



**Surana & Surana National Corporate Law
Moot Court Competition**
JSS Law College, Mysore
10 - 12 February 2012



Disclaimer: This problem is not an attempt to imitate or to preempt the outcome of any case *lis pendens* in India. The sole objective of the problem is to introduce the participants to evolving laws and case laws in the field of direct taxation and is purely for educational purposes.

Note to the participants: The problem has to be dealt with assuming that the Direct Tax Code ('DTC' or 'the Code') has come into effect in India and all the provisions of the DTC shall apply accordingly to argue and decide the below case law regardless the dates of the transactions. However, any judgments decided under the Income-tax Act, 1961 could be cited to the extent applicable. Further, international case laws, commentaries and guidelines to the extent applicable must be referred and explained in the memorials and during the oral arguments.

BEFORE THE HONORABLE SUPREME COURT OF INDIA

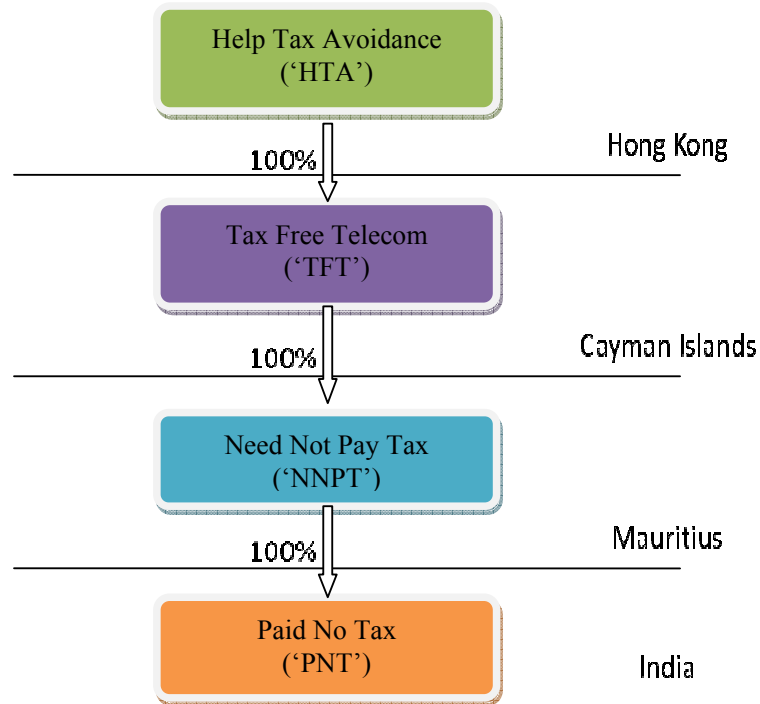
Civil Appeal No. 99999/ 2012

Why Pay Tax Inc. (YPT) Vs. Union of India (UOI) and Anr.

Facts of the case

1. The assessee, *Why Pay Tax Inc. ('YPT' or 'the Company')* is a company incorporated in Delaware, USA according to the company laws of state of Delaware and is having its registered office at Dover, Delaware. YPT is mainly into large scale business of telecommunication services in USA and other parts of the world. YPT was keenly interested in expanding its business in high potential countries in Asia especially in India. However, as on date of the transaction, YPT was not involved in any business in India either directly or indirectly and had no branch office, business connection/ transaction, source of income or any other nexus with India.
2. YPT wanted to expand its business in India but at the same time did not want to venture in incorporating a novice company instead planned to acquire a successful telecommunication company already having broad customer range in India. *Paid No Tax India Telecom Ltd. ('PNT')* incorporated in Bengaluru, India was one such company which exactly suited the requirements of the YPT.

3. PNT is an Indian company having the following share holding patterns:



4. It was sufficient for the assessee/ YPT to acquire 100% of shares of TFT from HTA as such an acquisition would give complete control over the drop down companies including the Indian company PNT, which is the target company. Therefore, YPT entered into Share Purchase Agreement ('SPA-I'), under which it was agreed that HTA would sell all its shares that it held in TFT to the assessee. However, just before purchasing the shares as agreed upon by the assessee from HTA, some of the pending matters with regard to identical transactions were decided by some Indian courts all of which were against such nonresident purchasers. The judgments held that such nonresident purchasers would be liable to withhold tax at the time of payment of sale consideration to any other nonresidents if the underlying capital assets and/ or interests in such capital assets which are sold are in India. Apprehending such judgments could cover the above transaction (though such judgments were decided only by High Courts, Authority for Advanced Ruling ('AAR') and Tax Tribunals), the assessee and HTA revoked SPA-I and entered into another fresh share purchase agreement ('SPA-II').

