Tax alert: Delhi HC denies the lifting of corporate veil

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The Delhi High Court (HC) has held that taxpayers were only owners of the shares of a company incorporated in British Virgin Islands (A Co), and not the owners of the property (in London) held by A Co. The income from the property which A Co earned, such as, rental income and capital gains on sale of property, could not ipso-facto be treated to be an income of the taxpayers, who were residents of India.

In a nutshell

The taxpayers being shareholders of the company, even if holding all the shares (100%), were only owners of the shares of A Co and not the owners of the property and the income which A Co had earned cannot ipso-facto be treated to be an income of the taxpayers, who were residents of India.

Tax, under the Income-tax Act, 1961 (ITA), being a fiscal statute, can be levied only if a transaction falls within the sweep of statutory provisions; it cannot be taxed by introducing some deeming fiction or concept not married to the ITA. It is a settled position of law that fiscal liability and provisions imposing tax are required to be interpreted strictly.

A taxpayer cannot be dissuaded, rather or penalised for earning an income through legally permissible methods and sources and get optimum return on his investment. If that is to be done, it can only be done by the legislature by enacting a valid law in this regard.

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Background:

- The taxpayers[1] are individuals who had certain papers containing details of expenditure incurred for upkeep, sale, purchase, renovation, maintenance furnishing and leasing of house properties in London. These house properties were owned by a foreign company (A Co) incorporated in British Virgin Islands (BVI).
- The shares of A Co were held by the taxpayers and their relatives, having 20% shareholding each in the said company.
- In the audit proceedings, the Assessing Officer (AO) added the income from house property and also the income from capital gains arising out of sale of the aforesaid London house properties.

  The AO held that the entire investment in A Co was made by the taxpayers, who were residents of India. Also, though the payments were made from their declared sources and under permitted Liberalized Remittance Scheme (LRS) of the Reserve Bank of India (RBI), from time to time, the taxpayers were the real beneficial owner of A Co's assets and thus were liable to pay tax under the Income-tax Act, 1961 (ITA).
- Aggrieved, the taxpayer preferred an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)] challenging the issue of assessing A Co's income in the taxpayers' hands.
  The CIT(A), observed that the taxpayers had active involvement in connection with the purchase/sale of the properties and they had appointed nominee directors in A Co who had no say in the management of the estate of the company and thus rejected the taxpayers' appeal on the taxability of A Co's income in taxpayers' hands.
- Aggrieved, the taxpayers filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT). The ITAT held that the taxpayers were not the beneficial owners of the property or assets of A Co and, therefore, neither any income arising from the property of the said company as capital gain nor any other income of the company such as rent or bank interest, was assessable in the hands of the taxpayer or any of their family members who might have held shares in A Co.
- Aggrieved, the Revenue filed an appeal before the Delhi High Court (HC).

Decision of the HC:

- The taxpayers had invested in shares of A Co, registered under the provisions of law in the BVI. The said company having obtained loan from banks, subsequently purchased properties and earned rental income for 3-4 years, and had also sold the properties at a higher value. Hence, it was A Co which earned rental income and generated gains for itself on account of appreciation in the value of the property it had purchased.
- Since the company and the properties were situated within the precincts of the United Kingdom, tax if any, was payable under the laws of the United Kingdom. The AO had taken it to be a device, essentially because the taxpayers happened to hold 100% shares of A Co.
- In earlier Supreme Court (SC) rulings[2], it has been a consistent view of the SC that Revenue cannot tax a subject without a statute to support, and that every tax payer was entitled to arrange his affairs so that his taxes are as low as possible and he cannot be compelled to choose that pattern which will replenish the treasury.
- What is tax evasion, tax avoidance and when the corporate veil can be lifted has been elucidated by the SC in its earlier ruling[3]. Though after this ruling was delivered, the Finance Act, 2012 brought in amendments in

