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This issue contains:

Kind regards

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SECP opposes criminal penalty for insider trading

The Securities and Exchange Commission of Pakistan (SECP) here on Tuesday opposed introduction of criminal penalty (imprisonment) for committing the crime of 'insider trading' on the stock exchanges under the proposed Securities Act and strongly suggested to change criminal penalty to civil penalty for charging heavy fine, speedy recovery and implementation of other administrative/enforcement actions in capital markets.

While explaining the objectives of the proposed Securities Act at National Assembly Standing Committee on Finance, SECP Chairman Muhammad Ali shared with the committee that some vested interests in Karachi, having no role in stock market, have threatened SECP that they would try to block the approval of Securities Act from NA body as well. "We want insider trading as civil offence, as it is very difficult to prove insider trading in criminal law", the SECP chairman said.

He said that there is no role of common man in country's stock market and the new legislation would help them make safe investment in securities. Through the effective legislation, the proposed Securities Act, it would restore the confidence of the small investors and encourage them to make investment in the capital market.

He said that the present law is silent on the issue if anyone establishes stock exchange without SECP approval. From legal point of view, at present this is not a crime and SECP is not able to go after the persons who would do so.

When MNA Bushra Gohar termed the new legislation as martial law for stock market, Muhammad Ali assured the committee that at all present practices of stock market are being made part of the proposed Securities Act so as to regulate them accordingly and nothing unfair would be included in it. SECP termed 90 percent players in stock market as good guys and said that there is a need to have a proper legislation to deal with 10 percent bad guys.

He said that proposed Securities Act would help meet the national obligations related to anti-money laundering in stock market as the proposed legislation would make it mandatory for the brokers to get in filled all the documents required for identity and safer investment. He said that a key section of proposed legislation would make it mandatory for disclosure of price-sensitive information by the companies to shareholders as well as investor so that no one on the Board of Directors or key official, including chief executive of the company, would use this information for his personal benefit through insider trading.

The representative of the Ministry of Law clarified to the committee that the Finance Ministry has proposed to consider insider trading as criminal offence and Law Division had not floated this proposal. On the recommendation of the Ministry of Finance, insider trading has been treated as criminal offence to fulfill obligations under the anti-money laundering law.

The SECP Chairman informed the committee that due to anti-money laundering obligations, a criminal penalty for insider trading in stock market has been proposed. However, he said, SECP strongly supports civil penalty like fine and removal from key posts or Board of Director upon proof of insider trading.

Despite the fact that the insider trading has been declared as criminal offence in many modern regimes, Pakistan's stock markets are young as compared to other markets which are operating for last many years. "It is very difficult in our jurisdiction to prove insider trading as criminal offence due to prolonged litigation". The punishment of the insider trading under the criminal offence is imprisonment and when any judicial system is going to give punishment of imprisonment, the evidence should be very strong to prove such harsh punishment to the violators, Muhammad Ali added.

He further stated that although criminal penalty like imprisonment is proposed in new legislation, it would be difficult to prosecute the persons involved in insider trading. Practically, the cases would take decades to decide and people involved in insider trading would be at liberty to continue insider trading and distort the market. The civil penalty would help improve compliance and help menace of insider trader. It is hoped that the insider trading would come to an end after making it a civil offence. If the insider trading would continue to be a criminal offence under the proposed law, there are apprehensions that the menace of the insider trading could not be controlled in the stock exchanges.

Muhammad Ali also referred to two cases of insider trading in USA where imprisonment over six months was given to the persons who committed the offence.

He admitted that there is rampant manipulation in stock market which is evident from the present state of affairs in the capital market. He said that stock market crisis of 2005 and 2008 was due to the selling of client's shares by the brokers and then winding up of brokerage houses. To stop this kind of practice in brokerage houses, SECP has barred the brokers from clubbing their own assets and assets of the claims in proposed Securities Act.

He said that no matter the big players sit at night and set strategy for lowering or raising price of shares for next day at stock market, SECP has put in place a mechanism for elimination of this act by putting condition of display of transactions on stock market computer screen as well settlement of these transactions through clearing house the same day. Explaining the proposal contained in the proposed SECP Act on establishment of SECP Tribunals for quick disposals of cases, SECP Chairman said that Supreme Court of Pakistan has already termed placing 30 days or 90 days deadlines and relevant clauses in legislations as recommendatory in nature. A director of the SECP informed the committee that the commission can seek assistance of the local police for taking administrative actions under the proposed Securities Act. The new law is separate and a self-contained law. "We can call the local police for enforcement actions required under the law". – *Courtesy Business Recorder.*

Supreme Court's speedy decision of tax cases fetched Rs 100 billion revenue: Hafeez

Finance Minister Dr Abdul Hafeez Sheikh has said that speedy disposal of major tax related cases involving billions of rupees by the Chief Justice of Pakistan had helped the government generate additional revenue of Rs 100 billion.

He said that economy of Pakistan is passing through a difficult phase, mainly because of policy lapses, external shocks, and other factors.

While inaugurating the three-day 27th annual general meeting and conference of Pakistan Society of Development Economists (PSDE) arranged by Pakistan Institute of Development Economics (PIDE) here on Tuesday, he said that at present Pakistan's economy is on the path of recovery.

He further identified control of fiscal deficit, increase in tax collection and participation of private sector, among other things, as key challenges facing Pakistan's economy.

Due to high fiscal deficit (over 6 percent of GDP), which increased because of higher security spending and rise in international oil prices in the last three years, non-development expenditures have been kept at a freeze.

He added that the Federal Board of Revenue has issued tax notices to over 0.2 million persons, of which t25,000 people have started paying taxes.

Hafeez expressed firm resolve of the government that this year about 0.7 million tax evaders would be brought into the tax net, who possess properties and frequently travel abroad, but pay no tax.

"We will go after these evaders and collect taxes from them as the country cannot progress without tax collection," he said.

He also outlined the concrete steps taken by the government that helped put Pakistan's economy on a sustained growth path.

The government allocated additional Rs 800 billion to the provinces and their share in total revenue is now 60 percent, whereas Balochistan is given 110 percent additional resources from Federation.

Gilgit-Baltistan and FATA will also get more resources, he added.

For the development of higher education, HEC gave Rs 40 billion.

Last year, GDP growth was estimated at 4.6 percent, which could not cross 2.6 percent because of floods and other shocks, he said, adding that exports were $25 billion and remittances reached $1 billion a month.

The Minister said that Rs 6 billion has been collected in taxes so far.

Mentioning the difficulties being faced by the government in managing inflation, which is now hovering around 12-13 percent at present, he said that during the last five months inflation had reduced.

Earlier, Dr Rashid Amjad, Vice Chancellor of PIDE and President of Pakistan Society of Development Economists, said that despite many setbacks, Pakistan's economy has shown great resilience. – *Courtesy Business Recorder.*

Nato containers scam: FBR hands over complete record to NAB

In an extraordinary development in Isaf/Nato containers scam, the Federal Board of Revenue has handed over all the relevant record and documents to the National Accountability Bureau (NAB) for initiation of criminal proceedings against the customs officials and others involved in the scam.

A senior government official confirmed to here on Tuesday that the FBR has given all relevant record pertaining to the Isaf/Nato containers scam to the NAB for further investigation and initiation of criminal proceedings against the culprits.

"Yes we have handed over all the relevant documents to the NAB for further investigation covering the criminal side, whereas the recovery and adjudication process would be carried out by the FBR," the official added.

The Board had unearthed duties and taxes' evasion of over Rs 55 billion as 28,802 containers carrying International Security Assistance Force (Isaf) commercial cargo under Afghan Transit Trade (ATT) went missing en route from Karachi Port to Afghanistan.

Besides, rest of the 322,000 containers, dispatched for Afghanistan from Karachi under non-commercial category, meant for Isaf have not been found yet, further denting national exchequer heavily.

The Supreme Court of Pakistan had issued directives to the Chairman of National Accountability Bureau (NAB) to cooperate with the FBR Chairman to initiate proceedings against criminals involved in the scam whereas the FBR Chairman was directed to conduct adjudication against the people involved in the scam whose cases would be referred to the NAB, if they are at fault.

In this scam, the loss of revenue in terms of duties and taxes was around Rs 55 billion.

However, clearance collectorates have adjudicated 108 cases against 184 containers so far, whereas total liability adjudged against them is Rs 424 million (duty & taxes) along with Rs 210 million penalty (total Rs 634 million). – *Courtesy Business Recorder.*

2011 PTR 1454 (H.C. Del.)

<u>HIGH COURT OF NEW DELHI</u>

A.K. Sikri and M.L. Mehta, JJ.

General Electric Company & Anr
v.
Deputy Director of Income-Tax Circle 1(2), New Delhi & Others

FACTS/HELD

1. **Even if "Representative Assessee", no liability for unconnected income**
2. The whole of the share capital of Genpact India, an Indian company, was held by a Mauritius company. The whole of the share capital of the Mauritius company was in turn held by General Electric Co, USA. The Mauritius company "gifted" the shares of Genpact India to another Mauritius company, whose shares were then ultimately sold to a Luxembourg company. The AO claimed that the transaction of transfer of shares of Genpact India had resulted in capital gains to General Electric, USA, and so he issued a notice u/s 163 proposing to treat Genpact India as an "agent" of General Electric and to assess it as a "representative assessee". This was challenged by a Writ Petition. HELD upholding the challenge:

   The mere fact that a person is an agent or is to be treated as an agent u/s 163 and is assessable as "representative assessee" does not automatically mean that he is liable to pay taxes on behalf of the non-resident. U/s 161, a representative assessee is liable only "as regards the income in respect of which he is a representative assessee". This means that there must be **some connection or concern between the representative assessee and the income**. On facts, even assuming that Genpact India was the "agent" and so "representative assessee" of General Electric, there was **no connection between Genpact India and the capital gains alleged to have arisen to General**

Electric (from the sale of shares of Genpact India). Consequently, the s. 163 proceedings seeking to assess Genpact India for the capital gains of General Electric were without jurisdiction.

Petition allowed.

W.P. (C) 9100 of 2007.

Heard on: 12th July, 2011.

Decided on: 12th August, 2011.

Present at hearing: Harish Salve, Sr. Advocate with Anuradha Dutt, Fereshte Sethna, Anish Kapur, Ekta Kapil, Kuber Dewan, Shweta and Pratyush Miglani, Advocates, for Petitioner. Mohan Parasaran, A.S.G. with Sanjeev Sabharwarl, Sr. Standing Counsel, Soheb Horrain, Alok P. Kumar and Aarthi Rajan, for Respondent.

JUDGMENT

A.K. Sikri, J.–

1. By the present petition, the petitioners are challenging the legality and validity of the notices dated 10.04.2007 and 10.10.2007 issued under Section 163 of the Income Tax Act (hereinafter referred to as „the Act‟) vide which respondent No.1 proposes to treat respondent no.4 as an agent of the first petitioner and make an assessment on respondent No.4 as a representative assessee of the first petitioner.

2. Vide impugned notices served upon the respondent No.4 treating as a representative assessee of the petitioner No.1, the Department is seeking to bring within the tax net the purported income generated by the petitioner No.1 as capital gains arising from the transfer of shares of respondent No.4 which were held by the petitioner No.1. The contention of the petitioners is that such a transaction is not chargeable to tax in India when petitioner No.1, a non-resident company has transferred the share holding to another non-resident. However, that was not the issue canvassed before us. At present, the challenge to the validity of the aforesaid notice is confined on the ground that the respondent No.4 cannot be treated as representative assessee of the petitioner No.1 and therefore, the impugned notice is without any jurisdiction. We would, thus, like to take stock of the relevant facts surrounding this issue.

3. The first petitioner is a company incorporated in the State of New York in the United States of America its principal place of activity is the United States and it has business interests all over the world. It has been assessed to tax in India over the last several years in respect of its income taxable in India, as a non-resident, initially by the Deputy Commissioner of Income Tax 1(2) and currently by the Assistant Director of Income Tax, International Taxation, 3(1) at Mumbai. The second petitioner is a

company incorporated in Mauritius that holds shares of group companies and investments and had a wholly owned subsidiary in India called GE Capital International Services (for brevity „GECIS‟), now known as Genpact India, which is registered under the Companies Act, 1956 and is respondent No.4 herein. Respondent No.1 is the Deputy Director of Income Tax, International Taxation, who has issued a notice under Section 163 of the Act to the respondent No.4, i.e., impugned in the present petition. Respondent No.2 is the Assistant Director of Income Tax, who subordinate to respondent No.1 has taken further proceedings pursuant to the notice issued by the respondent No.1. Although the respondent No.4 is made a party to the petition, it has been added only as a proper/proforma party and no relief has been sought or claimed against it.

4. GECIS was incorporated in or about 1997 under the Companies Act, 1956 to carry on the business of computer software, i.e., data entry conversion, data processing, data analysis, business support billing, etc. The entire share capital of GECIS was acquired by the second petitioner along with certain individuals as nominee shareholders in 1998 with the approval of the Foreign Investment Promotion Board. The second petitioner is a wholly owned subsidiary, through various intermediate holdings, of the first petitioner. The remote business processing and offshore support operation that provided specified business process outsourcing services (BPO) to the first petitioner and its affiliates were carried out from facilities located in India (through GECIS as explained aforesaid), as well as in China, Hungary, Mexico, the United Kingdom and the United States of America, through other, this BPO business grew, acquiring outside clients apart from the petitioner‟s group of companies and gathered value. With certain investors evidencing interest in acquiring 60% of the petitioner‟s BPO business and, with a view to divesting it worldwide ownership in companies through which such business was conducted, the petitioners‟ along with other affiliated companies embarked on a series of transactions in December, 2004.

5. The series of transactions entered into in transferring the shares with the objective of acquiring of the BPO business of the petitioner is set out in Annexure-A to the writ petition. Though that may not be very relevant for deciding the controversy, for the sake of completing the narration of facts, we are reproducing the same as well:

"Particulars of Series of Transactions Undertaken in December, 2004

1. The first step in the series of reorganization and restructuring transactions to consolidate petitioners‟ BPO business in a single Luxembourg holding company was the transfer by the second petitioner of the shares it owned in GECIS to GECIS India Investments by way of a gift. Certain individuals who were nominee shareholders of shares of GECIS likewise made a

gift of the shares held by them to GECIS India Holdings GE CIS India Investments is a Mauritius incorporated company and a wholly owned subsidiary of GECIS India Holding, which is also incorporated in Mauritius and which, in turn, was set up as a wholly owned subsidiary of the second petitioner.