5. The outcome of SPA-II, *inter alia*, were as follows:

- i. The assessee would purchase not the shares of TFT from HTA instead the assessee would purchase all the shares which NNPT holds in PNT.
- ii. TFT would grant the necessary authorization for the transaction as it holds 100% in NNPT

- iii. HTA being the ultimate parent company would grant the necessary authorization permitting TFT to authorize NNPT to sell the shares to the assessee/ YPT at the agreed rates.
6. In the above agreement both HTA and TFT were not parties to the agreement but were only mentioned in the recital to show the holding structure of the selling company i.e. NNPT. The parties to the agreement were only the assessee and NNPT. The agreement was executed in Mauritius as per the laws of Mauritius. None of the transactions happened in India and this was an arrangement/ agreement/ transaction which entirely happened out of India including the payment and receipt of the sale consideration.
7. The agreement was executed and the sale consideration was paid to NNPT by the assessee as agreed upon. As a development after the transaction, NNPT transferred the entire amount to TPT being its parent company and TPT in turn transferred the entire amount to its parent company HTA. However, a minor spread of income was left at NNPT and TPT on this transaction. In short, it appeared as though the transaction was like a back-to-back arrangement by these group companies. Also, it was equally possible that the chain of events was merely coincidental. Also, the above cash movement occurred relatively in a shorter time after the sale transaction took place. This left HTA happy as it achieved indirectly what it could not achieve directly. The total sale consideration in Indian Rupees was INR 10,000 crores which was paid by the YPT to NNPT.
8. The Income-tax department of India on knowing the various money movements and change in ownership structure of the telecom major PNT, wanted to know the details of the transaction to ensure that any tax that is liable to be paid or to be withheld in India has not escaped. Therefore, one of the Joint Commissioners of Income-tax ('JCIT'), Range 100, Bengaluru Circle under the powers conferred under section 134 read with section 140 of the Direct Tax Code ('DTC' or 'the Code') issued a notice to PNT and also to the YPT/ assessee calling for all the information regarding the above transaction. YPT without resorting to questioning the jurisdiction of the JCIT in issuing such notice was more than willing to cooperate with her/ him and shared the documents.
9. On perusing the documents especially the SPA, the JCIT was convinced that the whole transaction was to evade the withholding tax liability in India on the sale of shares by NNPT held in PNT to the assessee and therefore, referred the matter to the Director of International Tax ('DIT') for his consideration and appropriate action. On instructions from the DIT, the Deputy Director of International Tax ('DDIT'), Bengaluru Circle issued a show cause notice ('SCN') under section 194 read with section 214 of the Code to the assessee/ YPT, requiring it to show cause as to why "*Why Pay Tax Inc. ('YPT')* should not be deemed to be an assessee in default ('AID') for failing to withhold the applicable capital gains tax while making the sale consideration to NNPT for the purchase of PNT shares". The DDIT fixed a hearing requiring

YPT to appear through its representative on the date fixed and submit such records and evidences in support of its case failing which YPT would be deemed to be an AID and the consequences under the Code shall follow.

10. YPT, without agitating the jurisdiction of the DDIT keeping in mind some of the adverse Supreme Court judgments, fully complied with the DDIT's notice and produced such documents and records to establish primarily that:

- i. There is no need for YPT to withhold any tax on the sale consideration as the whole transaction occurred out of India;
- ii. None of the properties transacted were situated in India;
- iii. This was purely a transaction occurring between two nonresidents situate out of India and therefore, neither the DTC nor the Indian income-tax authorities have locus to tax such a transaction;
- iv. Since the alienator of PNT shares is a resident of Mauritius, applying the Double Taxation Avoidance Agreement ('DTAA') between India and Mauritius, certain judgments of the Hon'ble Supreme Court of India and certain circulars of the Central Board of Direct Taxes ('CBDT'), the Indian income-tax authorities have no powers or jurisdiction to tax such a transaction;
- v. The Indian income-tax authorities are bound to honor such treaties as per Article 51(c) of the Constitution of India; and
- vi. The assessee cooperates in the proceeding under protest in writing.

