Landmark International Tax Cases decided by Indian Judiciary - Summary

Chapter 134

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Synopsis

The past year has seen several landmark developments in India in international tax matters, both on the legislative front, with the retrospective amendments on indirect transfers, royalty provisions etc., introduced by this year's Finance Act as well as the introduction of the general anti-avoidance rule. On the judicial front, the approach of courts tended towards substance over form, with authorities such as the Authority for Advance Rulings taking an increasing number of pro-revenue positions, in the process departing from previously settled positions of law.

This paper attempts to provide a broad overview of the judicial developments from this past year. We will focus on key cases relating to the application of the capital gains provision to corporate reorganisations, availability of tax treaty benefits, the treatment of royalty/fees for technical services and the concept of permanent establishment, particularly in the context of temporary set-ups such as liaison offices.

1. Vodafone and its legacy

This paper shall not examine the text of the Vodafone ruling of the Supreme Court of India ("**Supreme Court**"), considering that the impact of the ruling was undone shortly thereafter by retrospective legislative amendments, pursuant to which the report by Dr. Parthasarathi Shome followed. However, the Vodafone case has brought the discussion on periodic retrospective amendments into the spotlight, and should be examined if only on this brief point.

For a brief recap, the Indian revenue authorities had initiated high profile litigation against Vodafone in relation to the purchase by Vodafone of an offshore company which indirectly held assets in India. Claims were initiated on the basis that Vodafone had failed to withhold Indian taxes on payments made to the selling Hutch entity. The Supreme Court delivered a judgment in favour of Vodafone in January this year, stating *inter alia* that no Indian tax was required to be withheld on a transfer of offshore assets between two non-residents. Shortly thereafter, the Finance Act, 2012 introduced Explanation 5 to Section 9(1)(i) of the Income-tax Act, 1961 ("**ITA**"), "clarifying" that an offshore capital asset would be considered to have a situs in India if it substantially derived its value (directly or indirectly) from assets situated in India. The amendment is currently retroactively applicable from 1961. Several other "clarificatory" amendments were also introduced to the definitions of "capital asset", "transfer" and the withholding tax provision, to bring offshore indirect transfers within the Indian tax net. The Prime

Minister set up the Shome Committee to engage with stakeholders and examine the implications of the new rule to tax indirect share transfers, and the Committee report which came out in the first week of October spoke out strongly against the retrospective application of tax statutes. Meanwhile, a couple of significant judicial developments have taken place on the issue of retrospectivity and tax avoidance.

In *Avani Exports*[1], the Gujarat High Court held certain retrospective amendments to s. 80HHC to be violative of Article 14 on the basis that they placed two assessees of the same class on a different footing. On this basis, the amendment was quashed to the extent that it was retrospective. The Bombay High Court subsequently followed this ruling in *Vijaya Silk*[2]. While these cases may not lay down principles which are significantly new, in the framework of retrospective tax statutes, they achieved prominence during the course of this year on account of the attention drawn by the Vodafone ruling to retrospective amendments, and the approach adopted by the revenue authorities and legislature of using retrospective amendments to undo the impact of unfavourable court rulings.

2. Corporate reorganisations and capital gains

There were some significant cases this year in the context of the capital gains implications of corporate reorganisations, several of which pertained to section 47 and the carve outs from the definition of taxable transfers.

The case of RST[3] dealt with a situation of buy-back of shares by an Indian subsidiary from its parent company i.e., RST which held 100% shares of the Indian subsidiary, directly, and through its nominees. Transfer of a capital asset from a parent company (including a foreign parent company) to its Indian wholly owned subsidiary is not treated as a taxable transfer as per section 47(iv)[4]

1 Special civil application No. 7926 of 2006; [2012]23 taxmann.com 62 (Gujarat)

2 Writ Petition No. 2446 of 2010

3 249 CTR 113 (AAR)

4 Section 45 of Act deals with capital gains, and brings under the ambit of tax any capital gains arising from the transfer of a capital asset including shares. Section 47 of the Act exempts certain types of "transfers" from the purview of the aforesaid section 45. Section 47(iv) specifically exempts any transfer of a capital asset by a company to its subsidiary company, if:

(a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and

(b) the subsidiary company is an Indian company.

of the ITA, and is exempt from capital gains tax in India. Therefore RST[5], a company incorporated in Germany held that there should be no tax implications on the buyback of shares by an Indian subsidiary from its German parent, an argument which was not accepted by the Authority for Advance Ruling ("AAR").

RST, a company incorporated in Germany, held 99.99986% shares in an Indian public limited company ("**Indian Subsidiary**"). The remaining shares were held by six nominees of RST, since the Indian Companies Act, 1956 ("**Companies Act**") requires a public company to have a minimum of seven shareholders. When the Indian subsidiary proposed to buy-back certain portion of the share capital from its shareholders, RST approached the AAR to ascertain its tax liability in India upon tendering its shares in the buy-back offer.

The AAR held that the exemption under Section 47(iv) of the ITA is available only where the parent company itself holds, or its nominees separately hold 100% shares of the shares of the subsidiary. The AAR also noted that it was legally not possible for the RST to hold 100% shares of the Indian Subsidiary and that the benefit of Section 47(iv) of the ITA would be available only in cases where the entire of the shareholding of a parent is held through its nominees. Even though it was submitted that the entire shareholding was held by it and its nominees only, the AAR observed that a nominee shareholder has the same rights in the company as any other shareholder viz., voting rights, right to receive dividends, allotment rights under section 81 of Companies Act, etc. and hence the shareholding by the nominees is not to be equated with the shareholding by RST. The AAR also held that it was not possible to accept the argument of RST that the phrase "the parent company or its nominees hold the whole of the share capital of the subsidiary company" should be read as "the parent company and its nominees hold the whole of the share capital of the subsidiary company", since the section would be workable even without such reading albeit in limited cases. Such a conclusion appears to result in a sort of anomaly, since Indian corporate law requires all companies to have a minimum of two shareholders, which makes the application of section 47(iv) impossible.

However, it was further observed that section 46A of the ITA was a specific provision that deems gains arising pursuant

5 249 CTR 113 (AAR)

to buy-back of shares as capital gains. Holding that Section 45 of the ITA is a general provision dealing with transfer of all capital assets and placing reliance on the principle that a specific provision prevails over a general provision, the AAR held that Section 46A has to prevail over Section 45. The AAR referred to the speech of the Finance Minister at the time of introduction of Section 46A wherein the Finance Minister clarified that the intent behind the section was to clarify that income earned on buy-back of shares would be deemed to be capital gains and not dividend income. On that basis, the AAR concluded that Section 47, which exempts certain transfers only from the applicability of Section 45, had no bearing on the capital gains taxable under section 46A and hence sum received by RST on buy back was taxable in India. The AAR further stated that it was not relevant to go into an enquiry as to whether section 46A of the Act was in the nature of a charging provision of tax or not in coming to such a conclusion.