The Second Petitioner had intimated to the Reserve Bank of India the factum of the gifts of the GECIS shares held by the First Petitioner as well as the nominee shareholders. The Reserve Bank of India, by its letter dated 16th June, 2005, had taken the transactions of the gift on its record as general permission was available for the gifts and the GECIS shares had initially been acquired after obtaining Reserve Bank of India approval. The petitioners crave leave to refer to and rely upon the correspondence with Reserve Bank of India when produced.

2. The next step undertaken was that the Second Petitioner transferred the shares it held in GECIS India Investments to another subsidiary company incorporated in Mauritius viz., GECOS India Holdings at their fair value and in consideration of such transfer, it was issued shares in GECIS India Holdings.
3. Thereafter the Second Petitioner transferred its shareholding in GECIS India Holdings to another subsidiary company incorporated in Mauritius viz., GECIS India International and in consideration of such transfer, it was issued shares by GECIS India International.
4. Thereafter the Second Petitioner transferred the shares it held in GECIS India International to another subsidiary, GECIS Gibraltar (set up as a wholly owned subsidiary of the Second Petitioner) which was a company incorporated in Gibraltar and in consideration of such transfer, it was issued shares in GECIS Gibraltar.
5. Simultaneously a company incorporated in Luxembourg wholly owned by the Second Petitioner as the new holding company of the Petitioners‟ BPO business viz., GECIS Global Holdings directly and indirectly through its subsidiaries bought out the shares/assets of the other operating companies which carried on the petitioners‟ BPO business activity in the United States, the United Kingdom, Hungary Mexico and China.
6. The Second Petitioner thereafter transferred its shareholding in GECIS Gibraltar to GECIS Global Holdings for a consideration which was discharged by issue of common stock, preferred stock, as well as a payment of US $37 million in cash by GECIS Global Holdings to the Second Petitioner. Subsequently GECIS Gibraltar was liquidated and hence the shares of GECIS India

International which hitherto belonged to GECIS Gibraltar were distributed to GECIS Global Holdings in liquidation.

7. The Second Petitioner in turn transferred the preferred stock it received in GECIS Global Holdings to GE Luxembourg Investments S.a.r.l, a company incorporated in Luxembourg for a consideration which was secured by issue of promissory notes by GE Luxembourg Investment S.a.r.l.
8. GE Luxembourg Investments S.a.r.l thereafter transferred the preferred stock it held in GECIS Global Holdings to another company incorporated in Luxembourg called GECIS Global (Lux), and in consideration of such transfer was issued preferred and nominal common stock of GECIS Global (Lux).
9. These restructuring and reorganization transactions detailed in this Annexure A were taken by the various affiliates of the First and Second Petitioner pursuant to a Security Purchase Agreement dated November, 7, 2004 entered into between the First Petitioner, the Second Petitioner and certain of its affiliates and General Electric Capital Corporation of the one part, and Garuda Investments Company (which was subsequently substituted by GECIS Investments Co. (Lux), f the other part.
10. Ultimately 99.1% of the preferred stock and 60.6% of the nominal common stock held by GE Luxembourg Investment S.a.r.l in GECIS Global (Lux) was transferred to GECIS Investments Co. (Lux) for a consideration equivalent to its cost of acquisition.
11. The name of GECIS was changed to Genpact India and the name of GECIS India Investments was changed to Genpact India Investments. GE Luxembourg Investment S.a.r.l was liquidated in December 2006."

6. As per the petitioners, these operations in different jurisdictions were carried out through various entities and controlled through separate entities keeping in mind the business expediency of the petitioner. The investors who desired to take over these business entities, were desirous of acquiring shares of a single holding company entity – which required a reorganization of the structure. The net effect of these restructuring and reorganization transactions which were undertaken pursuant to a Securities Purchase Agreement dated 07.11.2004 entered into between the first petitioner, second petitioner and some of its affiliates and General Electric Capital Corporation, of the one part, and Garuda Investment Company (which was subsequently substituted by Gecis Investments Co. (Lux) (hereinafter referred to as the "Securities Purchase Agreement") of the other part. An amendment as well as ancillary agreements was also executed between these sets of parties.

7. The consequence of these agreements was that:

(a) The shares of the Indian company moved, by a gift, from GECIM a Mauritius company to GECIS India Investments – another Mauritius company.

(b) The shares of the GECIS India Investments were transferred to a holding company. The shares with the holding company were then transferred and so on in a series of transactions, and finally the holding company was GECIS Global Holdings, in which other BPO businesses from other countries were also consolidated.

(c) The shares of GECIS Global holdings were sold to a Luxembourg company, and through a series of transactions, the holding shares were acquired by Gecis Investments Co. (Lux).

(d) In the aforesaid manner, Gecis Investments Co. (Lux) acquired 99.1% of the preferred stock and 60.6% of the nominal common stock of GECIS Global (Lux) a newly organized Luxembourg company and which was a transfer of a capital asset situated outside India – i.e. shares in a company incorporated in Luxembourg.

8. As per the petitioners, the only capital asset in India which was transferred in the course of the restructuring and reorganization transactions was the gift of the shares of CECIS by the second petitioner – a Mauritius company and certain nominee shareholders to GECIS India Investments and GECIS India Holdings, respectively (each a Mauritius incorporated company). Therefore, no income had accrued or arisen or can be deemed to accrue or arise in India. The Income Tax Department, on the other hand, maintains that it is a taxable event in India.

9. However, as pointed out above, we are not concerned with this aspect in the present proceedings. We are at a stage anterior to that as the question before us is as to whether the respondent No.4 can be treated as representative assessee of the first petitioner.

10. The first petitioner had filed its return of income for the assessment year 2005-06 on 29th October, 2005 with the Assessing Officer, having jurisdiction over the first petitioner's case, viz., the Assistant Director of Income Tax (International Taxation 3(1), Mumbai. The first petitioner declared a total income of Rs. 2,64,07,840/- that accrued to it from rendering certain technical services to GECIS and had filed with its return of income a computation of its total income as well as the Transfer Pricing Report required to be furnished in From 3CEB.

11. Thus, the first petitioner though a non-resident is assessed in India in respect of income which it is earning from operations in India and which income can be deemed to accrue or arise out of transactions in India. Fact remains that the petitioner No.1 is assessable in India and

comes within the jurisdiction of Assistant Director of Income Tax, Range 3(1), (International Taxation), Mumbai. As far as the petitioner No.2 is concerned, it had filed its Transfer Pricing Report (International Taxation) Mumbai stating that other than interest on which tax was deducted at source at the appropriate rates, no other income is exigible to tax in India. On the basis, it was informed that the petitioner No.2 was not filing in income tax return.

12. Respondent No.1 who is the Deputy Director of the Income Tax (International Taxation) in New Delhi issued a show cause notice dated 11.04.2007 to the respondent No.4. In this notice, it was stated that from the records available with him, it appeared that General Atlantic Partners and Oak Hill Capital had purchased 60% shareholding in respondent No.4 from the first petitioner. The notice further recites that the said shareholding transferred which was valued at US Dollar $500 million and that no application was made under Section 197 of the Act by the payee "with regard to the transactions relating to the sale of the stake" in respondent No.4. It was further stated that the income arising to the first petitioner from the sale of its direct/indirect stake in respondent No.4 is liable to tax in India in view of the deeming provisions contained in Section 9(1)(i) of the Act. It was proposed in the notice to treat the respondent No.4 as an agent and consequently, the representative assessee of the first petitioner under the provisions of Section 136 read with Sections 160 and 161 of the Act and proposed to proceed to act in accordance with law. This show cause notice also referred to the earlier notice dated 02.11.2006 issued to the respondent No.4 stating that such information had not been furnished. Accordingly, the respondent No.4 was required to show cause as to why such action of treating the respondent No.4 as representative assessee be not taken and income accrued to the petitioner No.1 assessed in accordance with the law.

13. Respondent No.4 submitted its reply to the said show cause notice, *inter alia*, stating that it had no obligation to deduct the tax at source in respect of such transactions between the petitioners on the one hand and General Atlantic Partners and Oak Hill Capital on the other hand. According to it, merely because by the said transaction, shareholding of respondent No.4 was transferred by one party to other, both being non-resident, the respondent No.4 could not be treated as representative assessee. Since none of the conditions specified in Section 13 of the Act were fulfilled. It was also submitted that the petitioner No.1 is not and had never been a direct shareholder of respondent No.4 and therefore, question of any income accruing or arising to the petitioner, which is chargeable to tax in India would not arise.

14. Nothing happened for almost six months. However, a letter dated 10.10.2007 was addressed by the respondent No.2 to respondent No.4 asking for some more information. It is averred in the petition that this

letter could not be served upon the respondent No.4 and, therefore, it was again sent and served upon the respondent No.4 along with letter dated 26.10.2007. From this letter, the petitioners were informed about the proposed move of the respondent No.1 to 3 to treat the respondent No.4 as an agent of the first petitioner.

15. After receiving this information, the petitioners filed the present petition in December, 2007 questioning the proprietary, validity and legality of the aforesaid show cause notice. Notice in this involved writ petition and stay application was issued on 06.12.2007, but no *ex parte* stay was granted by this Court. Against non-grant of interim relief, the petitioners filed Special Leave Petition in which orders dated 14.12.2007 were passed restraining respondent Nos. 1 to 3 from passing final orders pursuant to show cause notices issued by the respondents. This stay was made applicable till 13.02.2008 when the matter was coming up before this Court. This Court has thereafter extended the said interim directions from time to time. Vide orders dated 23.03.2008, the interim orders passed by the Supreme Court on 14.02.2008 was continued till the disposal of the writ petition.

16. On 18.01.2008, in reply to show cause notice, an affidavit was filed on behalf of the respondent Nos. 1 and 2 to which rejoinder affidavit was also filed by the petitioners. However, thereafter a detailed counter affidavit dated 17.07.2008 was filed by the Department which is more comprehensive and incorporates the submissions made in earlier affidavit dated 18.1.2008 as well. We would like to point out at this stage that in the writ petition, the petitioners have also stated that from the transactions in question, no income has accrued or arisen to the petitioner No.1 which is taxable in India. This position is contested by the Official Respondents explaining their stand in much detailed in the counter affidavit. However, as pointed out above, since we are not concerned with that issue in the present petitioner, which was not pressed or argued by the petitioners, we are avoiding to take note of such averments for this reason.

17. The respondents have challenged the maintainability of the writ petition by raising certain preliminary objections. The main emphasis of the respondents in the counter affidavit and in particular the argument that was pressed at the time of hearing was that the matter is still at the show cause notice as to why the respondent No.4 be not treated as agent of petitioner No.1 and writ petition challenging show cause notice is not maintainable and the statute provides for efficacious remedy of appeal under the Act. It is also contended that writ petition is pre-mature as well. Maintainability is also challenged on the ground that disputed questions of fact arise and the High Court in exercise of its extraordinary jurisdiction under Article 226 of the Constitution of India would not exercise its discretionary powers in such a scenario.

18. The official respondents have also narrated the facts which led to the issuance of the show cause notice proposing to treat the respondent No.4 as the representative assessee. It is stated in this behalf that the respondent No.4, i.e., Genpact India was earlier known as GE Capital International Services (GECIS)/BPO company. The BPO company was created for providing BPO/IT-enabled services to petitioner No.1 and its affiliates with a paid up capital of Rs.3,60,00,000/-, comprising of 36,00,000 equity shares of Rs.10 each. It was the captive BPO unit of the GE Group. That out of 36,00,000 shares, GE Capital International Mauritius (GECIM) (hereinafter referred to as „the Mauritius company") was holding 35,99,980 shares till 31.12.2004. The said Mauritius company was in turn held by another Indian company, i.e., M/s GE Indian Services Holding Pvt. Ltd., which through the maze of various intermediate companies was ultimately held by General Electric Company, a corporation of United States of America, the petitioner herein. The income of BPO company during Financial Year ended 31.03.2004 and 31.03.2005 was of Rs.2,630 Crores. BPO company has been claiming deduction under Section 10A of Act for various years in respect of its income earned from BPO services. The company had not distributed/paid any dividends since its inception. The name of GECIS/BPO company was changed to Genpact India with effect from 06.06.2006, after the so-called reorganization of December, 2004. Genpact India/BPO company, through its authorized representative RSM & Co., filed an application under Section 195 of the Act on 25.07.2006 to the Income Tax Officer, (TDS), Ward (1), International Taxation, New Delhi, seeking a „NIL" withholding certificate with regard to payment of Rs.4800 lacs to another Mauritius company Genpact India Investments, Mauritius for the proposed buy-back of shares by the BPO company. Genpact India brought back 32,000 equity shares at a price of Rs.15,000/- per share. This transaction is different from the transactions during the year 2004 for which the petitioners have filed the present writ. During the proceedings under Section 195(2) of the Act, BPO company submitted that on 30.12.2004, GECIM (Mauritius company) contributed shares of BPO company to GECIS India Investments, Mauritius (GII) – another Mauritius company, which is wholly owned subsidiary of Mauritius company. This wholly owned subsidiary was incorporated in Mauritius on 07.12.2004 (i.e., after the Securities Purchase Agreement of 17.11.2004) and its name was subsequently changed to Genpact India Investment on 04.10.2005. These facts, which became available, indicated that the shares of BPO company, which were valued at Rs.15,000/- per share in 2006 were transferred by Mauritius company to GII at „Nil" value in December, 2004. In fact, the General Atlantic Partners, General Electric and Oakhill Capital Partners issued a joint press release on November 08, 2004. Upon perusal of press release, it is noticed that the transaction values GECIS/BPO company at $800 million. Upon closing GE rain a 40% stake in GECIS and receive cash proceeds approximately $500 million. It also states that the parties aim to complete the transaction sometime in the next six

months. Further, BPO company was carrying on a successful business and had potential to grow further. Its operations centres were not confined to Gurgaon only, but were started at other places also. It had hung reserves and surpluses. The petitioner No.1 through its various subsidiaries/affiliated companies sold 60% of its stake in GECIS/BPO company for approximately US$ 500 million. That on the basis of information collected during TDS proceedings and also information available in public domain, a *prima facie* belief was form that as per the provisions of Section 9(1)(i) of the Act, the income arising from these transactions, which otherwise was taxable in India but had not been offered to tax. The official respondents have maintained in the counter affidavit that conditions stipulated in Section 163 of the Act are satisfied and therefore, impugned show cause notice being perfectly valid, has rightly been issued.