[1] PCIT, Central-1 vs. Pradeep Wig [2026] 185 taxmann.com 1002 (Delhi-HC)
[2] Mc Dowell & Co. Ltd. vs. Commercial tax Officer [1985] 22 Taxman 11 (SC), Union of India vs. Azadi Bachao Andolan [2003] 132 Taxman 373 (SC) and Vodafone International Holdings B.V. vs. Union of India [2012] 17 taxmann.com 202 (SC)
[3] Vodafone International Holdings B.V vs Union of India [2012] 17 taxmann.com 202 (SC)

the ITA including section 9 of the ITA and introduced General Anti Avoidance Rule (GAAR) provisions. However, neither the provisions of GAAR nor any other provisions introduced in section 9 of the ITA were enough to sustain the tax which has been levied in the instant case.

- Section 9 of the Companies Act, 2013 encompasses the legal position that 'Company' is a juristic person and a separate legal entity from its members.
- The taxpayers' investment in purchase of A Co shares could not be said to be in violation of any of the provisions of law, including the ITA, for the following reasons:
  - A Co was registered in BVI and the properties were situated in the United Kingdom. Tax, if any, was payable under the laws of the United Kingdom.
  - The shares in A Co were acquired by the taxpayers and the amount towards share capital was sent through proper banking channels and remitted under the permitted LRS of RBI.
  - As the remittance was permitted under the LRS scheme of RBI, hence there was a valid approval for acquiring shares in A Co.
  - Apart from its own source, A Co took loans from a bank in the United Kingdom in order to purchase flats and thereby derive rental income.
  - Applicable tax under the laws of the United Kingdom had been paid and there was no denial to this fact.
  - The documents which the AO had recovered during search was related to various expenditure carried out by A Co, which the taxpayers even as shareholders, can ask and have.
- The taxpayers being shareholders of the company, even if holding all the shares (100%), were only owners of the shares of A Co and not the owners of the property as such. Similarly, the income which A Co had earned, could not *ipso-facto* be treated to be income of the taxpayers, who were residents of India. It was only the dividend income *qua* the shares of the company, which could be taxed and not the income of the company itself.
- Tax under the ITA, being a fiscal statute, can be levied only if a transaction falls within the sweep of statutory provisions. It cannot be taxed by introducing some deeming fiction or concept not married to the ITA. It is a settled position of law that fiscal liability and provisions imposing tax are required to be interpreted strictly. As of today, there is no provision of the ITA under which the set of transactions in present case, could be subjected to tax.
- A taxpayer cannot be dissuaded or penalised for earning an income through legally permissible methods and sources, and get optimum return on his investment. If that is to be done, it can only be done by the legislature by enacting a valid law in this regard.

Comments:

While a company is recognized in law as a distinct juridical entity separate from its shareholders, there may arise situations where one may need to look beyond the corporate form, to determine the true nature and ownership of income or assets. Concepts such as lifting of the corporate veil and beneficial ownership may be invoked to examine whether the legal structure reflects commercial reality or has been employed primarily for tax considerations.

The HC in this ruling has, *inter-alia*, held the following:

- The taxpayers being shareholders of the company, even if holding all the shares (100%), were only owners of the shares of A Co and not the owners of the property and the income which A Co had earned cannot *ipso-facto* be treated to be an income of the taxpayers, who were residents of India.

- Tax, under the ITA, being a fiscal statute, can be levied only if a transaction falls within the sweep of statutory provisions. It cannot be taxed by introducing some deeming fiction or concept not married to the ITA. It is a settled position of law that fiscal liability and provisions imposing tax are required to be interpreted strictly.
- A taxpayer cannot be dissuaded, or penalised for earning income through legally permissible methods and sources, and get optimum return on his investment. If that is to be done, it can only be done by the legislature by enacting a valid law in this regard.

It is pertinent to note that the HC has also, based on facts of the case, observed that neither the provisions of GAAR nor any other provisions introduced in section 9 of the ITA were enough to sustain the tax which has been levied in the instant case.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.