Other rulings where section 47 benefits were denied included that of *Orient Green*[6], where section 47(iii) benefits were denied to an intercorporate gift and taxpersons were ordered to probe intercorporate gifts. Another capital gains benefit denied to non-residents was by the AAR in the case of Cairn U.K. Holdings Ltd ("**CUHL**")[7]. In this case, the AAR held that a non-resident investor would not be entitled to the beneficial 10% tax rate on long term capital gains from the sale of listed securities. Ordinarily, long term capital gains are taxable at 20% (exclusive of applicable surcharge and education cess). CUHL was a private limited company registered in Scotland. CUHL sold its 2.29% stake in an Indian listed company, Cairn India Ltd. ("**CIL**") for a consideration of USD 241,426,378. This transfer took place off-market and the AAR was required to determine whether such gains were entitled to the benefit of the proviso to Section 112(1) of the ITA.

The AAR upheld the arguments put forth by the revenue holding that Section 48 of the ITA, which confers indexation benefits, is a provision which governs the mode of computation of income. Section 112(1) of the ITA specifies the rates that govern the taxability of such income. Therefore, the AAR held that the beneficial 10% taxation (of non-indexed capital gains) under the proviso to Section 112(1) comes into picture only with respect to capital assets to which the second proviso to Section 48 apply. Further, as the proviso to

6 (2012) 252 CTR (AAR) 123

7 337 ITR 131

Section 112 does not make a mention of the first proviso to Section 48, the class of persons covered by the latter are not entitled to the benefit of the former.

Further, on the question of applicability of the proviso to Section 112(1) of the ITA to zero coupon bonds, the two-judge bench of the AAR came up different interpretations, though leading to the same conclusion. V. K. Shridhar, the member, emphasised on the difference between a bond and a zero coupon bond, observing that in the case of the latter, among others, no benefits were to be received before maturity or redemption of the bonds. Thus, he held that zero coupon bonds were not removed from the second proviso to Section 48 by virtue of the third proviso to the same section and were therefore, entitled to the benefit of the proviso to Section 112(1) of the ITA. On the other hand, Justice P. K. Balasubramanyan, the Chairman, held that the proviso to Section 112(1) was applicable to the ambit of circumstances covered by the second proviso to Section 48 without taking into account the third proviso to the same section and that therefore zero coupon bonds were entitled to the benefit of Section 112(1).

However, on the positive side, the Bombay High Court in *AVM Capital Services*[8] and the Gujarat High Court in *Vodafone Essar*[9] held that a tax free corporate reorganization should not per se constitute a colourable device. Further, in *Euro RSCG Advertising*, the Mumbai ITAT held in favour of the taxpayer and held that the mere fact that a transfer may take place at cost to a parent entity should not result in the transfer being considered a sham. Similarly, the Gujarat High Court held in *Biraj Investment*[10] that it should not be a colourable device merely on account of pledged shares being sold at a loss to a group company. Therefore, while there has been significant activity in the context of corporate reorganisations, there appears to have been a mix of rulings which have gone in favour of as well as against the taxpayer.

3. The sanctity of the India-Mauritius Treaty – shaken but intact?

This year saw several rulings where the availability of India-Mauritius treaty benefits was considered, many of them overturning settled positions in favour of the revenue.

8 [2012] 115 SCL 81 (Bom.)

9 [2012] 115 SCL 94 (Guj.)

10 TAX APPEAL No. 260 of 2000

The Bombay High Court in the case of *Aditya Birla Nuvo Limited vs. DDIT and Union of India; New Cingular Wireless Services Inc vs. DDIT and Tata Industries Ltd. vs. DDIT. (Mum).*[11] relating to the transfer of shares of an Indian joint venture company, Idea Cellular Ltd. ("**ICL**") and also the transfer of shares of a Mauritian company which held shares in ICL wherein the Court dismissed the writ petitions filed by Aditya Birla Nuvo Limited, New Cingular Wireless Services Inc., ("**U.S. Co.**") and Tata Industries Limited ("**TIL**") and expressed its *prima facie* view that such sale of shares is liable to capital gains tax in India. This case dealt with whether any income chargeable to tax in India accrued or arose to U.S. Co. on account of US$ 150 million paid by Aditya Birla Nuvo Limited to AT&T Mauritius ("**M. Co.**", a wholly owned subsidiary of U.S. Co.) for the sale of about 16% stake in ICL and the subsequent consideration paid by TIL to U.S. Co., for acquiring the M Co. which held the remaining 17% interest in ICL.

AT&T Corp/AT&T Wireless Services Inc., U.S. and the Birla Group ("**Birla**") had entered into a joint venture ("**ICL**" or "**JV**") for carrying on wireless telecommunication in India. The agreement between the parties provided the shares in ICL shall be held by the 'founders' in their own name or through a 'permitted transferee' *i.e.* any corporation which is a wholly owned subsidiary of the founder of ICL. Accordingly, M. Co. subscribed to the shares of ICL and such investment was made after seeking an approval from the Reserve Bank of India ("**RBI**"). However, as stipulated in the JV agreement, all rights in respect of the said equity shares (voting rights, rights of management, right of sale or alienation etc.) vested in U.S. Co. It may be noted that subsequently TIL also subscribed to the shares of the JV Co. and a Shareholder Agreement ("**SHA**") was entered into between U.S. Co., Birla and TIL, whereby there was a change in the shareholding (as depicted hereunder).

In 2005, Birla and TIL were desirous of purchasing the entire 74,35,61,480 equity chares of ICL offered by U.S. Co. for USD 30 million, and it was agreed that each party could get 37,17,80,740 equity shares of ICL on payment of USD 150 million. Therefore, on 28 September 2005, Indian Rayon (now Aditya Birla Nuvo Limited, representing the Birla Group) pursuant to a Sale and Purchase Agreement ("**SPA**") purchased 37,17,80,740 equity shares of ICL from M. Co. and U.S. Co. for US$ 150 million. Further, TIL entered into an agreement on the same day for acquiring the entire issued and paid up share capital of M. Co. from U.S. Co.

11 2011 (113) BomLR 2706

As a result, the issue in question was whether the said ICL shares were owned by M. Co. or by U.S. Co. According to the Revenue, the said shares were owned by U.S. Co. and the capital gains arising or accruing thereform were taxable in India either in the hands of U.S. Co. or in the hands of Indian Rayon as an agent of U.S. Co. as per Section 163(1) of the ITA. Additionally, TIL was sought to be treated as an *assessee in default*, since it failed to deduct tax as required under the provisions of the Act before making a payment to U.S. Co. for the purchase of shares of M. Co. on the grounds that it represented a sale of shares of ICL by the U.S. Co.

Indian Rayon contended that the beneficial ownership of ICL shares vested solely in M. Co. and not U.S. Co., and therefore applying India–Mauritius Tax Treaty the capital gains accruing to M. Co. shall be taxable only in Mauritius and therefore there is no question of treating Indian Rayon as a *representative assessee*. Further, due emphasis was given to the fact that the RBI had approved such a share transfer. Established principles of tax law were relied on in this regard, specifically the principle of separate legal personality of a subsidiary company and the *Azadi Bachao Andolan* case where the Supreme Court validated the benefits of the Treaty for residents of Mauritius subject to there being a valid tax residency certificate issue by the Mauritian Government. It was argued that the sale proceeds received by M. Co. and immediately thereafter transferred to U.S. Co., as reflected from the cash flows of M. Co. was towards dividends and repayment of loan. The Revenue Authorities argued that the allotment of ICL shares in the name of M. Co. was only in the capacity of a permitted transferee of U.S. Co., and that M. Co. was not conferred any ownership rights relating to the shares.