19. Respondent No.4 has also filed the counter affidavit supporting the aforesaid legal stand taken by the petitioners questioning the validity of the impugned show cause notice.

20. Mr. Harish Salve, learned Senior Counsel appeared for the petitioners, has advanced detailed arguments in support of the plea that the respondent No.4 could not be treated as representative assessee qua the purported incomes of the first petitioner as the ingredients of Sections 161 and 163 have not been satisfied in the present case.

21. Frontal attack to the impugned show cause notice by Mr.Salve was predicated on the admitted position prevailing on the record of this case, which according to him, was as follows:

> The transaction in relation to which the present proceedings have been initiated relates to the transfer of shares of a holding company (which through downstream companies) controlled indirectly shares in a company was GE Capital International Services – respondent No.4).
>
> According to him, it is not in dispute that prior to the transfer (December, 2004), the shares in Genpact India were held by a Mauritius based entity – GE Capital International Mauritius (GECIM) – petitioner No.2. Above GECI, there were other holding companies and the ultimate controlling interest was with General Electric Company US – petitioner No.1. It is also not in dispute that as a result of the transfer of the shares of the upstream holding company, ownership (direct/indirect) to the extent of 60% approx of the shares of Genpact India stood transferred, and consequently the control also stood transferred. The question whether this transfer of shares of an upstream company resulted in a capital gain in the hands of the transferor – or petitioner No.1 – is a matter that would require consideration. The issue of the validity of the show cause notice

has, in the first instance, to be decided on the applicability of Section 163 on the facts as alleged in the show cause notice on a demurrer assuming them to be correct.

Respondent No.4 is the "target company", i.e., the company, the control of which has shifted on account of sale of shares (of the Luxembourg Company) – prior to the transaction, it was known as GE Capital International Services (GECIS India). GECIS India is the Indian company whose control passed pursuant to the transaction.

22. Mr. Salve‟s argument was that the aforesaid facts clearly demonstrate that conditions stipulated in Section 163 of the Act for the purpose of treating respondent No.4 as an agent of the petitioner No.1 had not been fulfilled. His submission was that Section 163 of the Act has to be read in conjunction with Section 161, which provides that the specified person can be treated as assessee "*…as regards the income in respect of which he is a representative-assessee…*" Therefore, an agent can only be a representative-assessee as regards the income in respect of which the alleged agent has business connection and/or from or through directly and/or indirectly the income was received.

23. In support of the aforesaid propositions, Mr. Salve relied upon the following case laws:

(1) *The Commissioner of Income Tax Vs. Currimbhoy Ebrahim and Sons* [AIR 1936 P.C. 1].

(2) *Ramnarayan Rajmal Vs. Commissioner of Income Tax* [(1953) 24 ITR 442.

(3) *P. Subramania Chetty Vs. Commissioner of Income Tax* [(1962) 46 ITR 724 Mad.]

(4) *C.R. Nagappa Vs. Commissioner of Income Tax* [(1969) 73 ITR 626 (SC)].

(5) *CIT Vs. Toshoku Ltd.* [(1980) 125 ITR 525]

(6) *CIT Vs. Fertilizers & Chemicals (Travancore) Ltd.* [(1987) 166 ITR 823.

24. Mr. Mohan Parasaran, learned A.S.G. pressed for dismissal of the writ petition as pre-mature and not maintainable at the show cause notice stage, forcefully contending that the matter was still at the stage of investigation and was being investigated. According to him, it was in the realm of disputed questions of fact and further facts could be gathered during investigation and therefore, this Court should not interfere at this stage, particularly, when the petitioners were not remediless, as the statute, viz., Income Tax Act provides for the remedies of appeal, writ petition, etc. In the wake of such alternative remedies available, the writ petition should be thrown at the threshold, was the vehement submission of Mr. Parasaran. He further submitted that in any case the main notice

vide which the respondent No.4 was sought to be assessed as the representative assessee of the petitioner No.1 was perfectly in accordance with the law as all the conditions for treating it as an agent of petitioner No.1 were satisfied. Referring to Section 163 of the Act, he submitted that any agent in relation to a non-resident includes any person in India, who has business connection with non-resident which fact was established on record in the present case. In this behalf, he submitted that the business connection between the petitioner No.1 and respondent No.4 were clearly established in view of the following factual position:

> The Secretariat for Industrial Approvals, Foreign Collaboration-II Section of the Government of India had allowed GE Capital Services India Ltd., New Delhi to have GE Capital Services, USA as the foreign collaborator for setting up the wholly owned subsidiary companies to undertake the business of hire purchase and lease financing and financial billing and services company.
>
> The Government of India, Ministry of Industry, Department of Industrial Policy and Promotion, Secretariat for Industrial Assistance, EOU Section vide letter No.FC/98/EOP/46/97 had allowed M/s GE Capital International Services, AIFACS Building, 1 Rafi Marg, New Delhi had conveyed approval to their foreign collaboration proposal. The name of foreign collaborator and country was GE Capital International (Mauritius), Mauritius (a subsidiary of M/s General Electric Capital Corporation, USA). The approval was for the manufacture of computer software. This approval dated 09.01.1998 was amended on 02.03.1998 as per request letter dated 20.02.1998 of M/s GE Capital International Services. As per the amendment, the foreign collaborators were M/s GE Capital International (Mauritius), Mauritius and M/s GE Capital Indian Service, Netherlands. The approved items of manufacture were computer software (data entry, conversion, data processing, data analysis, business support, billing, etc.) GE Capital International Services (Genpact India) has rendered IT-enabled services to General Electric Corporation and its affiliated companies since its incorporation in India. During the year ended 31.03.2005, the income of respondent No.4 form IT-enabled services were of Rs.13,518,433,002/-. Such income was Rs.12,788,233,532/- for the year ended 31.03.2004. The accounts of the company show the following transactions with the related parties with regard to each income:

Particulars	Holding Companies		Fellow subsidiary companies	
	31st March, 2005	31st March, 2004	31st March, 2005	31st March, 2004
Income from IT enabled services	6,153,984,825	3,675,372,862	7,129,591,134	8,746,058,412

> Further, the respondent No.4 (Genpact India) was a wholly owned subsidiary of the first petitioner and the latter is carrying on its IT-enabled services business in India through this subsidiary. This is an admitted position in para No.8 & 9 of the writ petition. The term business connection is not exhaustively defined in the Income Tax Act, 1961. However, various authorities have time and again interpreted this term.

25. In support of his submissions, he relied upon the judgment of the Supreme Court in the case of *Income Tax Vs. R.D. Aggarwal and Co.* [1965 AIR 1526] wherein the Apex Court had enumerated the broad characteristics of the concept of business connection in the following words:

> "Business connection contemplated by section 42 involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in the taxable territories, a stray or isolated transaction not being normally regarded as a business connection. Business connection may take several forms: It may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in the table territories, which facilitates or assists the carrying on of that business. In such cases the question whether there is business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case. The expression „business connection‟ postulates a real and intimate relation between he trading activity carried on outside the taxable territories and the trading activity within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity."

26. Mr. Parasaran submitted that the issue of jurisdiction for the issue of notice under Section 163 of the Act came up for consideration before the Kerala High Court. The Kerala High Court in the case of *Commissioner of Income Tax Vs. Fertilizers and Chemicals (Travancore) Ltd*. [(1987) 166 ITR 0823] held that a non-resident may have several representative assessees in respect of several heads under which income is derived by him. There can, therefore, be more than one assessment in respect of income accrued or arisen to a non-resident provided that there is more than one representative assessee. Direct assessment on the non-resident in respect of other income would not affect the jurisdiction of the Income Tax Officer to assess the agent of the non-resident on income

arising to the non-resident through him. Moreover, the respondent No.2 exercises jurisdiction in respect of persons being non-residents including foreign companies within the meaning of sub-section (23A) of Section 2 of the Act and having a permanent establishment "in terms of the applicable Double Taxation Avoidance Agreement in the areas lying within the territorial limits of National Capital Territory of Delhi or having a business connection" or having any source of income accruing or arising or deemed to be accruing or arising in the areas lying within the territorial limits of National Capital Territory of Delhi. Respondent No.4 (Genpact India) is a company incorporated under the Companies Act, 1956 and having its registered office at Delhi Information Technology Park, Shastri Park, Delhi – 110053. Therefore, the jurisdiction over the first petitioner, who is having business connection as well as the source of income within the territorial limits of National Capital Territory of Delhi lies with respondent No.2.

27. In order to appreciate their respective contentions and to find out as to whether the conditions stipulated in Section 163 read with Section 161 of the Act for the purposes of treating the respondent No.4 as representative of petitioner No.1 is satisfied or not, it would be apposite to first take note of the relevant provisions of the statute. These provisions fall in Chapter XV with caption "Liability in Special Cases". Section 159 fastens the liability upon the "Legal Representatives" under certain circumstances when a person is liable to pay tax dies. Section 160 defines "Representative Assessee" and Section 161 gives the circumstances under which liability of representative assessee arises. When representative assessee has to pay tax on behalf a person, Section 162 of the Act confers right upon such representative assessee to recover the tax paid from person on whose behalf it is paid. Section 163 of the Act comes under Chapter XV-C titled "Representative Assessee – Special Cases" and stipulates as to who may be regarded as an agent. Since in the present case, we are concerned with Sections 160 to 163 of the Act, relevant portions of these provisions are extracted below:

> "B-Representative assessees – General provisions
>
> **Representative assessee 160.**
>
> (1) For the purposes of this Act, "representative assessee" means–
>
> > (i) In respect of the income of a non-resident specified in sub-section (1) of section 9, the agent of the non-resident, including a person who is treated as an agent under section 163;
>
> xxx xxx xxx
>
> (2) Every representative assessee shall be deemed to be an assessee for the purposes of this Act.

Liability of representative assessee.

161. 1) Every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall, subject to the other provisions contained in this Chapter, be levied upon and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him.

Right of representative assessee to recover tax paid.

162. (1) Every representative assessee who, as such, pays any sum under this Act, shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.

(2) Any representative assessee, or any person who apprehends that he may be assessed as a representative assessee, may retain out of any money payable by him to the person on whose behalf he is liable to pay tax (hereinafter in this section referred to as the principal), a sum equal to his estimated liability under this Chapter, and in the event of any disagreement between the principal and such representative assessee or person as to the amount to be so retained such representative assessee or person may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability, and the certificate so obtained shall be his warrant for retaining that amount.

(3) The amount recoverable from such representative assessee or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such representative assessee or person may at such time have in his hands additional assets of the principal.

C-Representative assessees – Special cases.

163. Who may be regarded as agent

(1) For the purposes of this Act, 'agent', in relation to a non-resident, includes any person in India –

(a) Who is employed by or on behalf of the non-resident; or

(b) Who has any business connection with the non-resident; or

(c) From or through whom the non-resident is in receipt of any income, whether directly or indirectly; or

(d) Who is the trustee of the non-resident; and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India:

xxx xxx xxx

Explanation.– For the purposes of this sub-section, the expression "business connection" shall have the meaning assigned to its in Explanation 2 to clause (i) of sub-section (1) of section 9 of this Act.

(2) No person shall be treated as the agent of a non-resident unless he has had an opportunity of being heard by the Assessing Officer as to his liability to be treated as such."

28. A conjoint reading of the aforesaid provisions would show that under the given circumstances, certain persons can be treated as representative assessee on behalf of non-resident specified in sub-section(1) of Section 9 of the Act. This would include an agent of non-resident and also who is treated as an agent under Section 163 of the Act. Section 163 deals with special cases where a person can be regarded as an agent. These are:

(i) who is employed by or on behalf of the non-resident:

(ii) who has any business connection with the non-resident; or

(iii) from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or

(iv) who is the trustee of the no-resident; or

(v) any other person, a resident or even a non-resident, who has acquired a capital asset in India by means of transfer.

29. Once a person comes within the net of any of the aforesaid Clauses, such a person would be the „agent‟ of the non-resident for the purposes of the Act. However, merely because a person is an agent or is to be treated as an agent, it would lead to an automatic conclusion that he becomes liable to pay taxes on behalf of the non-resident. That would only mean that he would be treated as representative assessee. However, liability of such a representative assessee only if the eventualities stipulated in Section 161 of the Act are satisfied. Section 161 of the Act makes a representative assessee liable only "as regards the income in respect of which he is a representative assessee".

30. Of course, once a representative assessee is held liable, then he will be liable in the same manner as a non-resident and tax shall be levied and recovered from him in the same manner it could be recovered from the person represented by him. Since tax is recovered from such a representative assessee treating him as agent of other

person, Section 162 of the Act gives representative assessee right to recover the sum paid by him from the person on whose behalf it is paid. This Section even makes a provision allowing representative assessee to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid. In the event, the principal question is right to retain such an amount, the representative assessee or person may secure from the (Assessing) Officer a certificate stating the amount to be so retained pending final settlement or the liability, and the certificate so obtained shall be his warrant for retaining that amount. Issuance of such certificate even secures the representative assessee as at the time of final settlement, the amount recoverable form such representative assessee or person at the time of final settlement shall not exceed the amount specified in such certificate. The only exception is that when such representative assessee or person may at such time may have in his hands additional assets of the principal, as in that even, even if excess amount stipulated in certificate is recoverable from the representative assessee, he is secured by having additional assets of the principal in his hands from where the representative assessee can always recompense.

31. In the present case we proceed on the premise that the respondent No.4 has business connection with the petitioner No.1 as explained by the official respondents on the basis of business relation between them reflected through the transactions entered into between the petitioner No.1 and respondent No.4 over a period of time. Therefore, conditions prescribed in Clause (b) of sub-section (1) of Section 163 can be treated to have been, *prima facie*, fulfilled. Thus, respondent No.4 can be treated as "an agent in relation to the petitioner No.1 – a non-resident". As an agent respondent No.4 would be the representative assessee within the meaning of Section 161(1) of the Act. The question before us is as to whether in its capacity as representative assessee of the petitioner No.1, liability of the respondent No.4 arises within the meaning of Section 161 of the Act and it would be assessed in that representative capacity. To put it otherwise, whether the purported income earned by the petitioner No.1 through transfer of shares can be treated as the income in respect of which he is a representative assessee. It is because of the reason that Section 161 makes him liable only as regards that particular income.