11. After patiently hearing the submissions of YPT and after perusing all the documents submitted by YPT in this regard, the DDIT passed an order under section 194 read with section 214 of the Code as under:

- i. That the whole transaction is sham and colorable;
- ii. The main purpose of canceling the earlier agreement where the transaction was supposed to be between YPT and HTA and later on modifying the agreement in which the shares of PNT would be bought from NNPT is to evade the Indian income-tax;
- iii. Though the transaction has occurred between two nonresidents, the underlying capital asset (i.e. the assets of PNT and PNT as such) are situated and incorporated in India and therefore, the authorities under the DTC have sufficient powers to tax such a transaction;
- iv. Section 5 of the Code (Income deemed to accrue in India) is wide enough to cover such transactions
- v. Section 123 of the Code [i.e. General Anti Avoidance Rule ('GAAR')] grants wide powers to the income-tax authorities to tax such transactions. The Code being a statute later in time than the DTAA entered into between India and Mauritius, the Code shall prevail over the DTAA.

- vi. The principles laid down under Part IV of the Constitution of India is mere directive and is neither binding nor enforceable especially when the compliance of Article 51(c) of the Constitution would jeopardize the sovereignty of India's power to legislate statutes to safeguard its revenue interests. Further, Article 51 only expects that the State shall endeavor to comply with any treaty obligation and does not compel it to do so especially when India's interests are at risk.
12. Making the above observations, the DDIT passed an order levying tax at the rate of 20% being long term capital asset along with applicable surcharge and cess amounting to INR 2,060 crores. Further, a penalty equivalent of the tax payable was also levied under section 230 of the Code. Further, interest under section 214 of the Code was also levied.
 13. Against the impugned order, the assessee/ YPT immediately filed a writ petition in the Bangalore High Court vide W.P. No. 99999/ 2012 *inter alia* praying that:
 - i. the order of the DDIT is *non est* in law and has flagrantly violated the settled principles of Indian income-tax law and has traveled beyond its territorial limits by applying on a transaction happened completely out of India;
 - ii. the order has overtly violated the obligation of international treaty obedience and comity and has opened the Pandora box of transgressing the directive principles of state policy of the Constitution of India;
 - iii. the order is patently *per incuriam* of the order of the Supreme Court of India upholding the validity of the India-Mauritius tax treaty;
 - iv. the assessee in its writ petition challenged the constitutional validity of the provisions of GAAR of the Code which empowers the tax department to disregard an arrangement and restructure it in its own style stepping into the shoes of the corporations and thereby, declaring any transaction as sham and a colorable device. Also, it challenged the provisions of section 5 of the Code in so far as it permits the taxation of sale of underlying capital assets in India on a transaction completely happening outside India
 - v. to quash the order the passed by the DDIT and hold that the DDIT had no jurisdiction to issue the SCN and pass the impugned order
 14. After detailed hearing and consideration, the Hon'ble High Court dismissed the writ petition upholding the validity of the Code and held that as long as an extra territorial transaction has any nexus with Indian assets, then it is deemed to be Indian source income and therefore, taxation by source country is an accepted principle in international taxation. Further, the court held the directive principles of state policies under Part IV of the Constitution is unenforceable by any court and it is the prerogative of the State to decide as to when the treaty obligations could be overstepped especially when the interests of the country is at peril. However, the court directed the income-tax department not to indulge in any tax recovery proceedings until the matter approaches the Supreme Court if the aggrieved party prefers any special leave petition.

15. On filing of the Special Leave Petition, leave was granted and matter was directed to be heard on SLP paper books. Considering the importance of the matter, the matter was placed for consideration before a Constitutional Bench. On behalf of Union of India, the learned Attorney General of India and the learned Solicitor General of India are appearing along with other central government counsels and on behalf of the assessee a catena of top brass Supreme Court senior advocates is appearing.

16. The Hon'ble Supreme Court has sought the counsels appearing for either side to address the following issues and granted liberty to raise any other questions of law which are relevant to the case in adjudication:

i. Maintainability

- a. Whether the writ petition before the High Court was maintainable
- b. Whether alternative remedies were exhausted before approaching the High Court
- c. Whether the DDIT had powers to issue SCN to the assessee

ii. Constitutionality and income tax

- a. Whether the GAAR provision and income deemed to accrue in India provision of the Code have violated the Constitution, settled tax treaties and territorial limits of India
- b. Whether international treaty obligations under the Constitution have been flouted merely on the fact that India is not a signatory to the Vienna convention
- c. Whether the Code being a law later in time would prevail over DTAA. Scope of such doctrine?
- d. Can legislation unilaterally tax a transaction happening exclusively out of India between two nonresidents?

iii. Other issues

- a. Whether SPA-II was sham and was purely to treaty shop
- b. Who is the beneficial owner in the transaction?
- c. Did the DDIT commit *per incuriam* by not following the settled judgments of this Court?
- d. Such other issues as may be raised by the counsels with the leave of the Court