The Court held that the U.S. Co. was carrying on business in India and according to the JV agreement, M. Co. was not conferred any beneficial ownership since it held the shares only as a permitted transferee *i.e.* U.S. Co. was designated a representative to exercise all the rights and to perform all the obligations, with a few exceptions. The Court further noted that all the rights in the shares under the JV agreement vested with the U.S. Co. Further, the Court highlighted that U.S. Co. was a party to the SPA jointly with M. Co. and the contention raised by Indian Rayon that U.S. Co. was made party to the SPA on account of the warranties given by it was without merit since the shares of ICL could not be sold by M. Co. without U.S. Co's consent. The Court observed that the RBI approval does not elevate the status of M. Co. from that of a permitted transferee to a party shareholder.

Additionally, the Court distinguished the *Azadi Bachao Andolan* verdict on facts and stated the same cannot be applied to the present case since in this case the investment was made by U.S. Co. and not the Mauritian Company. Further, the Court denied recourse to the *Azadi Bachao Andolan* since the transaction (between TIL and U.S. Co.) was a colorable transaction and the U.S. Co. discharged its liability to pay for the equity shares of ICL by a device of advancing a loan to/subscription of shares of the Mauritian Co.

The Court further held that the fact that the shares of the JV stood in the name of AT&T Mauritius did not make AT&T Mauritius the legal owner of the shares because in the present case, allotment of shares of the JV was to the JV partner, receipt of the shares of ICL by AT&T Mauritius was on behalf of the JV partner and the sale of the said shares was from one JV partner another JV partner under the JV Agreement/Shareholder Agreement. Thus, the income accruing or arising in India to U.S. Co. on transfer of a capital asset situate in India, (sale of shares of ICL to Indian Rayon) would be income deemed to accrue or arise in India to U.S. Co. and can be assessed in the hands of the U.S. Co. or in the hands of Indian Rayon as an agent of the non-resident under Section 163 of the ITA.

On a related note, in the case of *Schellenburg Wittmer*[12] the AAR denied the benefits of the India-Swiss treaty to a partnership, notwithstanding that all the partners of the partnership were resident in Switzerland. This was done on the basis that the partnership was a transparent entity in Switzerland. Further, treaty benefits were not allowed with respect to the income of the partners as the payments were being made by an Indian payer to the partnership (and not the partners). This appears to be an anomalous stand to take. Having said this, there have been rulings such as *Dynamic Fund*[13] where Mauritius Treaty benefits were allowed to an entity with a tax residency certificate in spite of the recent amendments, and such as *Moody's Analytics*[14] where legal ownership of shares was considered instead of beneficial ownership.

In another case of *Ardex Investments Mauritius Limited* ("**AIML**"), a company was incorporated in Mauritius in 1998 and was held by Ardex Holdings U.K. Ltd ("**Ardex UK**"), a UK based

12 (2012) 253 CTR (AAR) 178

13 A.A.R. No. 1016 of 2010

14 A.A.R. No. 1186, 1187, 1188 and 1189 of 2011

company engaged in the business of manufacturing construction material. AIML was a resident of Mauritius and possesses a tax residency certificate issued by the Mauritian tax authorities. It held 50% of the shareholding in Ardex Endura (India) Pvt. Ltd. ("**AEIPL**"), an Indian company engaged in the business of manufacturing flooring adhesives. AIML proposed to sell its entire stake in the Indian company to Ardex Beteiligungs GmbH (ABG), a German group company, at fair market value. It sought an advance ruling on whether capital gains on the proposed sale would be chargeable to tax in India having regard to the provisions of the Treaty.

Relying on the landmark *Mauritius case*[15], the AAR held that there is nothing taboo about treaty shopping. The AAR also noted that the earlier *McDowell case*[16], did not address issues of treaty shopping and was hence not relevant. In the *McDowell case*, the Supreme Court held that colourable devices and subterfuges do not constitute legitimate tax planning. In the *Mauritius case*, the Indian Supreme Court held that treaty shopping is a legitimate exercise of tax planning and AIML cannot be denied benefits of the Mauritius Treaty in the absence of express treaty provisions limiting such benefits. Considering that the shares were held by AIML for a considerable period of time and are proposed to be sold at fair market value, the AAR did not view the arrangement as a tax avoidance scheme.

It also did not consider the theory of beneficial ownership to be relevant for deciding whether Ardex Holdings is the holder of the shares of the Indian company. Beneficial ownership is an anti-avoidance tool used in tax treaties aimed at restricting the availability of lower withholding tax rates to persons who exercise real and complete ownership rights over specific streams of income such as dividends, interest, royalty and fees for technical services. Interestingly, in an earlier case,[17] the AAR had noted that the concept of beneficial ownership may not be relevant for the purpose of capital gains, since treaties generally do not use this expression in the clause dealing with capital gains income.

15 Union of India vs. Azadi Bachao Andolan and Ors - 263 ITR 706 (SC)

16 AIR 1986 SC 649

17 KSPG Netherlands Holding B.V. vs. DIT, [2010] 322 ITR 696 (AAR).

On the issue of chargeability, the case of case of Z[18] before the AAR dealt with income arising from the sale of shares and Compulsorily Convertible Debentures ("**CCDs**"). The AAR re-characterised the income arising on such disposition as interest income and not capital gains income on the grounds that a CCD is in the nature of a debt till the time it is converted and any income arising on account of a CCD should be considered interest income, regardless of the fact that the income has arisen on account of sale of such CCD to a party, as a consequence of which the benefits of the India Mauritius tax treaty ("**Mauritius Treaty**") were held not to apply.

Z, the applicant based in Mauritius, and an Indian company V invested in to another Indian company S, which was a wholly owned subsidiary of V and subscribed to CCDs issued by S. S was engaged in development of a certain plot of land, which rights were transferred by V to S prior to this investment. Under the investment agreement executed between S, V and Z, the CCDs were mandatorily convertible into equity shares upon the expiry of 72 months from the investment date; additionally, prior to the mandatory conversion date, Z had a put option to sell specific number of equity shares and CCDs to V and V had the call option to purchase the said shares and CCDs from Z. V exercised the call option and purchased the CCDs from Z in multiple tranches. V approached the tax officer for a nil withholding certificate for the consideration paid to Z for the CCDs as such income, in the opinion of V, was in the nature of capital gains income exempt from tax under Article 13 of the Mauritius Treaty. The tax officer however rejected the application and asked V to deposit the withholding tax on this transaction. Z subsequently approached the AAR for a ruling on the issue.