32. This very aspect has been considered and explained in various judgments. In fact, similar provision existed in the Income Tax Act 1922 which repeatedly came up before the Courts for interpretation. We may start our discussion from the Privy Council"s judgment rendered in 1936. Name of the case is *Commissioner of Income Tax, Bombay Presidency, and Aden Vs. Currimbhoy Ebrahim and Sons, Ltd.* [AIR 1936 Privy Council 1]. That was a case where the respondent company was assessed

as agent of His Exalted Highness the Nizam of Hyderabad. The order was made in respect of income tax for the year of assessee 1931-32. Two items were included in the order, viz:

(i) The sum of Rs.27,960/- being income tax claimed to be due from the Nizam under the head “property” in respect of house property in Mumbai of which he was the owner.

(ii) A sum of Rs.3,15,214/- being the amount received in the year of account by the Nizam from the respondent company as interest due upon a loan of Rs.50,00,000 made by Nizam to the respondent company upon the terms of a written instrument dated 16.08.1929.

33. The question was as to whether the assessee could be treated as representative assessee qua the interest income earned by the Nizam in the aforesaid circumstances. As pointed out above, this interest income was earned by the Nizam from the property in Mumbai and insofar as this property is concerned, representative assessee had no concern or connection therewith. The business connection of the representative assessee was only qua the interests paid by it in respect of loan taken from the Nizam. On these facts, the Privy Council held that the income from house property could not be assessed at the hands of the respondent and the respondent could not be treated as representative assessee qua that income as it had no connection with the same. Following observations of the Privy Council, in the process, are worth to quote:

> “14. In the result, therefore, their Lordships come to the conclusion that the interest income in respect of which the respondent company has been assessed to tax as agent for the Nizam, is not to be deemed to have accrued or arisen within British India at all, and is, therefore, not liable to tax. The Income-tax Officer's order of June 5, 1931, whereby the respondent company was deemed to be an agent of the Nizam and liable to be made assessee in respect of these monies is without foundation and altogether invalid. In these circumstances it does not appear to their Lordships to be necessary that they should discuss any of the questions raised under Section 44 of the Act. It would indeed be strange if the respondent company as mere debtors to a non-resident paying him outside British India monies which are not assessable to Indian income-tax at all, could be made liable for the income-tax due on the nonresident's house property in Bombay with which they had no concern, and this notwithstanding that tax had hitherto been duly assessed upon and paid by the person managing the property on behalf of the non-resident……….”

34. Next case of some relevance would be the judgment of Bombay High Court in the case of *Ramnarayan Rajmal Vs. Commissioner of Income Tax, Bombay South, Bombay* [(1952) 22 I.T.R. 241]. In that case, M/s Ramnarayan Rajmal Rathi was treated as representative assessee by the Department and the assessment was made on it as against the non-resident, M/s. Shivnarayan Brothers of what was the former Hyderabad State. Ramnarayan Rajmal were the agent of the non-resident in respect of transactions effected by the non-resident principal through the assessee and it was not disputed that they had been rightly appointed an agent under Section 43 of the Income Tax Act, 1922 (which corresponds to Section 161 of 1961 Act). There was, thus, a business connection between the assessee/agent and the non-resident. However, the question was as to whether income which accrues to or earned by non-resident from business done through parties other than the agent and whether the appellant could be treated as representative assessee/agent. Answering this question in the negative, the Court held that even if because of business connection such an appellant is treated as agent, its liability was restricted to the income earned through his agency, i.e., income arising in respect of head qua which he was an agent. The Court relied upon the judgment of *Privy Council in Currimbhoy Ibrahim & Sons Ltd.* (supra) for arriving at this conclusion. The Court was of the opinion that provisions of Section 42 incorporated the principle of „vicarious liability‟ and the limit of that liability was that the agent must be concerned with the head in respect of which the principal is sought to be taxed. There was an interesting argument raised by the Department, viz., if this be accepted, then it may lead to multiplicity of assessments at the hands of several agents in respect of several heads under which the income is deemed to accrue or arises. The Court answered by observing that there could be more than one assessments, in the following words:

> "8. It is then urged by Sir Nusserwanji that this interpretation might lead to multiplicity of the assessments. It is said that a non-resident may have several agents in respect of several heads under which income is deemed to accrue or arise within the taxable territories. We see no objection in principal as to why there should not be more than one assessment. If the taxing Department chooses to tax non-resident in his own name, no difficulty can arise, because then there would be one assessment. But if the taxing Department chooses to tax a non-resident in the name of his agent, then in respect of each agency there must be a separate assessment because each agent is a separate assessee and treated as an assessee for all purposes under the Act. Therefore it is not a case of multiplicity of assessments in respect of one assessee. What Sir Nusserwanji overlooked is that each agent in respect of each business or each head under Section 42 is a separate

> assessee and there must be a separate assessment in respect of every assessee under the Indian Income-tax Act. Therefore we see no objection on principle to several agents of the non-resident being assessed and there being separate assessments."

35. According to the High Court, the Department was making an almost impossible claim by seeking to tax the appellant as agent on behalf of principal in connection with qua a particular income with which there was no connection. The judgment opened with the following interesting remarks:

> "1. The Income-tax Department is known to cast its net very wide in order to collect as much tax as possible. To the extent that its activities are legal and supported by the law, we have given every encouragement to the Department, but this is a striking case where there does not seem to us the slightest justification for the attempt made by the Department to collect the tax from this particular assessee."

36. The Supreme Court has also accorded the same reasoning in the case of *C.R. Nagappa Vs. Commissioner of Income Tax* [73 ITR 626]. In that case, the Apex court was concerned with the present Income Tax Act of 1961 and the same provisions, viz., Sections 160 and 161 of the Act, though these provisions came up for interpretation in the context of assessment of income at the hands of trustee under Section 64(v) of the Act. We may quote the following passage from the said judgment for our benefit:

> "14. In our view Chagla C.J. was right in observing in Balwantrai Jethalal Vaidya's case in dealing with the scheme of section 41 of the Income- tax Act, 1922, that
>
> > "....... it is clear that every case of an assessment against a trustee must fall under section 41, and it is equally clear that, even though a trustee is being assessed, the assessment must proceed in the manner laid down in Chapter III.... Section 41 only comes into play after the income has been computed in accordance with Chapter III. Then the question of payment of tax arises and it is at that stage that section 41 issues a mandate to the taxing department that, when they are dealing with the income of a trustee, they must levy the tax and recover it in the manner laid down in section 41."

37. The issue came up for consideration, in a more direct manner, before the Supreme Court in the case of *Commissioner of Income Tax, A.P. Vs. Toshoku Ltd.* [125 ITR 525]. In that case, during the previous year, relevant to the assessment year 1962-63, B, a dealer in tobacco in India, purchased tobacco and exported it to Japan and France through non-resident sales agents, a Japanese

company and a French business house respectively. Under the terms of the agreement, the Japanese company, which was appointed as exclusive sales agent in Japan for tobacco exported by B., was entitled to a commission of 3 per cent of the invoice amount. The sale price receivd on the sale in Japan was remitted whooly to B in India and B debited his commission account and credited the amount of commission payable to the Japanese company in his account books and later remitted the amount to the Japanese company. There was a similar agreement with the French business house in relation to the corresponding area and similar credit and debit entries and subsequent remittance of the commission were made. The question was whether the commission earned by the non-resident sales agents could be taxed in India, treating B as a representative assessee under Section 161 of the I.T. Act, 1961. The Court held as under:

> "It could not be said that the making of the entries in the books of B amounted to receipt, actual or constructive, by the non-resident sales agents as the amounts so credited in their favour were not at their disposal or control; they could not, therefore, be charged to tax on the basis of receipt of income, actual or constructive, in the taxable territorials.
>
> The non-residents did not carry on any business operations in the taxable territories: they acted as selling agents outside India. The receipt in India of the sale proceeds of tobacco remitted or caused to be remitted by the purchasers from abroad did not amount to an operation carried out by the non-residents in India as contemplated by Clause (a)of the Explanation to Section 9(1)(i) of the I.T. Act, 1961. The commission amounts which were earned by the non-residents for services rendered outside India could not be deemed to be income which had either accrued or arisen in India."

38. While so holding, the Court explained the scope of Section 160, 161 and 163 of the Act in the manner already stated by us hereinbefore.

39. The issue has been considered at length by Kerala High Court as well in the case of *Commissioner of Income Tax Vs. Fertilizers & Chemicals (Travancore) Ltd.* [166 ITR 823]. In that case, the assessee-company had entered into a collaboration agreement with a foreign company for construction of a synthesis gas plant. The assessee was to pay certain amount to the foreign company for construction of a synthesis gas plant. The assessee was to pay certain amount to the foreign company. The Income-tax Officer treated the assessee company as the agent of the non-resident foreign company under Section 163 of the Act and assessed the aforesaid amount in the hands of the assessee. The Appellate Assistant Commissioner cancelled the assessment as also

the orders under section 163 on the ground that the assessee company could not be treated as an agent of the foreign company as there was no business connection between the foreign company and the assessee. The Appellate Assistant Commissioner also found that since the non-resident foreign company had already been assessed directly in India, the said foreign company should not have again been assessed "through an agent". The Appellate Tribunal upheld the order of the Assistant Commissioner. On a reference, the High Court held that the Tribunal had not considered the question whether the assessee had any business connection with the non-resident so as to treat it as an agent of the non-resident under Section 163 of the Act. Only on deciding this issue, the question whether the orders passed by the Income Tax Officer under Section 163 and the assessment for the year of assessment 1968-69 could be said to be valid or not. The question required to be considered afresh.

40. While doing so, the Court delineated the scope of these provisions in the following words:

> "*Chagla C.J. in CIT v. Balwantrai Jethalal Vaidya* [1958] 34 ITR 187 (Bom), has observed as follows (at pages 194 and 195):
>
> "If the assessment is upon a trustee, the tax has to be levied and recovered in the manner provided in section 4l. The only option that the Legislature gives is the option embodied in sub-section (2) of section 41, and that option is that the Department may assess the beneficiaries instead of the trustees, or having assessed the trustees, it may proceed to recover the tax from the beneficiaries. But, on principle, the contention of the Department cannot be accepted that, when a trustee is being assessed to tax, his burden which will ultimately fall upon the beneficiaries should be increased and whether that burden should be increased or not should be left to the option of the Department. The basic idea underlying section 41, and which is in conformity with principle, is that the liability of the trustees should be co-extensive with that of the beneficiaries and in no sense a wider or a larger liability. Therefore, it is clear that every case of an assessment against a trustee must fall under section 41, and it is equally clear that, even though a trustee is being assessed, the assessment must proceed in the manner laid down in Chapter III ...... Section 41 only comes into play after the income has been computed in accordance with Chapter III. Then the question of payment of tax arises and it is at that stage that section 41 issues a mandate to the Taxing Department that, when they are dealing with the income of a trustee, they must levy the tax and recover it in the manner laid down in section 41."

41. We, thus, agree with the submission of Mr. Salve, learned Senior counsel appearing for the assessee, that a harmonious reading of Sections 160, 161, 162 and 163 would show that:

(i) In order to become liable as a representative assessee, a person must be situated such as to fall within the definition of a representative assessee;

(ii) The income must be such as is taxable under Section 9;

(iii) The income must be such in respect of which such a person can be treated as a representative assessee;

(iv) The representative assessee has a statutory right to withhold sums towards a potential tax liability;

(v) Since the liability of a representative assessee is limited to the profit representative assessee, there can be multiple representative assessees in respect of a single non-resident entity – each being taxed on the profits or gain relateable to such representative assessee.

42. The scheme underlying the aforesaid provisions is explained with clarity and precision in the commentary on Section 163 of the Act in "The Law and Practice of Income Tax (Kanga and Palkhivala at page No.1280, English Edition), the relevant extract is reproduced:

> "…Thus Section 163 really provides only the machinery for giving effect to Sections 160 and 161, and the mere appointment of an agent under Section 163 would be of no consequence unless there is income in respect of which the agent can be held to be a representative-assessee under Section 160 and can be assessed as such under Section 161 of the Act. **In other words, any person appointed an agent under Section 163 is not necessarily assessable as a representative assessee in respect of the non-resident's income; it is only in relation to the income covered by Section 160 that the status of representative assessee emerges and the liability to be assessed under Section 161 arises**. For instance, though there may be a business connection between a resident and non-resident company, **where there is no evidence to show that any profits accrued to the non-resident company through the business connection, no assessment can be made on the resident company as the agent of the non-resident company** and the mere appointment of the resident company as such agent under this section would be of no avail."

43. In view of our discussion, it would be difficult to accept the contention of Mr. Parasaran. From his arguments taken note of above, it is clear that the entire thrust is that there is a business connection

between the petitioner and the respondent No.4. We have ourselves proceeded with the matter on that basis. But that by itself would not be sufficient for the Revenue to sail through. Even if business connection is proved, it would at the most make the respondent No.4 an agent of the petitioners and in that eventuality, the Income Tax Department can treat the respondent No.4 as representative assessee of the first petitioner. However, in order to assess a particular income, it has to be further established by the Department that the respondent No.4 had some connection with the income earned by the first petitioner which is sought to be taxed at the hands of the respondent No.4. Even when we examine the case treating the allegations made by the Department as correct, we find no such live link of income earned by the first petitioner and the respondent No.4 in respect of the transaction which is sought to be taxed. As already held by us that Section 163 has to be read in conjunction with Section 161 which provides that the specified person can be treated as assessed "……..as regards the income in respect of which he is a representative – assessee………" Therefore, an agent can only be a representative – assessee as regards the income in respect of which the alleged agent has business connection and/or from or through directly and/or indirectly the income was received.

44. At this stage, it would be necessary to deal with another contention of Mr. Parasaran, questioning the maintainability of this writ petition at this stage on the ground that it is pre-mature proceeding only a show cause notice has been issued and the facts are yet to be ascertained/investigated. We are not impressed with this argument either. We may point out that the petitioners have gone to the extent of arguing that it has no business connection with respondent No.4. However, we have proceeded on the basis that allegations in the show cause notices to this effect are correct. Even then, the ingredients of Section 161 are not satisfied as the petitioner as assessee could be taxed only as regards the income and in respect of which he is a representative assessee. No case is made out by the Department that in respect of transaction in question, viz., transfer of share to third party, that too, outside India. Respondent No.4 is sought to be taxed as representative assessee when he had no role in the said transfer. Merely because those shares relate to the respondent No.4 company, that would not make respondent No.4 as agent qua deemed capital gain purportedly earned by the petitioner. Therefore, writ petition is maintainable.

