do. Let's assume that the UK taxes gains on sales of shares in UK companies by non-residents. Based on my assumption, consider the following: Tata Motors Ltd. in India owns the UK Jaguar Land Rover Group. In fact, that is not strictly right. Tata Motors owns all the shares in TME Holdings PTE Ltd. (Singapore), a Singapore intermediate holding company. That company owns all the shares in Jaguar Land Rover PLC, a UK resident company. Now suppose (which I hope will not happen), Tatas decide to sell Jaguar Land Rover, and they do so by the Indian

shareholder selling all the shares in TME to another Indian party. How would the Indian tax authorities react if the UK decided TME could be looked through so that the “real” transaction was the sale of shares in Jaguar Land Rover PLC? The answer is, I think, pretty obvious. The repercussions would soon bring an end to any UK-Indian cooperation as recently championed by Prime Minister Cameron on his visit to India in February 2013. Even our GAAR Guidance makes warm noises to the effect that the GAAR would not apply in this sort of international transaction.

Coming back to *Sanofi*, it's not as if ShanH was inserted in the structure to effect the sale. It was incorporated on 31<sup>st</sup> October 2006 and was designed to be the joint holding company for acquiring and holding the SBL stake. Given that both GIMD and MA are French, there was clearly some logic in ShanH being French too. So, the Andhra High Court rejected the tax authorities' contentions that it had no substance and that the transaction was a tax avoidance scheme. They found that neither GIMD nor MA exercised “any extraordinary or chilling control” over the affairs of ShanH so as to warrant a “see-through” attitude towards ShanH. I do not know what chilling control is, but I suppose it causes the person controlled to freeze and do nothing. That was not how ShanH behaved.

Because of the way the case was argued, the Andhra High Court was required to reopen some old sores in the anti-avoidance arena, which the Supreme Court in *Vodafone* had closed. We had another 11 pages on the meaning of Chinappa Reddy J's judgment in *McDowell* and what the Supreme Court thought of it in *Azadi Bachao*. *McDowell* was a somewhat controversial decision of the Supreme Court in 1985, not least because there was Chinappa Reddy J's judgment to the effect that the *Ramsay Principle* had killed off the *Duke of Westminster* in the UK. He was the first importer of the *Ramsay Principle* in Indian case-law, but unfortunately, what was imported did not really fit the facts

before the Supreme Court. Nevertheless, they managed to fit square pegs in round holes and applied the *Ramsay Principle* to a simple sales tax invoicing wheeze. The Supreme Court attempted to make amends in *Azadi Bachao* in 2003 by limiting the *Ramsay Principle* and resuscitating the Duke. The Indian tax authorities did not like *Azadi Bachao*. In fact, I cannot recall such a vehement reaction to a court decision by a taxation authority. The *Azadi Bachao* decision, incidentally, was very important in supporting the taxpayer's judicial victory in *Vodafone*, and was, not surprisingly given that the doctrine of precedent applies in India, followed by the Andhra High Court.

The Indian tax authorities' approach to construing tax treaties was interesting. They tried to apply a broad interpretation to Article 14(5) of the France/India tax treaty dealing with "alienation" of shares representing a "participation" in a company resident in a contracting state. Article 14(5) states:

"Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State."

Alienation is a strange word. One does not come across it in everyday usage. And of course it is not defined in the treaty. It is essentially the same as transfer, but transfer in the normal sense—not the extended anti-*Vodafone* definition as now contained with retrospective effect in the Indian Income Tax Act 1961. The effect of the High Court's decision is that there is no scope for reading "indirect" into alienation or in relation to "representing a participation". If the alienation is directly of shares in a French holding company, the taxing right stays with France. The shares in the French company do not represent participation in the underlying Indian company, only in the French company.

But the fundamental point is that the transaction did not involve double taxation at all. It was simply a French domestic purchase and sale. So of course that is where the taxing right

should be. In *Vodafone*, the Supreme Court distinguished between the “look through” approach and the “look at” approach to construing documents. In following the latter approach, they followed *Westminster*. The Andhra High Court also followed the “look at” approach when looking at the facts and documents.

The rejection of the application of the Indian tax authorities’ attempt to apply the retrospective definition of “transfer” to tax treaties is a sensible result and a shot in the arm for certainty. Of course, as the High Court mentioned, the proposed Indian GAAR will be very broad and will expressly take precedence over treaties, when implemented in 2015. So, the certainty may be short-lived unless the GAAR is applied rationally.

The High Court again emphasised the importance of construing documents holistically. It seems clear that the tax authorities, contrary to what the Supreme Court said in *Vodafone* was permissible, started with the proposition that this must be a tax avoidance scheme and then expended great effort in attacking it.

One worrying trend with these cases on indirect transfers of shares is the length of the judgments on issues of tax avoidance. I wholly endorse the proposition that all the arguments must be dealt with by the judges, no matter how “ambivalent or incoherent” (the High Court’s description of the tax authorities’ argument impugning the commercial substance of ShanH). I would, however, respectfully say that there is something to be said for doing so with greater brevity. The more words used, the greater the risk of misstatement, particularly where judges incorporate subjective treatises on tax theory with selective references to foreign case-law in their decisions.

The Indian tax authorities have decided to take the *Sanofi* case to the Supreme Court, and have made it clear that they intend to reopen the old wounds mentioned above including the impact of the *Azadi Bachao* decision. The war on indirect transfers of shares continues. Watch this space, but please do not hold your breath...