The AAR examined various authorities and case laws to hold that a CCD was in the nature of a debt instrument which continues to so remain till the time the debt is repaid. The AAR also observed that the obligation to repay the principal and an interest component were embedded in the concept of debt and that such payments were not necessarily required to be in the form of debt and could be in the form of cash, as was in this case. The AAR further observed that the definition of 'interest' under the ITA and the India-Mauritius Tax Treaty to conclude that 'interest' denotes any type of income that become payable on a debenture.

18 345 ITR 411 (AAR)

The AAR studied the provisions of the investment agreement which set out the purchase price required to be paid by V to Z for the CCDs, which purchase price was an aggregate of:

a) the amount invested by Z,

b) a pre-determined rate of return compounded quarterly, which rate varied with the period of investment;

c) 10% of the value of the project being developed by S; and

d) 8% of the investment amount calculated for a specified period.

The AAR further examined the other provisions of the investment agreement to conclude that while S and V were two separate legal entities, S had no power to exercise any management control over its business and that for all practical purposes V and S were a single entity. The AAR based this conclusion on provisions in the agreement which provided rights to V and Z to nominate directors to the board, right of V and Z with respect to material business decisions of S, consent requirement for S to enter in to any related party transaction by S, among other management rights granted to V and Z. Additionally, V was required to share with Z, its financial statement, debt servicing status etc. In light of such provisions, the AAR observed that on a close reading of the investment agreements, it was apparent that the commitment to repay the debt was on V, the parent of S and not S and therefore, the purchase of CCDs by V from Z should be considered repayment of the debt such that income arising to Z should be treated as interest income, as a consequence of which Mauritius Treaty benefits were held to not be available.

4. Royalty & Fees for Technical/Included Services

There were some significant (and retrospective) amendments to the definition of royalty this year, which expand the scope of the provision to include payments towards shrink wrap computer software, database subscriptions etc. which may not ordinarily be considered to be in the nature of royalty.[19] However, the cases below

19 In this regard, it is relevant to mention the ruling of the Delhi High Court in the case of Nokia (TS-700-HC-2012 (Del.), which has held that the expansive domestic definition of royalty shall not apply if the recipient is entitled to the benefits of a favourable tax treaty. While this is not a new principle, its significance is that most tax treaties would have a narrower definition of royalty as compared to the expansive definition introduced by this year's Finance Act.

pertain not so much to the retrospective amendments, which have been recently introduced, as the application of the royalty provision to evolving situations.

4.1 Payments to Satellite Operators for broadcasting does not qualify as royalties

The Delhi High Court in the case of *Asia Satellite Telecommunications Co. Ltd. vs. DCIT*[20] held that payments made for using capacity in a transponder for uplinking/down linking data do not constitute 'royalty' under the provisions of the Income-tax Act, 1961. The High Court held that the customers did not make payments for the use of any process or equipment, since control over the process or equipment was with the taxpayer and not with the customers.

Asia Satellite Telecommunications Co Ltd ("**ASTCL**") was in the business of private satellite communication and broadcasting facilities using its satellites. For providing transponder capacity it entered into contracts with television channels, etc (the customers) and enabled them to relay their signals over the footprint of the satellite, which includes India. The customers would uplink the signals containing TV programmes, which were received by the ASTCL's satellites. The satellites would then amplify the signals and relay them to various continents (including India) over which it had a 'footprint'. The only activity ASTCL performed was telemetry, tracking and control of the satellite, which was carried out from Hong Kong. There was no presence, facilities or assets of the taxpayer in India. The Tribunal had held that the customers were using a process as a result of which the signals, after being received in the taxpayer's satellite were converted to a different frequency and were relayed to the area covered by the footprint, after amplification and hence the satellite's facilities could be termed as royalty. An appeal was made to the High Court. The revenue contended that the business of ASTCL was to help its customers in relaying their programmes to the regions in its satellite footprint (including India). Further, it was contended that it is the duty of ASTCL to make those programmes available in India. Hence, it was urged that ASTCL had a direct business connection in India.

However, the High Court observed that since ASTCL did not have any assets, facilities or presence in India and all operations

20 [2003] 85 ITD 478(Del.)

were performed outside India, it did not amount to operations being carried out in India. Hence, the provisions of the ITA were not attracted. The High Court held that various clauses of the agreement clearly indicated that the control over the transponders was always with the taxpayer. It was observed that ASTCL had merely given access to a broadband/capacity available with the transponder to its customers. Further, the High Court also held that just because the satellite had a footprint in India, it could not be said that the process took place in India and so payment for use of the satellite's facilities could not be termed as royalty.

4.2 Payment towards provision of International Private Leased Circuit is taxable as Royalty

The Chennai Tribunal in the case of *Verizon Communications Singapore Pte Ltd vs. ITO*[21] held that the consideration for provision of International Private Leased Circuit ("**IPLC"**)/dedicated bandwidth qualify as royalty. The Tribunal held that such consideration would be regarded as towards use of process or equipment.

Verizon Communications Singapore Pte Ltd. ("**Verizon**") was a non-resident company engaged in providing international connectivity services largely in the Asia-Pacific region. When a customer required a leased line facility between his office in India and any overseas location, they would enter into two separate agreements. The first agreement was with Verizon for providing international connectivity and the other with Videsh Sanchar Nigam Limited ("**VSNL**") for the Indian half circuit services connectivity. Verizon used telecom services equipment situated outside India in order to provide IPLC services from the aforesaid virtual point up till the overseas customer's destination. However, Verizon, did not either 'own' or 'utilise' any landing station/equipment in India for providing international half-circuit-services. For these services, the customer received two invoices – one from VSNL for providing connectivity within India and second from Verizon for providing connectivity outside India. The issue before the Tribunal was whether amounts received by the tax payer for provision of IPLC/ bandwidth services outside India is royalty for use of 'equipment' or 'process' under section 9(1)(vi) of the ITA read with Article 12(3)(b) of the India-Singapore Tax Treaty.

21 [2011] 45 Sot 263 (Chennai)

Verizon contended that it used telecom services equipment situated outside the territory of India to provide international connectivity services; it neither 'owned' nor 'utilised' any landing station in India for providing international half circuit services. As per Verizon, since it did not have a PE in India, payments received for international connectivity services were not taxable in India. The revenue, however, contended that based on the order of the CIT(A), Verizon had provided single, composite and indivisible circuit which would constitutes 'equipment' and VSNL was only a 'provisioning entity' for providing local part of the services.

The Tribunal ruled that as per the agreement entered into between the Verizon and the Indian customers, the customers acquired significant economic or possessory interest in the equipment of the taxpayer to the extent of bandwidth hired by the customer. Further, it is a well-settled position that physical possession of equipment is not a must. It further held that even if bandwidth is not used, the customer has to pay the committed charges. Thus, Verizon did not bear any risk of diminution in receipts or increase in expenditure if the customer does not make the use of the capacity. Therefore the payment made for hiring bandwidth would correspond to the rental value. Thus, even if payment made by the Indian customer to the Singapore company was not royalty for use of equipment, it was royalty for use of 'process' and, hence, the payment was held to be royalty income and subject to tax in India.