45. As a result, rule is made absolute. Impugned show cause notices are hereby quashed and this writ petition is allowed. We make it clear that it would be open to the Department to issue notice to the respondents which is though a non-resident is an assessee in India, subject to the condition that such an action is still permissible under the Act. However, on the facts of this case, we order parties to bear their respective costs.

2011 PTR 1478 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "G" BENCH, MUMBAI

R.S. Syal, Accountant Member and Asha Vijayaraghavan, Judicial Member

FACTS/HELD

1. **S. 153A: Assessee can agitate claim which was given up at s. 143(3) stage**
2. The assessee filed a ROI declaring a loss of Rs. 3.93 crores. The AO passed a s. 143(3) order by which he disallowed interest of Rs. 58 lakhs. *The assessee accepted the disallowance and it became final.* Subsequently, pursuant to a search u/s 132, the assessee filed a ROI u/s 153A in which it *reserved its right to claim deduction for the said interest of Rs. 58 lakhs*. The AO rejected the claim though the CIT (A) gave part relief. The department filed an appeal before the Tribunal claiming that in *s. 153A proceedings the assessee was not entitled to seek relief on additions which were made in the original assessment as s. 153A did not permit assessment at an income lower than the one assessed in original assessment*. HELD dismissing the appeal:

   S. 153A requires the AO to make the assessment afresh and compute the "*total income*" in respect of each of the relevant six assessment years. **There is no inhibition on the jurisdiction of the AO on the including of new income and likewise there is no restriction on the assessee to claim any deduction which was not allowed in the original assessment**. The determination of total income u/s 153A has to be done afresh without any reference to what was done in the original assessment. The fact that there was an addition in the original assessment does not preclude the assessee from contesting it in the s. 153A proceedings. **As it is a fresh exercise of framing assessment of "total income", the assessee is not estopped from arguing about the merits of his case qua the additions made in the original assessment**. Debarring the assessee from making a claim about the deductibility of any item, which was earlier disallowed, counters the very concept of fresh assessment of total income (**Sun Engineering Works** 198 ITR 297 (SC) & **Goetze (India) Ltd** 284 ITR 323 (SC) distinguished)

Appeal dismissed.

ITA No.4238/Mum/2010 : Assessment Year 2001-2002.

Heard on: 24th August, 2011.

Decided on: 30th August, 2011.

Present at hearing: Pavan Ved, for Appellant. Aarti Vissanji, for Respondent.

JUDGMENT

Per R.S. Syal:– (Accountant Member)

This appeal by the Revenue arises out of the order passed by the Commissioner of Income-tax (Appeals) on 30.03.2010 in relation to the assessment year 2001-2002.

2. The Revenue has raised following grounds:–

"(i) On the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in giving relief to the assessee on the income disclosed by him in the return of income filed u/s 153A ignoring the fact that the Assessing Officer has merely assessed the total income at the returned income.

(ii) On the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in determining the total income at a figure lower than the returned income ignoring the fact that the assessee did not resort to the provisions of filing revised return within the prescribed time as it envisaged by the Supreme Court in the case of Goetz (India) Ltd. 284 ITR 323."

3. Briefly stated the facts of the case are that the assessee filed its return u/s 139(1) on 31.10.2001 declaring loss of Rs.3,93,88,570. Search action was taken upon the assessee on 22.03.2007. Accordingly notice u/s 153A was issued, in response to which the assessee filed its return of income on 03.03.2008 declaring total loss of Rs.3,43,19,413. It is pertinent to note that the original return filed by the assessee on 31.10.2001 was subjected to scrutiny assessment and in the order u/s 143(3) dated 31.03.2004, the A.O. disallowed interest of Rs.58,86,483. The assessee-company did not agitate the disallowance of interest before the first appellate authority. In other words, the disallowance so made in the original assessment attained finality. However, while filing the return in response to notice u/s 153A on 03.03.2008, the assessee voluntarily disallowed the disallowance of interest of Rs.58.86 lakh

made in the original assessment subject to the reservation of right for contesting the allowability of entire interest during the course of assessment proceedings. Copy of computation of income along with the Notes furnished along with the return filed on 03.03.2008, is available on record and Note No.3.5, which is relevant for our purpose, reads as under:–

> *"In quantifying business loss for the year, the assessee company has disallowed said disallowance of Rs.58,86,483/-, subject to reservation of right to make such submissions, as it may consider appropriate, for allowability of entire interest expenditure for the year, in assessing income for the year."*

4. During the course of assessment proceedings u/s 153A, the assessee made submissions in support of the deductibility of interest of Rs.58.86 lacs. The Assessing Officer simply accepted the total loss as returned at Rs.3.43 crore without any further deliberation on the interest aspect. Thus the disallowance of interest as made in the original assessment was impliedly upheld, *albeit* without any discussion of the issue. When the matter came up before the first appellate authority, it was contended that the funds available in the hands of the assessee were mixed and there was no question of apportionment of such funds available for business as well as for granting interest free loan on one hand and investment in shares on the other. The assessee also put forth that a detailed submission, in support of deduction of interest, was filed before the Assessing Officer on 24.12.2008 and the assessing authority had not taken it into consideration. The learned CIT(A) required the assessee to establish nexus between the utilization of funds borrowed at interest with the the carrying on of business. The assessee made submissions in support of the deduction of interest, which the learned CIT(A) forwarded to the A.O. seeking his comments. The Assessing Officer sent his remand report on 24.03.2010 quantifying the disallowable interest in relation to granting of loans and advances and investments made in shares. Considering such remand report, the learned CIT(A) directed the A.O. to disallow interest of Rs.10,81,326 and ordered for the deletion of the remaining disallowance. The Revenue is in appeal on the above extracted grounds.

5. After considering the rival submissions and perusing the relevant material on record it is found as an undisputed fact that in the original assessment made u/s 143(3), the A.O. disallowed interest of Rs.58.86 lakh which was not assailed by the assessee in appeal. However after the search, it filed return in response to notice issued by the AO u/s 153A declaring income by voluntarily making the disallowance of the interest made in the original assessment and keeping the right reserved for making submission at the stage of assessment in support of the deduction. The view point of the learned Departmental Representative is that the assessee was not entitled to seek relief on any addition which

was finally made in the original assessment as the provisions of section 153A do not permit the assessment at income lower than the one finally assessed in original assessment completed before the date of search. In order to appreciate this contention it would be relevant to note down the provisions of section 153A which is as under:–

> *"153A. Assessment in case of search or requisition.– (1) Notwithstanding anything contained in section 139, section 147, section 148, section 149, section 151 and section 153, in the case of a person where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after the 31st day of May, 2003, the Assessing Officer shall–*
>
> > *(a) issue notice to such person requiring him to furnish within such period, as may be specified in the notice, the return of income in respect of each assessment year falling within six assessment years referred to in clause (b), in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under section 139 ;*
> >
> > *(b) assess or reassess the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made:*
> >
> > *Provided that the Assessing Officer shall assess or reassess the total income in respect of each assessment year falling within such six assessment years:*
> >
> > *Provided further that assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in this section pending on the date of initiation of the search under section 132 or making of requisition under section 132A, as the case may be, shall abate.*
>
> *(2) If any proceeding initiated or any order of assessment or reassessment made under sub-section (1) has been annulled in appeal or any other legal proceeding, then, notwithstanding anything contained in sub-section (1) or section 153, the assessment or reassessment relating to any assessment year which has abated under the second proviso to sub-section (1), shall stand revived with effect from the date of receipt of the order of such annulment by the Commissioner.*

Provided that such revival shall cease to have effect, if such rder of annulment is set aside.

Explanation.–For the removal of doubts, it is hereby declared that,–

(i) save as otherwise provided in this section, section 153B and section 153C, all other provisions of this Act shall apply to the assessment made under this section ;

(ii) in an assessment or reassessment made in respect of an assessment year under this section, the tax shall be chargeable at the rate or rates as applicable to such assessment year."

6. From the prescription of the above section, the following features are noticeable in so far as we are concerned with the instant appeal:–

– Assessment pursuant to search is to be made notwithstanding anything contained *inter alia* in section 147;

– Clause (a) of sub-section (1) provides that the relevant provisions shall apply as if the return filed in response to notice u/s 153A(1) is a return required to be furnished under section 139 ;

– First proviso to sub-section (1) states that the Assessing Officer is required to assess or reassess "total income" in respect of each assessment falling within the relevant six assessment years.

– The second proviso to sub-section (1) provides that the assessment or reassessment, if any, relating to any of the six assessment years pending on the date of search u/s 132 or making requisition u/s 132A, shall abate.

– Sub-section (2) of section 153A provides that if due to one reason or the other the assessment made u/s 153A is annulled in any appeal or any other proceedings then the assessment or reassessment which had abated in second proviso to subsection (1) shall stand revived with effect from the date of receipt of the order of such annulment.

7. A close look at the above provision manifests that the Assessing Officer is required to make assessment afresh and compute the `*total income*' in respect of each of the relevant six assessment years. As there is no specific inhibition on the jurisdiction of the Assessing Officer in not including any new income to such fresh total income pursuant to search which was not added during the original assessment, in the like manner, there is no restriction on the assessee to claim any deduction which was not allowed in the original assessment. The requirement of section 153A

is to compute the total income of each of such assessment years. Such determination of the total income has to be done afresh without any reference to what was done in the original assessment. Of course, the AO is entitled to make any addition in the fresh assessment, which he made in the original assessment, provided he is satisfied with the merits of the addition. But the mere fact that there was some addition in the original assessment, would not preclude the assessee from contesting the addition in the subsequent proceedings. As it is going to be a fresh exercise of framing assessment or reassessment of the total income at the end of the AO, the assessee cannot be stopped from not even arguing about the merits of his case *qua* the addition which was made in the original assessment. Debarring the assessee from making a claim about the deductibility of any item, which was earlier disallowed, counters the very concept of fresh assessment of total income.

8. The reliance of the learned Departmental Representative on the judgement of the Hon'ble Supreme Court in the case of *CIT Vs. Sun Engineering Works Pvt.Ltd.* [(1992) 198 ITR 297 (SC)] is misconceived. The reason for the same is that in that case the Hon'ble Supreme Court was considering the provisions of section 147 and it was held that once an assessment is validly reopened it is not open to an assessee to seek a review of concluded items unconnected with the escapement of income. Here it is pertinent to note that the conditions for taking action u/s 147 *vis-à-vis* under section 153A are altogether different. Even though assessment u/s 147 is made read with section 143(3), but the initiation of assessment or reassessment u/s 147 originates from the belief of the AO, on the basis of some tangible material, that income chargeable to tax has escaped assessment. After forming such belief, the AO is called upon to record reasons for the reopening of the assessment before issuing mandatory notice u/s 148. If the foundation of reassessment, being the reasons about the escapement of some income do not exist, then it is impermissible to go ahead with the assessment u/s 147. It is *sine qua non* that some escaped income must be brought to charge in order to make a fresh assessment u/s 147. On the contrary, the search action itself mandates on the Assessing Officer to pass orders u/s 153A computing total income for all the relevant six assessment years, irrespective of the fact whether some concealed income has surfaced as a result of search or not. It is thus apparent that the ambit of assessment u/s 147 cannot be imported into the scope of section 153A.

9. It is further important to note that the provisions of assessment in the case of search u/s 153A etc. have been inserted by the Finance Act, 2003 with effect from 01.06.2003. These provisions are successor of the special procedure for assessment of search cases under Chapter XIV-B starting with section 158B. Whereas Chapter XIV-B required the assessment of "undisclosed income" as a result of search, which has been defined in section 158B(b), section 153A dealing with assessment in case

of search with effect from 01.06.2003 requires the Assessing Officer to determine "total income" and not "undisclosed income".

10. If any deduction is claimed by the assessee in the proceedings u/s 153A that cannot be rejected simply on the ground that it was not claimed in the original assessment or was disallowed. The starting point of assessment is the amount of income declared in the return of income, which is further enhanced with the additions. We are unable to appreciate the qualitative difference between the two situations viz., the first in which the assessee files return in response to notice u/s 153A disclosing lower income than the one originally assessed u/s 143(3) and the second situation in which the income is disclosed at the increased level, that is, after considering the additions so made in the original assessment and then agitates during the assessment proceedings about the deductibility of the amount(s) which was/were not allowed earlier. Probably the second course is adopted so as to preempt any move on the part of the Revenue to impose concealment penalty, if the addition is sustained in the assessment u/s 153A. In our considered opinion when the Assessing Officer has to compute the total income of the assessee on the basis of return filed after considering the submissions made during the course of hearing before him. There cannot be any scope for arguing that the assessee has been rendered powerless to even lodge a claim in respect of which deduction was not allowed earlier. Here it is important to note that the total income is not reduced simply on the basis of making a claim. The Assessing Officer is fully empowered to consider the question of deductibility as per the provisions of the Act. If after going through such claim, he feels that addition is called for, he will obviously make addition and *vice versa*.

11. Adverting to the facts of the instant case it is seen that the assessee made a claim of deduction of interest of Rs.58.86 lakh which was not allowed in the original assessment. In the remand report the A.O. himself came to the conclusion that the disallowance only to the tune of Rs.10.81 lakh was warranted and the learned CIT(A) has sustained the disallowance to this extent thereby deleting the remaining amount of disallowance. Thus, the examination made by the Assessing Officer in the remand proceedings has clearly upheld the claim of the assessee *qua* the deduction of interest to the tune of Rs.48.05 lakh.

12. The Revenue has pressed into service the judgement of the Hon'ble Supreme Court in the case of *Goetze (India) Ltd. Vs. CIT* [(2006) 284 ITR 323 (SC)]. The learned Departmental Representative contended that the claim for a deduction not made in the return cannot be entertained by the Assessing Officer otherwise than by filing a revised return. In the light of the above judgement, it was argued that since the assessee did not file revised return u/s 153A, the A.O. was right in not considering deductibility of interest of Rs.58.86 lakh on the basis of notes to the computation of total income.