4.3 Payment made towards the transfer of right to broadcast live matches is not royalty

In the case of *ADIT (Intl. Tax) vs. Neo Sports Broadcast Pvt. Ltd.* [22], Neo Sports Broadcast Private Limited ("**Neo**") filed an application under section 195(2) of the ITA seeking permission for lower/nil deduction of income tax on the payments to be made to Nimbus Sports International Pte. Ltd. ("**Nimbus**") in pursuance to the agreement for grant of licence for live broadcast of cricket matches. The AO observed that there was a business connection between Nimbus and receipts in India as the matches were to be broadcasted in India and without the receipt of signal of the matches to be played, no income would accrue to Nimbus. However, the matches were to be broadcasted on the Indian Territory, and the income by way of advertisement revenue and subscription revenue were received by Nimbus. The AO further held that the Explanation

22 [2011] 133 ITD 468 (Mum.)

2 to section 9(i)(vi) of the ITA covered both the payments for broadcasting of live matches and pre-recorded matches, being in the nature of royalty. However, the CIT(A) held that the payment made towards live telecast was not covered by Explanation 2 to Section 9(1)(vi) of the ITA and therefore was not in the nature of royalty. An appeal was preferred to the Tribunal on the ground whether the payment made towards transfer of rights to broadcast live cricket matches was royalty and whether Nimbus had a business connection in India.

On the ground of business connection, the Tribunal observed the relevant criteria is the carrying out of business operations in India by a non-resident and not the earning of income by any resident from the use of any product acquired from the non-resident. Where the non-resident only allows some resident to exploit certain right vested in it on commercial basis, it cannot be said that the non-resident has carried out any business activity in India. The act of Neo earning revenues from India cannot lead to a business connection of Nimbus in India as the transaction between the taxpayer and Nimbus was confined to receiving broadcasting right for a consideration. The transaction between Neo and Nimbus was on a principal to principal basis. Further, Nimbus has provided licence for the live broadcast of certain matches to the assessee for a definite consideration. The rights in such broadcast were vested with Nimbus. After the live broadcast by Neo, Nimbus would continue to hold rights over such broadcast. The mere act of allowing the taxpayer (by Nimbus) to broadcast the matches live for a defined consideration would not constitute a business connection in India for Nimbus.

On the ground of construing the payment as royalty, the Tribunal referring to the Copyright Act, 1957, held that 'copyright' means exclusive right to use the 'work' in the nature of cinematography. The question of granting exclusive right to do any work can arise only when such 'work' has come into existence. In other words, the existence of work is a pre-condition and must precede the granting of exclusive right for doing of such work. Unless the work itself has been created, there cannot be any question of granting copyright of such work. The process of doing or creating the work itself cannot be simultaneous with the use of such work. It is only when the work has been created that its copyright could be conceived. On this basis, it was held that there is no copyright in live events and depicting the same cannot infringe any copyright.

4.4 Payment made for services rendered pursuant to a Data Processing Services Agreement does not constitute FTS

The AAR in the case of *RR Donnelley India Outsource Private Ltd.*[23] ("**RRD India**") ruled that services rendered by a foreign company under the Data Processing Services Agreement ("**DSPA**") to RRD India cannot be said to be technical, managerial or consultancy services under the ITA and hence consideration received for such services is not taxable us FTS.

RRD India was engaged in the business of commercial printing, product customisation, print fulfilment, logistics, call centres, print management, online services, digital photography, colour services, etc. It entered into a data processing services agreement with RR Donnelley Global Document Solutions Group Ltd. ("**RRD UK**") for efficient discharge of its services to the customers. RRD UK was engaged in the business of communication management delivering creative and presentation services, pre-media, print management, transactional print and mail, warehousing, logistics and distribution, and data processing. As per the agreement, RRD UK was rendering services specified in the agreement and the consideration is paid by RRD India as per the invoices raised by RRD UK. RRD UK needed to issue a monthly invoice to RRD India specifying the fees itemised by services and any applicable taxes payable by the applicant for such calendar month. Fees were to be paid in full by RRD India within 90 days following receipt of an invoice from RRD UK. RRD India sought an advance ruling on the issue whether the amount received/receivable by RRD UK as per the DPSA was taxable as FTS and if the amount received/receivable by RRD UK is not taxable in India.

The AAR observed that services rendered by RRD UK were not in the nature of rendering any managerial, technical or consultancy services since RRD India contended that these services are in the nature of routine data entry, application sorting, document handling and data capturing services. Hence, the consideration received for such services are not taxable. Further it held that since it does not involve the usage of any sophisticated technology and hence Article 13 of India-UK Double Tax Avoidance Agreement ("**India-UK Tax Treaty**") would not apply to the case. The AAR relied on Supreme Court's decision in case of Ishikawajima-Harima Heavy Industries Ltd.[24] wherein it was held that the services

23 [2011] 335 ITR 122 (AAR)

24 Ishikawajima-Harima Heavy Industries Ltd. vs. DIT, 288 ITR 408 (SC)

rendered outside India will not be taxable in India. Since the amount received by RRD UK is neither taxable under the Indian Act nor under Article 13 of the India-UK Tax Treaty, the question of withholding tax under section 195 of the ITA did not arise.

5. The permanence of temporary establishments

5.1 Liaison offices

This year saw several cases on the permanent establishment exposure caused by liaison offices.

One such case was that of Jebon Corporation *DDIT (International Taxation) vs. Jebon Corporation of India*[25]. In this case, Jebon Corporation, a South Korean enterprise ("**JCo**"), was dealing in the supply of printed circuit boards, liquid crystal display and switching mode power supply to worldwide customers. The taxpayer set up a liaison office ("**LO**") in Bengaluru, India, with prior approval of the Reserve Bank of India ("**RBI**").The role of the LO was to locate intending buyers for JCo's products, obtaining enquiries and communicating it to the Head Office ("**HO**") in Korea. The LO engineers identified customers on basis of their past sales experience and co-ordinated with the HO for communication to the customer of the purchase price, technical details, availability and lead time. The LO also had the complete discretion to add the appropriate sales margin to the purchase price communicated by the HO and provide the same to the customers in India. In fact, the LO was given annual sales target for the sales based on the forecasts given by the LO to the HO. The payment for the goods however, was made directly to the HO by the customers. On assessment, the Assessing Officer ('**AO**') concluded that the LO constituted a PE of JCo in India, which allegation was rejected by the Commissioner of Income Tax (Appeals) ("**CIT(A)**") and an appeal was preferred to the Tribunal.

Under the India-Korea Double Taxation Avoidance Agreement ("**India-Korea Tax Treaty**"), an exception is carved out from the PE definition for a place which is used primarily for advertising, supply of information, or any other activity which is considered to be auxiliary and preparatory in nature and therefore, not actual business of the company in India. A LO set up in India, in accordance with the provisions of the exchange control regulations, is required to restrict its activities to acting as a channel of communication between the company and Indian parties; there

25 2010(1) ITR (Trib) 655

is a specific prohibition for LOs to undertake activities which are of commercial, trading or industrial nature.

The Tribunal made a systematic analysis of the activities undertaken by the LO in India against the thresholds of business connection, under the domestic tax laws, and permanent establishment under the India-Korea Tax Treaty. The Tribunal concluded that the LO in reality was involved in the process of securing orders from customers in India, as its activities ranged from identification of customers to the finalisation of the orders and negotiating the selling price. The Tribunal observed that the functions of the LO travelled beyond the being auxiliary and preparatory and this was most evident in the authority of the engineers at the LO in the matter of fixing the sale price of the products and therefore, the LO would constitute a PE of the JCo in India.

However, an appeal from the Tribunal was preferred to the Karnataka High Court[26]. The Karnataka High Court ruled that a LO engaged in commercial activities constituted a PE in India in accordance with Article 5 of the India-Korea Tax Treaty and the business profits earned by the LO in India would be liable to tax under Article 7 of the India-Korea Tax Treaty. It stated that the LO was carrying on the commercial activities of procuring purchase orders, identifying the buyers, negotiating and agreeing the price, ensuring material dispatch to the customers, follow up for payments from the customers and also offering after sales support. It also noted that the LO was engaged in activity of trading and therefore entering into business contracts, fixing price for sale of goods. Merely because the officials of the LO were not signing any written contract would not absolve them from liability.

5.2 LO not restricted to purchase of goods subject to PE Exposure

In another case[27], also relating to LOs, the AAR held that a LO in India which was engaged in activities not confined to purchase of goods from India for export, would lead to constitution of a PE under the India-USA Double Taxation Avoidance Agreement ("**India-USA Tax Treaty**"). This ruling of the AAR becomes noteworthy in view of the nature of activities undertaken by the LOs of foreign companies, including co-ordination with purchasers outside India, merchandising, production management, quality control etc.

26 Jebon Corporation of India vs. CIT (International Taxation) & Anr. (2011) 55 DTR 113 (Kar.)

27 Columbia Sportswear Company, [2011] 337 ITR 407 (AAR)

Columbia Sportswear Company ("**CSCo.**"), a company incorporated under the laws of the USA, was engaged in the business of outwear manufacture and selling skiwear. It had a LO in Chennai. The LO, besides co-co-ordinating for purchase of goods from India, Egypt and Bangladesh was engaged in activities relating to other purchase functions of CSCo., like vendor identification, quality control, uploading prices on internal product data management, *etc*. The goods procured by the LO are directly sold outside India. CSCo. sought an advance ruling as regards the taxability of its income in India.

The AAR held that its Indian LO, which was engaged in activities not confined to purchase of goods from India for export, would lead to constitution of a PE under the India-USA Tax Treaty. Subsequently, the income attributable to the activities of the LO of CSCo. was held to be taxable in India. The AAR observed that a person engaged in the business of manufacturing and selling cannot be taken to earn profits only from the sale of goods and that it would be unrealistic to take a view that all activities other than the actual sale are not integral to the business. The AAR further held that the case of the LO was not covered by Article 5(3)(e) of the India-USA Tax Treaty since the LO was not solely involved in advertising, supply of information, scientific research or other activities which are preparatory or auxiliary in character, and that its activities ranged beyond all of the above. Finally, the AAR held that the activities, functions and operations of the LO lead to constitution of a PE of the Company in India, and hence its income attributable to the operation carried out in India are taxable in India.

This ruling of the AAR in this case is noteworthy in view of the nature of activities undertaken by the LO of foreign companies, including co-ordination with purchasers outside India, merchandising, production management, quality control, etc. It is significant to note that a LO of a non-resident may be established in India pursuant to the Foreign Exchange Management (Establishment in India of branch or office or other place of business) Regulations, 2000 ("**Regulations**") as amended from time to time. As per the Regulations a LO can undertake only liaison activities, *i.e.* it can act as a channel of communication between head office abroad and parties in India. Further, the Regulations permit LO to only undertake the following activities:

1. Representing in India the parent company/group companies.

2. Promoting export/import from/to India.

3. Promoting technical/financial collaborations between parent/ group companies and companies in India.

4. Acting as a communication channel between the parent company and Indian companies.

This ruling may have a far reaching impact on many foreign companies, which have set up LO in India where the LOs undertake wide activities ranging from co-ordination, collection of information, engaging employees in India, marketing, implementing company policies, *etc*. While AAR rulings are applicable only to the parties in question, it is possible that the tax department may take a view that the wide nature of activities undertaken by such LOs lead to the creation of a permanent establishment of the foreign company in India, and hence an Indian tax incidence.

5.3 Project Office of Foreign Company constitutes PE in India

In the case of *Samsung Heavy Industries Co. Ltd vs. ADIT (Intl. Tax)*[28] the Delhi bench of the ITAT held that a Project Office ("**PO**") of a non-resident entity in India constituted a PE under Article 5 of the India-Korea Tax Treaty. It also held that an installation PE under Article 5(3) of the India-Korea Tax Treaty was not an exclusionary clause to be read in isolation but extends to the scope of Articles 5(1) and 5(2) of the India-Korea Tax Treaty.

Samsung along with Larsen & Toubro Ltd. ("**L&T**") had entered into an agreement with Oil and Natural Gas Company ("**ONGC**") for conducting surveys (pre-engineering, pre-construction/pre-installation and post construction), design, engineering, procurement, fabrication, installation, modifications at existing facilities, start up and commissioning of entire facilities, etc. The project was a turnkey project under the agreement. Samsung provided ONGC with an organisation chart and curriculum vitae of every project member involved within a prescribed time of commencement of work. A Board Resolution was also to be passed by Samsung indicating that a PO was to be opened for the "co-ordination and execution" of the project. Samsung opened a PO in India after obtaining RBI approval. Subsequently there was a loss declared in the income return statement as computed in accordance with Article 7 of the India-Korea Tax Treaty which pertained to business profits and there was non-disclosure of income from offshore activities carried outside India on the pretext that it was

28 [2011] 133 ITD 413 (Del.)

not applicable to the PE and no such income was to be received nor did it arise as per Section 5(2) of the Income-tax Act, 1961. Samsung relied on the Supreme Court decision in the case of Hyundai Heavy Industries Co. Ltd.[29]

Samsung argued that the PO was not involved in the pre-contract meetings because the said meetings were held before the setting up of the PO. Further, the PO had not undertaken anything apart from acting as interface between the Samsung and ONGC and the activities carried out by the PO were only preparatory and auxiliary in nature. Samsung also relied on the Delhi Tribunal's decision in the case of Hyundai Heavy Industries[30] and contended that mere existence of project office should not constitute a PE, given the nature of the contract which was predominantly in the nature of installation project.

The revenue, however, contended that the PO was continuously co-ordinating with ONGC which was an important part of the contract and the contract could not be executed without it. Therefore, these activities were not auxiliary or preparatory in nature. It further argued that the Supreme Court's decision in the case of Hyundai Heavy Industries Ltd. could not be applicable as the facts of the case were different in the present case. The contract was not divisible and therefore was taxable in India, right from the beginning, to the extent of profit attributable to such PE.