13. There is no quarrel on the proposition laid down by the Hon'ble Supreme Court in the afore-noted case that the claim for deduction not made in the return of income cannot be entertained by the A.O., otherwise than by filing a revised return. However it is not the end of the matter. The Hon'ble Supreme Court in para 4 of the same judgment has clarified the position by further holding : "*However, we make it clear that the issue in this case is limited to the power of the assessing authority and does not impinge on the power of the Income-tax Appellate Tribunal u/s 254 of the Income-tax Act, 1961.*" From this judgement it is obvious that the restriction has been placed on the Assessing Officer for not entertaining any claim for deduction otherwise than by filing a revised return. However this judgement does not lay down that the appellate authority shall have any fetters on its powers in entertaining the claim made otherwise than by filing a revised return which is sustainable in law.

14. The Hon'ble Supreme Court in the case of *National Thermal Power Company Ltd. Vs. CIT* [(1998) 229 ITR 383 (SC)] has held that the Tribunal has the jurisdiction to examine a question of law which arises from the facts as found by the authorities below and having a bearing on tax liability of the assessee notwithstanding the fact that it was not raised before the learned CIT(A). The purpose of assessment proceedings is to assess correctly the tax liability of an assessee in accordance with law. When we consider the judgement of the Hon'ble Supreme Court in *Goetze (India) Ltd.* (supra) in juxtaposition to *National Thermal Power Company Ltd.* (supra), it becomes patent that although the assessee cannot make a claim before the Assessing Officer otherwise than through the return of income, but there are no restrictions on the powers of the Tribunal to entertain such claim for examination provided the facts exists on record.

15. Coming back to the facts of the instant case we note that the assessee made a claim for deduction of Rs.58.86 lakh by way of Note to the return of income on account of interest expenditure, which the Assessing Officer in the remand proceedings found to be acceptable to the tune of Rs.48.05 lakh. Under such a situation the Department cannot take the shelter of the judgement of the Hon'ble Supreme Court in the case of *Goetze (India) Ltd.*(supra) before the Tribunal contending that the addition so held by the first appellate authority be restored.

16. For the foregoing reasons, we uphold the impugned order.

17. In the result, the appeal is dismissed.

Order pronounced in the open Court on this **30th day of August, 2011**.

2011 PTR 1486 (Trib. Ind.)

AUTHORITY FOR ADVANCE RULINGS (INCOME TAX) NEW DELHI

Justice. P.K. Balasubramanyan (Chairman), V.K. Shridhar, Member

FACTS/HELD

1. **Gains arising on sale of shares of foreign company by NR to NR taxable in India if the foreign co only held Indian assets**
2. Two French companies named "Murieux Alliance" ('MA') and "Groupe Industrial Marcel Dassault" ("GIMD") held shares in another French company named "ShanH". MA & GIMD acquired shares in an Indian company named "Shantha Biotechnics Ltd" ("Shantha"). The shares in Shantha were transferred to ShanH. MA and GIMD subsequently sold the shares in ShanH to another French company named "Sanofi Pasteur Holding". The assessees filed an application for advance ruling claiming that as the two French companies had sold the shares of another French company to a third French company, the gains were not chargeable to tax in India. The department opposed the application on the ground thatShanH was formed with no purpose other than to hold the shares of the Indian company and that the transaction was taxable in India. HELD upholding the department's plea:
   (i) **Azadi Bachao Andolan**, though binding on the AAR, may not be the final word because under the proviso to s. 245R(2), the AAR is entitled to disallow an application if the question raised therein relates to an issue which is designed, prime facie, for the avoidance of income-tax. The AAR is entitled to see whether the steps taken were a device to avoid liability to tax. Also it is difficult to accept the arguments based on **Azadi Bachao Andolan** because that judgement appears to proceed on the basis that the views expressed by Chinnappa Reddy, J. were his own and did not represent the view of the Court as a whole. **The view that has emerged is that notwithstanding the legal validity of a transaction or a set of**

transactions, if the purpose was to create a legal smoke screen to avoid the payment of tax that would legitimately be due as having arisen on the basis of a transaction or an event, the legal effect of the transaction in the context of the taxing statute, has to be considered, notwithstanding its reality or validity;

(ii) On facts, the French company's (ShanH) **only asset were the shares in the Indian company** & it had no other business.**When its shares were sold, what really passes were the underlying assets and the control of the Indian company**. A gain was generated by the transaction. **If the transaction is accepted at face value, control over Indian assets and business can pass from hand to hand without incurring any liability to tax in India. Such transactions have to be treated as ineffectual**. It is not necessary to ignore the existence of ShanH to come to a conclusion that what is put up is a **façade** in the context of the tax law and would amount to a **scheme for avoidance of tax**;

(iii) Under Article 14(5) of the India-France DTAA, gains from the alienation of shares representing a participation of at least 10% in an Indian company may be taxed in India. Here, **though the shares being transferred are that of a French company, the situs of the underlying assets & controlling interest cannot be ignored**. What is involved in the transaction is an **alienation of the assets and controlling interest of an Indian company**. Consequently, even though such interest is not an alienation of the shares of an Indian company, still, on a purposive construction of Article 14(5), the capital gains is taxable in India.

Order accordingly.

A.A.R. No.846 & 847 of 2009.

Decided on: 28th November, 2011.

Present at hearing: Porus Kaka, Sr. Advocate, Manish Kanth, B.M. Singh, Advocates Dominique Tazikawa Co.Rep. Rohan Shah, Rohit Jain, Advocates Parth Contractor, C.A. and Kumar Visalaksh, Advocate, for Applicant. Girish Dave, Advocate and Gangadhar Panda, Addl. DIT (Int. Taxation), Hyderabad, for Department.

JUDGMENT

Justice P.K. Balasubramanyan:– (Chairman)

Murieux Alliance, hereinafter referred to as '**MA**' is said to be a part of an International Health Care Group dedicated to prevention, diagnosis and treatment of infectious diseases. It is incorporated in France. It claims that after negotiations with Groupe Industrial Marcel Dassault, hereinafter referred to as '**GIMD**', another company incorporated in France, it formed a wholly owned subsidiary in France on 31.10. 2006 named „ShanH‟. On 6.11.2006, MA entered into a share purchase agreement acquiring the shares of an Indian company, called „Shantha Biotechnics Ltd, („Shantha‟). ShanH was shown as a permitted assign. 599630 shares were acquired. On 12.3.2007 GIMD came into the picture by acquiring 120000 shares amounting to 20% of the shares from MA in ShanH. Further capital increase of shares on 25.3.2009 were also taken by MA and GIMD in the same proportion. In May, 2009 Mr. Georges Hiborn acquired 10400 shares from MA and 2600 shares from GIMD. Due diligence of Shantha was got done by MA. MA claims that ShanH, through its representative, also actively participated in managerial and technical issues relating to the growth of Shantha. The shares in Shantha were acquired by ShanH or in the name of ShanH. Admittedly, the original capital flowed from MA and even the stamp duty was paid by MA though it is submitted that the amount spent in that behalf by MA was subsequently made good by ShanH. MA also appointed a director on the Board of ShanH. With a view to ensuring the achievement of better progress in business by Shantha, MA and GIMD felt that Shantha needed the backing and support of a leading global vaccine company. MA and GIMD started looking for a strategic alliance in relation to their larger interest in the field of immunotherapy in developing countries and also in relation to the activities of Shantha. A commercial transaction was evolved whereby Sanofi Pasteur Holding (hereinafter„„Sanofi‟), another company incorporated in France, came forward to participate actively with MA and GIMD, provided the representatives of MA continued to be Members of the Board of Directors of ShanH having a say in the policies and approach to be pursed by ShanH. With a view to further improve the business and performance, MA and GIMD sold their shares in ShanH to Sanofi in August, 2009. On 20.11.2009, MA and GIMD filed applications before this Authority under section 245Q(1) of the Income-tax Act, 1961 (hereinafter referred to as „the Act‟) seeking an advance ruling on the questions raised in the applications. The application filed by GIMD was numbered as Application No. 846 of 2009 and that filed by MA was numbered as Application No. 847 of 2009.

2. The approach by the two companies to this Authority was preceeded by certain steps taken by the Revenue. On 4.8.2009, a survey under section 133A of the Act was conducted in the office premises of Shantha. This was on the basis of information that became available that

Sanofi was proposing to acquire 80% of the stakes in Shantha from MA and GIMD through their subsidiary ShanH for a consideration of Rs.2,500 crores pursuant to a share purchase agreement executed by the concerned parties on 10.7.2009. The assessing officer on 7.8.2009 informed Sanofi about its likely obligation under section 195 of the Act arising out of the share purchase agreement. The details were called for. Another notice was issued on 24.8.2009. By replies dated 27.8.2009 and 3.9.2009, Sanofi intimated the Income-tax department that the share purchase agreement had a closure with effect from 31.7.2009. This was followed by the notice to show cause under section 195 of the Act issued by the assessing officer to Sanofi. Sanofi was asked to show cause why it should not be treated as an assessee in default under section 201(1) of the Act in respect of payments made by it to MA and GIMD for acquisition of the majority controlling interest in Shantha through the transfer of the shares of ShanH, the subsidiary of MA and GIMD. The department also requested MA and GIMD to provide related documents to enable the department to ascertain their liability to tax consequent on the share transfer. It is in the face of these proceedings that MA and GIMD approached this Authority for a ruling essentially on the question whether the sale of shares by them in ShanH to Sanofi is liable to be taxed in India. The questions formulated by MA in its application are:

(1) In terms of the provisions of the double taxation avoidance treaty dated 6th September, 1994 as amended from time to time, entered between the Republic of India with the Government of French Republic ("Indo-French Tax Treaty") read with section 90 of the Income-tax Act, 1961, whether the Capital gains arising from the sale of shares of ShanH (French incorporated Entity) by the Applicant (French Incorporated Entity) to Sanofi (French Incorporated Entity) is liable to tax in France or in India?

(2) Without prejudice to the above, whether controlling interest (assuming while denying that it is a separate asset) is liable to be taxed in France under Article 14(6) of the Indo-French Tax Treaty?

GIMD has raised only the first question indicated above, in its application.

3. To recapitulate the facts, MA a French company, possibly after arriving at an understanding with GIMD, another French company, decided to invest in Shantha by purchasing 80% of the shares of Shantha. With that in view while entering into an agreement with the sharesholders of Shantha for purchase of its shares, it got the due diligence of Shantha done, and also formed a 100% subsidiary, ShanH. The shares in Shantha were acquired in the name of ShanH or by ShanH. The consideration and stamp duty proceeded from MA. Thereafter, GIMD acquired 20% of the shares of ShanH from MA. Mr. Hebon also purchased some of the shares of ShanH. Thereafter, for business reasons, according

to the applicants, they decided to sell their shares in ShanH to Sanofi. The case of MA and GIMD in a nutshell is that what was involved in the transaction of the two applicants selling their shares in ShanH to Sanofi, was only the sale of shares held in a French company and that had nothing to do with the shares of Shantha, the Indian company, the sale of which might or might not attract liability under the Indian Income-tax Act. MA and GIMD, therefore, claim that any attempt to tax in India the sale of shares of ShanH by them to Sanofi, was not sanctioned by the Income-tax Act and certainly not by the Double Taxation Avoidance Agreement (DTAA) between India and France. The essential contention of the Revenue, as we understand it, is that ShanH was only a front, a paper company, having no office and no employee. The Director of MA was also its director. What was involved in the alleged sale of shares of ShanH by MA and GIMD to Sanofi was the transfer of the assets of an Indian company and certainly the controlling interest in the Indian company, Shantha. In reality, the sale of shares in ShanH held by MA and GIMD to Sanofi, attracted capital gains tax in India and the transaction was liable to be taxed in India. This stand of the Revenue is met by MA and GIMD by pointing out that the tax authorities in India could not ignore the incorporation of the Company ShanH, the Tax Residency Certificate produced and the recognition of the transaction even by the Government of India and proceed to tax what it calls the underlying transaction. In the light of the principle settled by the decision in *Azadi Bachao Andolan* (263 ITR 706), there is no question of attempting to pierce the veil and attempting to go behind the existence of ShanH in the eye of law and ignoring the tax residency certificate issued to it by the French Authorities. It is pointed out that there was no treaty shopping or evasion of tax involved since the capital gain, if any, was taxable in France under the French law and all that was being sought for, was a ruling on the interpretation of the relevant article in the DTAA between India and France.

4. Facts in detail and the incidents relating to the transaction have been presented before us. The attempt of the Revenue was to persuade us to invoke the proviso to Section 245R(2) of the Act to find that what was involved was the devising of a scheme to avoid tax payable in India and in such a context, no ruling ought to be given by this Authority under section 245R(4) of the Act. The pendency of the proceedings under section 201 as against Sanofi was also put forward as a bar to the entertaining of this application. Originally, this Authority had admitted the applications on 17.12.2009 for giving a ruling under section 245R(4) of the Act on the basis that no valid objection in terms of Section 245R(2) of the act had been put forward. The Revenue came forward with an application to have the question re-examined and this Authority re-examined the question and found no reason to change the position earlier adopted that there was no valid objection to the entertaining of the application for giving a ruling. But considering the persistence with which the Revenue

questioned the original allowing of the application under section 245R(2) of the Act without actually hearing it, this Authority specified that the question of avoidance of tax and the bar created by the pendency of other proceedings under the Act, would be considered again while giving the ruling under section 245R(4) of the Act in terms of the order already passed under section 245R(2) of the Act. This Authority recorded in its order dated 3.8.2010, "Having been prima facie satisfied that there was no compelling reason to revoke the earlier order of admission and to refuse hearing on merits and that a comprehensive final order could be passed as regards the grounds made out for revoking the admission as well as on the merits, this case was posted for hearing on merits under section 245R(4) of the Act on the specified date." Not satisfied, the Revenue chose to challenge the order of this Authority in Writ Petition Nos. 18132 and 18133 of 2010 in the High Court of Andhra Pradesh. The original order challenged was the one allowing the application under section 245R(2) of the Act, without hearing the Revenue, since the Revenue had not appeared and later by amendment, the subsequent order on the application of the Revenue to re-consider the question, an order passed after hearing the Revenue. The Division Bench of the High Court considered the Writ Petitions. In the meanwhile, this Authority had listed the matter for final hearing to render the ruling under section 245R(4) of the Act. The hearing was spread over for days and was very elaborate. In view of the request made by the High Court of Andhra Pradesh to this Authority to withhold the ruling since they were entertaining the Writ Petitions against the orders under section 245R(2) of the Act and were to render a decision on the question whether the applications were rightly allowed under section 245R(2) of the Act or not, the ruling was withheld. Subsequently, the Division Bench heard the writ petitions finally. But the learned Judges differed in their conclusions – one of them taking the view that there was no warrant for interference with the order allowing the application under section 245R(2) of the Act, since the final ruling was yet to be rendered and this Authority had itself clarified that the question sought to be raised by the Revenue would again be considered while giving the final ruling. But the other learned Judge took the view that it was a question of jurisdiction of this Authority to entertain an application under section 245Q of the Act. Since according to him, there was violation of natural justice in that the Revenue was not given a proper opportunity of being heard, the orders of this Authority were liable to be quashed. A post decision hearing would not suffice and was not authorised since it was a question of jurisdiction. The Writ Petitions were then placed before a third Judge who found that there was no reason to interfere with the orders under section 245R(2) of the Act passed by this Authority. The learned Judge concluded that the Revenue had failed to substantiate an infringement of any legal right conferred on it under the Statute while allowing the application under section 245R(2) of the Act. Since the request not to render a ruling continued all this while, this Authority could not give a ruling under section 245R(4) of the Act. By the time, the path became clear for this Authority to give its ruling, one of the Members - Member(Law) - had retired and this resulted in the application having to be posted again for a hearing under Section 245R(4) of the Act. The parties took full advantage of that opportunity and re-argued the matter in detail. The ruling is being given after such fresh hearing.