The Delhi Tribunal held that a PO of a foreign company constitutes a PE in India. With reference to the agreement, the Tribunal observed that the contract obtained by the taxpayer was a composite contract. The resolution and minutes of the Board, the approval of RBI did not lay any restriction on the PO activities and expressly stated that the PO was opened for co-ordination and execution of project in India. Although, the exclusionary clause under Article 5(4) of the India-Korea Tax Treaty deals with preparatory or auxiliary activities would not apply as the PO had a key role to play in the execution of the entire contract. Further, the documents on record proved that all the activities to be carried out were routed through the PO only.

The Tribunal further held that the decision of the Supreme Court in the case of Hyundai Heavy Industries was not applicable

29 CIT vs. Hyundai Heavy Industries Co. Ltd. [2007] 291 ITR 482 (SC)

30 CIT vs. Hyundai Heavy Industries Co. Ltd. [2007] 291 ITR 482 (SC)

as the contract in the said case was divisible into two parts, one was for fabrication of the platform and the other was installation and commissioning of the said platform. Further taxpayer in the said case had only a LO and such LO was not permitted to carry on any business activity in India. Therefore, there was no PE in India.

The Delhi Tribunal in the case of *Nimbus Sport International Pte. Ltd. vs. DDIT (Intl. Tax)*[31] held that income of a non-resident from production of television signals for broadcasting of cricket matches in India is taxable as Fees for Technical Services ("**FTS**") on gross basis and in the absence of a PE. Advertisement revenues from the Indian advertisers for matches held outside India and telecasted internationally would not be taxable in India.

Nimbus Sport International Pte. Ltd. ("**Nimbus**") was company incorporated in Singapore and had entered into an agreement with Prasar Bharti ("**PB**") to produce and broadcast live television signals of international quality, covering international cricket events. Nimbus was a 50:50 joint venture between Nimbus Communication Worldwide Ltd. ("**NCWL**"), a company incorporated under the laws of Mauritius and World Sports Group Ltd. ("**WSG**"), a company incorporated under the laws of British Virgin Islands.

The Co-Chairman and a director of the NCWL was also holding positions as directors in Nimbus. Nimbus contended that it was wholly managed and controlled from Singapore and did not have any PE in India under the India-Singapore Tax Treaty. Consequently, in the absence of a PE, the income received, being in the nature of business profits was not taxable in India. The AO, however, held that Nimbus had a PE in India and the income of the taxpayer from production of live TV signals was in the nature of FTS. The AO accordingly taxed the gross receipts at the rate of 20 per cent under section 44D read with section 115A of the Income-tax Act, 1961. On appeal, the CIT(A), held that office of the share holder of NCWL was used for the purpose of rendering a part of technical services and therefore, Nimbus had a fixed place of business in India. With regards to the nature of payment, the CIT(A) observed that the services of production and generation of live TV signals were in the nature of technical services. It also held that the taxpayer made available technical knowledge, experience, skill, know-how and processes which consisted of development and transfer of technical plan and design relating to production and generation of live TV

31 (2012) 145 TTJ (Delhi)

signals to PB. Accordingly, the CIT(A) held that the amount received from PB was FTS within the meaning of the ITA as well as under Article 12(4) of the India-Singapore Tax Treaty. An appeal was filed to the Tribunal.

The Tribunal observed that the agreement was signed by Nimbus in Singapore, and all the activities relating to this agreement were carried out from Singapore. The holding of one board meeting in India would not lead to the conclusion that the control and management of foreign company's affairs are situated only in India. The Tribunal further observed that holding office in group companies in India by the directors of foreign company may not necessarily mean that they are carrying on business activities of foreign company in India. Hence, it ruled that Nimbus did not have any fixed place PE in India and the income was not chargeable to tax in India.

5.4 Branch Office set up in India does not constitute PE

In an interesting and unique case, the Delhi Tribunal held that a Branch Office ("**BO**") set up in India does not constitute a PE *vide* Article 5 of the India-USA Tax Treaty merely because it remunerated employees seconded by the US group company and hence was not taxable in India[32]. Whirlpool India Holdings Ltd. ("**Whirlpool**") was a wholly owned subsidiary of Whirlpool Corporation, USA ("**Parent Company**"). Whirlpool opened a BO in India with prior RBI approval for undertaking import/export activities from India, providing service support to local suppliers for development of good quality raw material, components and finished products for local and overseas requirements and promoting technical/financial collaboration and other incidental activities. The primary object was to watch and safeguard the interest of the Parent Company in India. The Parent Company wanted to ensure placement of top tier employees in its subsidiary to manage affairs. However, on account of recurring losses by the subsidiary, the Parent Company had to compensate the employees through the BO. In its return of income, Whirlpool declared losses and zero income since it had no business operations in India and since the salary expenses were met out of repatriation of foreign exchange from USA, the loss was not claimed.

The Tribunal observed that even though Whirlpool has a fixed place of business in India in the form of a BO there seemed

32 Whirlpool India Holdings Ltd. vs. DDIT, [2011] 140 TTJ 155 (Delhi)

to be nothing on record to reflect that the business of Whirlpool had been conducted wholly or partly through its BO. It noted that the employees could be either of the wholly owned subsidiary on the ground that they were under the supervision and control of the Board of Directors or they could be of the Parent Company on the ground that the salaries were paid by them, but it was difficult to come to a conclusion that the employees are those of the Whirlpool. Since the Whirlpool was not chargeable to tax in India under Article 5 of the India-USA Tax Treaty, the Tribunal ruled that where the BO was to be used only for the purpose of remunerating employees seconded by the parent to work for the subsidiary in India, such BO could not be considered as rendering any service thereby could not be constituted as a PE.

6. Procedural Developments

6.1 Petition in respect of rulings by AAR can be subject to writ jurisdiction of the respective High Court

In a significant ruling, the Supreme Court held that petitions in respect of rulings by the AAR, can be subject to the writ jurisdiction of the respective High Court under Article 226 of the Constitution of India ("**Constitution**"), and that the Supreme Court may decline to exercise its jurisdiction under Article 136 of the Constitution if it is of the view that the matter may more appropriately be dealt with by the High Court under Article 226.

A Special Leave Petition ("**SLP**") was filed by the Columbia Sportswear Company[33]. A three-judge bench of the Hon'ble Supreme Court passed an order requiring the applicant to make arguments on the maintainability of the SLP, and also clubbed all the SLPs filed against the rulings of AAR to consider the preliminary question of whether an advance ruling pronounced by the AAR can be challenged before a High Court under Article 226/227 of the Constitution prior to consideration by the Supreme Court under Article 136 of the Constitution.

Under Article 227 of the Constitution, it is specified that the High Court shall have superintendence over all courts and tribunals throughout the territories in which it has jurisdiction. Further, under Article 136 the Supreme Court has the discretion to grant special leave from any judgment/decree, etc. by any court or tribunal in India. The first issue which was considered by the Supreme Court

33 Columbia Sportswear Company vs. DIT, AIR 2012 SC 3038

is whether the AAR would constitute a "Tribunal" for the purposes of Articles 227 and 136. The basis of this consideration was that a "Tribunal" has been defined by virtue of previous case law as a body invested with judicial (as against purely administrative or executive functions), which was relevant to consider in light of the fact that AAR rulings are only binding on the parties involved.