5. Before proceeding to deal with the various contentions, it appears to be proper to observe that the object of creating this Authority for Advance Ruling is likely to be defeated if parties are given the opportunity to challenge the rulings either at the first stage or at the subsequent stage before High Courts. We may clarify that this has nothing to do with the composition of this Authority being presided over by a retired Judge of the Supreme Court. But permitting a challenge in the High Court would become counter productive since writ petitions are likely to be pending in High Courts for years and in the case of some High Courts, even in Letters Patent Appeals and then again in the Supreme Court. It appears to be appropriate to point out that considering the object of giving an advance ruling expeditiously, it would be consistent with the object sought to be achieved, if the Supreme Court were to entertain an application for Special Leave to appeal directly from a ruling of this Authority, preliminary or final, and render a decision thereon rather than leaving the parties to approach the High Courts for such a challenge. It is for the legislature to consider whether an appeal directly to the Supreme Court should not be provided against a ruling rendered by this Authority to ensure that the delay in procedure is minimised and the object of creating this Authority is achieved.

6. Persisting in its objection based on the proviso to section 245R(2) of the Act, in spite of the dismissal of the Writ Petitions by the High Court of Andhra Pradesh, but taking advantage of the observation of the Authority that the objection will be considered while giving a Ruling under section 245R(4) of the Act, the representative for the Revenue again reiterated before us the contention that the hearing of the applications and the giving of a ruling under section 245R(4) of the Act was barred by clause (i) of the proviso to Section 245R(2) of the Act. He pointed out that in its second order rejecting the application made by the Revenue for reconsideration of the question this Authority had agreed to re-consider the question while giving the ruling under section 245R(4) of the Act. Counsel for the applicant submitted that the High Court of Andhra Pradesh having dismissed the writ petition challenging the order of this Authority allowing the application under section 245R(2) of the Act, there remained nothing for the Revenue to contend on this objection. There may be some force in the submission of learned Senior counsel for the applicant. But, in view of this Authority leaving open that question for consideration afresh in its second order and an objection based on

clause (iii) of the proviso is not necessarily confined to the stage of a hearing under section 245R(2) of the Act, we think it appropriate to deal with the question.

7. What is contended on behalf of the Revenue is that the issue regarding taxability of the transaction is being examined by the DDI(IT), Hyderabad, during the course of the proceedings against Sanofi under section 201 of the Act. He submitted that an order dated 25.5.2010 was passed overruling the contentions of Sanofi and treating it as an assessee in default in respect of the payments made by it for purchasing the shares of ShanH. A proceeding has also been taken against ShanH relating to the transaction. The Revenue, therefore, submitted that the hearing of the application was squarely barred by clause (i) of the proviso to Section 245R(2) of the Act.

8. This Authority has consistently taken the view that the initiation of proceedings under section 195 or 197 of the Act and even a final order passed therein, would not create a bar to entertaining an application for advance ruling. This was based on the scope and object of enacting Section 195 of the Act. The Supreme Court has also indicated the scheme of and the nature of the proceedings under section 195 of the Act. [See *Transmission Corporation of Andhra Pradesh v. CIT* (239 ITR 587) and *GE Indian Technology Centre P. Ltd. v. CIT* (327 ITR 456)].

9. The proceedings under section 201 of the Act is a consequence of the failure to comply with the requirement of Section 195 of the Act. Even earlier, this Authority had noticed that such a proceeding cannot stand in the way of an application being considered for a ruling under section 245R(4) of the Act. We do not find any reason to depart from that position adopted by this Authority earlier. If so, the pendency of the proceedings or the order passed under section 201 of the Act against Sanofi cannot stand in way of our proceeding to give a ruling. The main thrust of the argument in the earlier round on alleged violation of natural justice, stands concluded by the decision of the Andhra Pradesh High Court. Even otherwise it has lost its steam since all the facts are now before this Authority at the instance of the Revenue and we are in a position to render a satisfactory decision on the bar claimed to have been created by of the proviso to Section 245R(2) of the Act. Suffice it to say, we overrule the objection of the Revenue that giving of a ruling under section 245R(4) of the Act was barred by clause (i) in the proviso to Section 245R(2) of the Act.

10. Counsel for the applicants contended that having initiated proceedings against Sanofi on the purchase of the shares of ShanH by it and also against ShanH based on the sale, the Revenue was not entitled to question the transfer of shares of ShanH by its shareholders to Sanofi or the reality of that transaction or take up the theme of tax avoidance. The representative for the Revenue submitted that adequate facts were not disclosed by the applicants and could not be gathered by the Revenue

at the time of initiation of proceedings against Sanofi and ShanH and now that the facts are clear, this Authority has to consider the nature of the transaction and the effect of the transaction in the context of the ruling sought for. The proceeding against ShanH is also under section 201 of the Act. We do not think that it would be proper for us to decline to consider the rival claims in the context of these applications based on the effect of the proceedings initiated against Sanofi and/or ShanH canvassed for by Counsel for the applicant. As we have noticed, the nature of the proceedings based on section 195 of the Act, is not conclusive and is only preliminary in nature. It cannot stand in the way of our considering this objection also even while we consider the main application for a ruling.

11. We may here notice the ruling of this Authority in Canaro Reources Ltd. (313 ITR 2) relied on. Therein an objection based on clause (iii) of the proviso to Section 245R(2) of the Act was not taken when the application was being allowed under section 245R(2) of the Act for giving a Ruling. But at the hearing under Section 245R(4) of the Act, the objection was taken. The applicant objected to the question being considered. This Authority overruled that plea on the basis that it was an objection "pertaining to the maintainability of the application". Subsequently in ABC In re (AAR No.840/2010), this Authority has indicated that the consideration of such an objection at the stage of hearing under Section 245R(4) of the Act was not taboo and had to be dealt with on merits. It is really an objection to the jurisdiction to give a ruling. We cannot keep out a consideration of the objection and clutch at a jurisdiction; we may or may not have. We, therefore, proceed to consider the objection that the transaction is designed to avoid tax in India.

12. Before doing so, we have to notice the argument of counsel for the applicant that the stand of the applicants was only that the transaction was taxable in France and not in India in terms of the DTAA and that no avoidance of tax was involved. What this Authority is entrusted with, is a jurisdiction to rule in advance, whether a transaction is taxable in India, going by the Act or the overriding DTAA. Therefore, the question of avoidance of tax that has to be considered is the avoidance, if any, of the tax in India. Therefore, the argument on behalf of the applicants that tax on this transaction has to be paid in France where the companies involved were incorporated and of which they were tax residents and hence no avoidance of tax was involved, even if acceptable to the extent it goes, cannot stand in the way of this Authority considering whether designing of a scheme for avoidance of payment of tax in India has been resorted to. Hence, this aspect raised by the Revenue has to be considered.

13. On behalf of the Revenue, it was submitted that the prior transactions leading to the present transaction relied upon by the applicants were only transactions on paper and it was part of an elaborate scheme to avoid tax in India. The Revenue submits that ShanH

was created merely for the purpose of dealing with the assets of Shantha and its creation was merely to avoid the tax that may be due while dealing with the shares of Shantha. Counsel for the Revenue submitted that on 6.11.2006, MA had entered into an agreement for purchase of the shares of Shantha. It was MA that got the due diligence done. Though it is claimed that ShanH was formed as a 100% subsidiary of MA on 31.10.2006, it was not ShanH that entered into the share purchase agreement on 6.11.2006. ShanH had no office, no staff and the director of MA was also its director. Only in March, 2007, GIMD came into the picture by acquiring 20% shares in ShanH. Subsequently one Mr. Hebon also acquired some shares in Shan H. ShanH had no other business and it held no assets other than the shares in Shantha. The Revenue, therefore, submits that ShanH was merely a front created for avoiding the liability to tax that may arise on dealing with the shares of Shantha by MA which still held the controlling interest in Shantha through ShanH. What was now being done was to sell the shares of ShanH to Sanofi virtually handing over the assets and control of Shantha. It is also pointed out that MA assumed the right to nominate the Members of the Board of Shantha and the entire transaction now put forward was a clear attempt to avoid tax by way of capital gains. Even on a *prima facie* scrutiny, this was clear and hence the objection that the giving of a ruling under section 245R(4) was barred by clause (iii) of the proviso to sub-section (2) of Section 245R of the Act, was liable to be upheld.

14. On behalf of the applicant it is submitted that the setting up of a subsidiary company for making fresh acquisitions was a legal, permissible and known method of business and there was nothing illegal in MA and GIMD forming a subsidiary ShanH for the purpose of acquiring shares in Shantha. He submitted that ShanH had three shareholders including the two applicants and the shares of ShanH are now acquired by Sanofi. ShanH being a French company and a tax resident of France was entitled to claim the protection of the DTAA between India and France. What was involved was the transfer of shares of Shan H held by the two applicants to another French company Sanofi and the capital gains, if any, arising out of the transaction to the applicants, was taxable in France. This was not a case of an attempt to avoid the payment of tax. This was not a case of treaty shopping. The tax had to be paid in France in terms of the DTAA and as a matter of fact, the tax payable would be more in France since treatment of long term capital gains in France was to the disadvantage of the applicants, where shares had to be held for two years before sale, for qualifying as long term capital gains whereas it was only one year in India. All the companies were within the tax jurisdiction of France and the transaction was taxable in France. By virtue of Article 13 of the India-France treaty, the power to tax rested with France and not with India. The applicants were only claiming the benefit of a Treaty, and were not attempting to avoid tax. The argument that what was really being transferred, were the

assets of Shantha, the Indian company, had no substance. The shares of Shantha were not being dealt with, though the consequence of the buying of shares of ShanH by Sanofi might be to give control of the affairs of Shantha to Sanofi. But then, it was a legal and legitimate business route taken by the applicants and the transaction did not attract taxability as capital gains in India.

15. Counsel for the applicant submitted that in the light of the decision of the Supreme Court in [1]*Azadi Bachao Andolan*, there was no question of going

behind the transaction to ascertain its so-called real nature especially in cases governed by agreements for avoidance of double taxation. Here, the applicants were claiming the benefit of DTAA between India and France to be taxed in France. He also submitted that Tax Residency Certificates have been produced and it was not open to the Revenue or this Authority to go behind them in the light of the position settled in *Azadi Bachao Andolan*. It was also not open to ignore the existence of properly incorporated companies under relevant laws of the country to which the parties belonged. There is no substance in the contention raised by the Revenue in the light of the decision in *Azadi Bachao Andolan*.

16. We may straightaway notice, that the decision in Azadi Bachao Andolan, obviously binding on this Authority, may not be the final word in a given situation, when this Authority is approached for an advance ruling. The proviso to Section 245R(2) of the Act mandates that this Authority shall not allow the application for pronouncing a ruling where the question raised in the application relates to a transaction or issue which is designed, *prime facie*, for the avoidance of income-tax. This obviously means that this Authority has to decline jurisdiction when it finds that the ruling sought for relates to a transaction which is designed *prime facie* for the avoidance of income-tax. In considering that question what this Authority is doing is not piercing the veil of the corporate entity, but is only asking itself the question whether there was a step taken or a series of steps taken, that may have business purpose but was clearly a device to avoid the liability to tax and look at the transaction within the confines of the proviso.

17. We also find some difficulty in accepting the arguments based on Azadi Bachao Andolan. Azadi Bachao Andolan was inter alia considering the effect of the ratio of the earlier constitution bench decision of the Supreme Court in *McDowell and Co. Ltd. v. Commercial Tax Officer* (154 ITR 148). One of the main aspects involved was whether a tax avoidance scheme or attempt at avoidance of tax was liable to be accepted by the Court once it was shown that it was not an objectionable evasion. Four of the learned judges speaking through Ranganath Misra J. are seen to

[1] 263 ITR 706

have left it to the other learned judge, Chinnappa Reddy, J. to deal with this aspect. The four learned judges referred to some of the earlier decisions on the subject and did observe:

> "The planning may be legitimate provided it is within the frame work of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."

But, they did not stop there. They proceeded to say:

> "On this aspect, one of us, Chinnappa Reddy, J. has proposed a separate and detailed opinion <u>with which we agree</u>" [emphasis supplied].