In this regard, the Supreme Court stated that the test for determining whether a body is a 'Tribunal' or not is to determine whether it has the power to pronounce upon the rights and liabilities arising out of some special law. For this purpose, the Supreme Court looked into the definition of advance ruling, according to which the AAR may make a ruling in relation to a proposed or a completed transaction that is undertaken or proposed to be undertaken by a non-resident applicant, or in relation to the tax liability of a non-resident arising out of such transaction. Further, considering Section 245S of the ITA, the Supreme Court observed that the determination made by the AAR is binding on the applicant, the Indian tax authorities and the parties involved in the transaction. The Supreme Court importantly noted that while with respect to other parties the ruling is of merely persuasive nature, this would not imply that the principle of law laid down in a case by the AAR is not to be followed in future. Accordingly, the Court concluded that the AAR is a body acting in judicial capacity exercising judicial power conferred on it by Chapter XIX-B of the ITA and can thus, be regarded as a 'Tribunal' and that the decision of an AAR is amendable to challenge under Articles 226/227 and 136 of the Constitution.

The Supreme Court examined two issues in relation to the availability of the writ petition route under Article 226. The first was whether parties could file a writ in a situation where the AAR ruling was, by virtue of the statute declared binding. In this regard, the Supreme Court relied on previous cases such as *Kihoto Hollohan vs. Zachillhu*[34] *and Others* to hold that the powers of the Supreme Court under Article 136 of the Constitution, and the powers of the High Court under articles 226 and 227 cannot be affected by a statute made by the Legislature.

The second issue was whether an AAR ruling can only be challenged by way of an SLP under Article 136 of the Constitution. In this regard reference was made to the observations of the AAR in *Groupe Industrial Marcel Dassault In re*[35], where it was emphasis ed

34 1992 Supp (2) SCC 651

35 In re 2012 340 ITR 353 (AAR)

that the object of an advance ruling is expeditious justice and that permitting a challenge before the High Court would be "counter productive since writ petitions are likely to be pending in High Courts for years" and involve multiple levels of adjudication.

The Supreme Court held as follows: *"We have considered the aforesaid observations of the Authority but we do not think that we can hold that an advance ruling of the Authority can only be challenged under Article 136 of the Constitution before this Court and not under Articles 226 and/or 227 of the Constitution before the High Court. In* L. Chandra Kumar vs. Union of India and Others (supra)*, a Constitution Bench of this Court has held that the power vested in the High Courts to exercise judicial superintendence over the decisions of all courts and tribunals within their respective jurisdictions is part of the basic structure of the Constitution. Therefore, to hold that an advance ruling of the authority should not be permitted to be challenged before the High Court under Articles 226 and/or 227 of the Constitution would be to negate a part of the basic structure of the Constitution."* However, due regard was paid to the objective of expeditious justice delivery and the Supreme Court held that when an advance ruling is challenged at the High Court, it should be heard directly by the Division Bench and be dealt with in an expeditious manner.

Finally, the Supreme Court considered the circumstances when an SLP would be admitted, and referred to various cases which included *Sirpur Paper Mills Ltd. vs. Commissioner of Wealth Tax, Hyderabad*[36] to hold that SLPs would be admitted only where they involve questions of great importance.

6.2 Reversal of settled AAR positions

The AAR in the case of *Castleton Investment Limited*[37] ("**Castleton**") held that transfer of shares in an Indian company by a Mauritius holding company to a Singapore company as a part of internal re-structuring is not liable to capital gains under Article 13(4) of the India-Mauritius Tax Treaty.

Castleton was a company incorporated in Mauritius holding shares in a listed company in India ("**Indian Company**"). Castleton proposed to transfer its investment in the Indian Company at fair value to an associated enterprise in Singapore ("**Singapore Company**") off the market and not through a recognised stock

36 AIR 1970 SC 1520

37 AAR No. 999 of 2010

exchange i.e. without attracting Securities Transaction Tax ("**STT**"). Castleton, the Indian company and the Singapore company are all part of the same group.

On the issue of the characterisation of the shares of the Indian company held by Castleton, the AAR held that the shares would be characterised as capital assets as the shares were held for long-term benefit as investment and not for the purpose of trading. Further it ruled that the transfer of shares of the Indian company by Castleton would be liable to capital gains tax in India. However, the AAR relying upon the Supreme Court judgment in the case of *Azadi Bachao Andolan*, ruled that Castleton could claim exemption under the provisions of Article 13(4) of the India-Mauritius Tax Treaty on capital gains arising on the transfer of shares.

On the issue of whether transfer pricing provisions will be applicable even when the transfer of shares by Castleton to the Singapore company was not taxable in India, the AAR deviating from its own ruling in the case of *Vanenburg Group BV*[38], ruled that whether or not the gain or income is taxable in India, the transfer pricing provisions would apply if the transaction is of such a nature that would come within those provisions. It held that the provisions of sections 92 to 92F of the ITA were applicable and the aspect that the exercise of applying the transfer pricing provisions may not be fruitful would not affect the applicability of the statutory provisions.

The AAR further held that since the income from transfer of shares would not to be chargeable to tax under the provisions of the ITA there was no obligation to withhold tax.

On the issue of applicability of Minimum Alternate Tax ("**MAT**"), the AAR ruled that the term 'company' as referred to in Section 115JB of the ITA would be applicable to 'every company' and the definition of a company under the ITA includes a foreign company. Further, the fact that the foreign company did not have a PE would not make a difference to the applicability of MAT provisions.

Interestingly, the AAR also ruled that the theory of precedents does not have a strict application to it and it is bound only by the decisions of the Supreme Court and the decisions of the High Court have only persuasive value.

38 Vanenburg Group BV vs. CIT., [2007] 289 ITR 464 (AAR)

7. Conclusion

This year has seen some major developments in the area of tax practice. Apart from the financial budget making significant changes to the ITA, the judiciary has also contributed substantially to the explanations and purview of the ITA.

Even though in cases like *Vodafone*, *Moody's Analytics Inc.*[39] the judiciary has reiterated the principle of 'form over substance', various judicial pronouncements as seen above, indicate an approach towards substance rather than form, by reiterating some of the principles or laying down some newer approaches to interpret the international tax law. Further, the revenue authorities have been perceived as adopting an aggressive stance to safeguard tax collection in the face of weakening world economies and stiff international competition. Rulings such as *Dynamic Fund*[40] where treaty benefits were allowed to an entity in spite of the recent amendments, and such as *Moody's Analytics*[41] where legal ownership of shares was considered instead of beneficial ownership. Even with respect to royalty and fee for technical services, the approach of the judiciary has been quite similar. In light of the various cases discussed, it would be interesting to see how the next financial budget makes changes to the ITA and how the judiciary progresses in accepting such changes.

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39 AAR No. 1186 of 2011, AAR No. 1187 of 2011, AAR No. 1188 of 2011 decision dated June 7, 2012.

40 AAR No. 1016 of 2010

41 AAR Nos. 1186, 1187, 1188 and 1189 of 2011