18. With respect, *Azadi Bachao Andolan* seems to proceed on the basis that the views expressed by Chinnappa Reddy, J. are his own and do not represent the view of the Court as a whole. This, with respect, does not appear to be correct. An analysis of the Ramasay principle as discussed and adopted in later decisions of the House of Lords show that much water had flowed under the bridge since *IRC v. Duke of Westminister* was rendered. In *IRC v. Burmah Oil Company Ltd* [1982 STC 30(HL)] Lord Diplock stated that no one can assume that Ramasay did not mark a significant change in the approach adopted by the House of Lords in its judicial role into preordained transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax; which in the absence of those particular steps would have been payable. The learned Law Lord continued, "The difference is in approach. It does not necessitate the overruling of any earlier decisions of this House; but it does involve recognizing that Lord Tomlin's oft quoted dictum in IRC v. Duke of Westminister, "Everyman is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be," tells us little or nothing as to what methods of ordering one's affairs will be recognized by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straight forward way." *Furniss v. Dawson* [(1984) AC 474] took the concept forward followed by *Ensign Tankers* [(1992) 2 WLR 469 HL] and *Moodi* (1993) 1 WLR 266 HL. An attempt was made to confine the operation of the doctrine in *Cravan V. White* [(1988) 3 WLR 423 HL] by the majority therein, and some decisions that followed it. But, recently in *HMRC v. Tower MCashback LLC* [(2011 UK SC 19] the Supreme Court of England has reiterated and applied the Ramasay principle to find a transaction found to be genuine to be part of a tax avoidance scheme to deny the full relief to the assessee therein. As we understand it, the view that has emerged is that notwithstanding the legal validity of a transaction or a set of transactions, if the purpose was

to create a legal smoke screen to avoid the payment of tax that would legitimately be due as having arisen on the basis of a transaction or an event, the legal effect of the transaction in the context of the taxing statute, has to be considered, notwithstanding its reality or validity. As observed by Lord Hoffman in *Macniven v. Westmoreland Investments* [(2001) UKHL 6], "The point to hold on to is that something may be real for one purpose, but not for another."

19. What is it that is happening in this case? A company in France, invests in acquiring shares in an Indian company. Ultimately it acquires a controlling interest. For this purpose, it creates a fully owned subsidiary. The shares are taken in the name of the subsidiary. Subsequently, another company also comes in and acquires a part of the shares (20%) in the subsidiary. The only asset of the subsidiary is the shares in the Indian company. It has no other business. Now the two shareholders of the subsidiary are selling the shares of the subsidiary to another company. By that process, what really passes is the underlying assets and the control of the Indian company. A gain is generated by this transaction. By repeating the process, the control over the Indian assets and business can pass from hand to hand without incurring any liability to tax in India, if the transaction is accepted at face value.

20. This type of attempt is what is frowned upon by the McDowell decision. This is the line of reasoning adopted by the English Courts in Ramasay and the subsequent decisions. The payment of tax on capital gains over the shares of Shantha can be perpetually avoided by dealing with the shares of ShanH earlier with MA and GIMD, but now with Sanofi, but passing effective control over the assets and the business of Shantha. It is the adoption of such devices that is not accepted at face value by courts and treated as ineffectual for the purpose of averting payment of tax due under the statute.

21. It is argued on behalf of the applicant that what is taxed by the taxing statute is the gain arising out of the sale of the shares of an Indian company and that taxing event has not taken place. He also submitted that the concept of underlying assets and controlling interest are not concepts that can come into reckoning while interpreting the taxing statute. A taxing statute is to be construed strictly and nothing is to be added or subtracted. Nor can it be interpreted in such a manner that transactions not directly hit by it, are also roped in based on presumed intention or purpose. Counsel for the Revenue submitted that what we are concerned with, is to see whether there is an attempt to avoid payment of tax in India for declining a ruling and in arriving at that conclusion, nothing is being added to or subtracted from the section. Section 9 of the Income-tax Act and the DTAA permit a see through of the transaction to ascertain its true purpose and that is all that is needed to be done in this case.

22. The whole endeavour on the side of the applicants was to show that the coming into being and existence of ShanH as a commercial and corporate entity cannot be ignored. It is emphasized that ShanH is the shareholder in Shantha, that in the books of account of ShanH, the investment originally made in the purchase of shares of Shantha is shown as a loan from MA, that the stamp duty has also been accounted for by ShanH, that the French Tax Authorities and the Indian authorities have accepted the existence of ShanH as the investor in Shantha and that the legal and valid existence of ShanH cannot be ignored. It is not necessary to ignore the existence of ShanH to come to a conclusion that what is put up is a facade in the context of the tax law and would amount to a scheme for avoidance of tax. In that view, the fact that GIMD and George Hiborn held shares in ShanH would not make a difference.

23. The legal validity of a transaction or the adoption of a series of transactions commonly used, like creating a fully owned subsidiary for making such investments in another country, cannot stand in the way of the question being asked whether it is acceptable in the context of the taxing statute. When we ask ourselves that question in this case, we get the answer that by accepting it in the context of the taxing statute we would be opening the door for the passing of the assets and control of an Indian company repeatedly without the shares of the Indian company being touched, though in reality it is only by acquiring shares of the Indian company, that control over it and its assets can otherwise be acquired. When dealing with such a question we cannot ignore the aspects of underlying assets and control over the affairs of the company, passing from one hand to another.

24. When can an usually adopted business scheme be treated as an attempt at avoidance of tax liable to be not accepted by the tax regime? It appears to us that it will depend on the effect of the scheme as a whole on the liability of the entity to be taxed. In this case, a permissible commercial scheme has been adopted to acquire the shares, the underlying assets and control of an Indian company. But thereafter, in the guise of dealing with the shares of a subsidiary formed for such acquisition, the underlying assets, business and control of an Indian company is passed from one hand to another. By repeating this process, without touching the shares of the Indian company, the right and dominant control over its assets and business can pass from hand to hand. On a look at the series of transactions from the commencement of the formation of ShanH, it appears to us to be a pre-ordained scheme to produce a given result, viz., to deal with the assets and control of Shantha without actually dealing with the shares of Shantha or its assets and business. This scheme adopted, has to be seen as one for avoiding payment of capital gains which would otherwise arise if the shares of the Indian company had been transferred, leading to the same result as now achieved. We are satisfied that a scheme of the nature cannot be accepted

simply for the reason that "upon the true construction of the Statute, the transaction which was designed to avoid the charge to tax, actually comes within it." [See *Norglen Ltd. v. Reeds Rains Prudential Ltd*. [1999 2 AC 1 at 14).

25. It is pointed out that ShanH would continue to exist inspite of the sale of shares in it by the applicants to Sanofi. The question may also arise as to what would happen if Sanofi were to sell the shares of ShanH, it has acquired, to another. We do not consider it proper to go into that question since our ruling is invited only on the transaction involved herein, namely, transfer of the shares of ShanH by MA and GIMD to Sanofi. Our ruling can only relate to that transaction on the scheme of the Act. May be, a subsequent transaction by Sanofi of the shares in ShanH may have to be considered based on all the facts then available including the assets and line of business then held by ShanH and the reasons put forward in support of that transaction.

26. We are, therefore, of the view that the transaction involved is not one to be taken at face value by the Taxing Statute since it is one intended to avoid payment of tax on capital gains in India. The questions posed have to be answered in this context.

27. The object of the Double Taxation Avoidance Convention between India and France is not only to avoid double taxation but also to prevent fiscal evasion with respect to taxes on Income and capital. This is clear from the preamble to the convention itself. The said preamble reads:

> "The Government of the Republic of India and Government of the French Republic, desiring to conclude a convention for avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on Income and capital".**(emphasis supplied)**.

Have agreed to its terms: To test whether a scheme adopted is with the object of avoidance of tax which would have been otherwise payable an enquiry in that behalf is contemplated by the very tax convention relied on by the applicant. This is in addition to the power available to this Tribunal under the proviso to Section 245R(2) of the Act and the law settled by courts in decisions like the one in McDowell. Therefore, when a plea of attempt at tax avoidance is raised by the Revenue in a proceeding before this Authority for a Ruling on the question of liability to tax of an applicant in respect of a transaction, an enquiry in that behalf cannot be avoided. This can be done even while we consider the application under section 245R(4) of the Act, when all the facts relevant, are available before us or ought to be made available to us.

28. It is the case of the applicant that the transaction in question is governed by Article 14 of the DTAA. Under Article 14.5 gains from alienation of shares representing a participation of atleast 10% in a company which is a resident of France, may be taxed in France. It is the

contention that the capital gain arising out of the sale of the shares of ShanH in France, can be taxed only in France. It is pointed out that neither the applicants nor Sanofi are tax residents of India.

29. On behalf of the Revenue, it is reiterated that what is really sold is the property and the controlling interest in Shantha and so considered, the capital gains arising out of the sale of shares is liable to be taxed in India. The whole case of the Revenue depends upon the plea that what is really being dealt with by virtue of the transaction in question is the underlying assets, business and controlling interest of an Indian company and consequently, any transfer for a consideration giving rising to a gain could be taxed in India. The further argument is that the payments made by Sanofi for the purchase to the shares of the applicants is for acquisition of control and management and other bundle of rights in Shantha and consequently, the transaction would give rise to capital gains in India, as Shantha is a company incorporated in India and located in India. The transfer of shares of ShanH would amount to the transfer of the assets of Shantha, if not of its shares formally.

30. In view of our conclusion that the transaction must not be taken at face value since it amounts to a scheme for avoidance of tax in India, the logical stand this Authority has to adopt on the scheme of the Act is to decline a ruling on the questions posed for our ruling. Therefore, invoking the ratio of the decision of the Supreme Court in McDowell and in the light of clause (iii) of the proviso to Section 245R(2) of the Act, we decline to rule on the questions raised.

31. This Authority had allowed the application under Section 245R(2) of the Act but had clarified that the bar created by Section 245R(2) of the Act will be reconsidered while giving a ruling under section 245R(4) of the Act. This behaves us to consider the questions on merits and to give rulings on them. A ruling is also necessary for a completion of this proceeding and to avoid a remit of this matter to this Authority, in case, on the question of tax avoidance, the Supreme Court were to disagree with our conclusion. It will be unjust to leave open the question raised and argued.

32. The primary and common question raised in these applications is whether the capital gains arising to the applicants from the sale of their shares in ShanH to Sanofi, another company incorporated in France is taxable in France alone or in India. Looked at blandly, the transaction in the manner put through, is taxable in France. We have earlier concluded that the fact that the transactions are commercially real and taken step by step valid, does not preclude us from considering the scheme or the scope of the transaction as a whole from the point of view of taxation and so looked at, it is a scheme for avoidance of tax in India. We have held that what is involved is a preordained scheme for avoidance of tax and it cannot be given effect to in the context of the taxing statute. In substance, what is dealt with are the underlying assets and the

controlling interest in Shantha, a consequence that would naturally spring out of the sale of shares of Shantha itself. The transfer of shares of ShanH may have commercial and business efficacy or validity. But that does not prevent us from looking at the transaction in the context of the Income-tax Act and/or the DTAA between the countries and assessing its efficacy from the point of view of taxation.

33. Article 14 of the Convention between India and France deals with capital gains. It is the case of the applicants that paragraph 5 of the said Article is attracted and since the shares being sold are of a company incorporated in France, which is a tax resident of France, to another tax resident of France, the gain therefrom is taxable in France. Article 14.5 reads:

> "5. Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of atleast 10 per cent in a company which is a resident of a contracting state may be taxed in that contracting state."

It is the contention that ShanH, the shares of which are being sold is a company incorporated in France in which the applicants have a participation above 10 per cent and since the gains is that of a resident of France, it is liable to be taxed only in France. It is contended that unlike paragraph 1 of Article 14 relating to immoveable property, paragraph 5 does not permit a see through and the transaction has to be accepted as it is. The fact that the asset is located in another country is irrelevant. The option to provide for a "see through" has not been exercised while entering into the Treaty with France.

34. Alternatively, it is submitted that even if paragraph 5 is held to be not applicable to bring about the above result, in terms of paragraph 6 of the Convention, the transaction is taxable only in France. Article 14.6 reads:

> "6. Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 4 and 5 shall be taxable only in the contracting state of which the alienator is a resident."

It is submitted that the applicants, the alienators are resident of France and going by paragraph 6 of Article 14, the transaction would be taxable in France. By no stretch of imagination can the alienator be deemed to be a resident of India.

35. On behalf of the Revenue, it is submitted that alienation is a word of wide import and read with the words participation of atleast 10 per cent in a company, it would mean that conveying of such rights of participation would also attract tax in India, if the interest of participation is of an Indian company. It is submitted that transfer of the right of participation in an Indian company even by a non-resident, outside India which allows the transfer of participation interest in an Indian company would be taxable in India as per paragraph 5 of Article

14 of the Convention. Participation in a company, according to the Revenue would mean, the right to vote, the right to nominate Directors, control and management, day to day decision making and right to get distribution of profits. It is submitted that all these rights in respect of the Indian company, Shantha are with MA or with MA and GIMD, the applicants and hence the transfer now being effected is taxable in India in terms of paragraph 5 of Article 14.

36. It is true that a Double Taxation Avoidance Convention has to be construed on its terms. On a literal construction paragraph 5 would lead to the position that the transfer of shares of ShanH in this case, can be taxed only in France. But the contention of the Revenue is that the situs of the underlying assets cannot be ignored and the underlying assets and controlling interest are that of a company incorporated in India and a resident of India. We have found that what is involved in this transaction, is an alienation of the assets and controlling interest of an Indian company. It will logically follow from our finding that the transactions gone through are part of a scheme for avoidance of tax and the scheme has to be ignored, that the gain from the transaction is taxable in India. Even then, it is not an alienation of the shares of an Indian company, on a literal interpretation of paragraph 5 of Article 14 of the treaty. But a purposive construction of the said paragraph of the treaty leads us to the conclusion that the capital gains arising out of the transaction is taxable in India. The essence of the transaction takes within its sweep various rights including a change in the controlling interest of an Indian company having assets, business and income in India.

37. We, therefore, rule on question no. 1 in the application by MA and on the question in the application by GIMD, that the transactions of sale of shares by them in ShanH to Sanofi are taxable in India in terms of paragraph 5 of Article 14 of the Double Taxation Avoidance Convention between India and France.

38. This ruling is obviously without prejudice to the right, if any, of the applicants to the benefits, if any, available to them under Article 25.2 of the DTAA.

39. Since we have ruled on question no.1 that the transaction is liable to be taxed in India in terms of Article 14.5 of the DTAA, the second question posed in application No. 847 of 2009 filed by MA does not arise. Article 14.6 has application only if Article 14.5 has no application. Hence, we are not inclined to consider the question whether controlling interest is an asset that would be taxable in France under Article 14.6 of the Treaty.

40. Accordingly, the ruling is pronounced on this 28th day of November, 2011.