NATIONAL JUDICIAL ACADEMY

WORKSHOP FOR HIGH COURT JUSTICES ON DIRECT TAXES [P-1235]

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PROGRAMME REPORT

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OVERVIEW OF THE PROGRAMME

A two-day "Workshop for High Court Justices on Direct taxes" was organized by National Judicial Academy through online mode. The workshop refreshed High Court Justices on areas *viz.* history and basic features of tax laws, constitutional provisions for finance bills, money bills & scheme of the Income Tax Act, 1961 (IT Act). The workshop also engaged the Justices in discussions on "International tax Treaty, double tax avoidance agreement, and transfer pricing, and were provided with a platform to share knowledge and experiences on appellate and writ jurisdiction of High Courts.

DAY 1

Session 1 - History and Basic features of Tax Laws, Constitutional Provisions for Finance Bill and Treaties, Money Bills & Scheme of Income Tax Act, 1961

Session 2 - International Tax Treaty Law and Double Tax Avoidance Agreements: An Overview

DAY 2

Session 3 - Transfer Pricing: Basic Principles & Major Areas of Dispute

Session 4 - Appellate and Writ Jurisdiction of High Courts: Jurisdiction and Limitations

DAY 1

Session 1 - History and Basic features of Tax Laws, Constitutional Provisions for Finance Bill and Treaties, Money Bills & Scheme of Income Tax Act, 1961

Speaker - Mr. Porus F. Kaka

Chair - Justice S. C. Dharmadhikari

On the concept and rationale of taxation the statement of Franklin D. Roosevelt was quoted "Taxes, after all, are dues that we pay for the privileges of membership in an organized society." It was deliberated that the concept of income tax began consequent to the Napoleonic War in 1798. The main principles of taxation were reiterated to be convenience, certainty, equity, simplicity, and efficiency. Basic features of tax, welfare functions of the State, and the elements of tax i.e. tax base, rate of tax & tax payer were highlighted. Taxation at source and division of IT Act, 1961 into five schedules (salary, house property, capital gain, income from business & Profession and other sources) are two principal additions continued till today. It was stated that the instrument of taxation is not merely a means to raise a revenue in India, it ought to reduce inequality. It was emphasized that any tax to be levied must be constitutionally valid. The session included an overview of Directive Principles of State Policy and relevant legislations giving effect to international agreements. *Manganbhai Ishwarbhai Patel* (1970) 3 SCC 400 and *Azadi Bachao Andolan* (2004) 10 SCC 1 were quoted to clarify the constitutionality of tax treaties. Lastly, the scheme of the IT Act was discussed along with the provisions and concerns attached to GAAR and SAAR.

Session 2 - International Tax Treaty Law and Double Tax Avoidance Agreements: An Overview

Speaker - Mr. Porus F. Kaka

Chair - Justice S. C. Dharmadhikari

It was highlighted that the law of taxation is peculiar and different from other branches of law. Direct Taxes and Indirect Taxes are two major branches of law with different flavors. The speaker dwelt upon the leading international tax models and commentary along with adjudication fora in India, and also focused on the history and objects of tax treaties. It was emphasized that adhering to the basic principles of a Treaty, parties should honor the treaty commitments and avoid invoking their internal laws as justification to address failure of a treaty commitment.

The evolution of income tax laws of India and the international agreements and intitations viz. OECD ant their functional areas were traced and discussed. Objects of the treaties were discussed with the help of landmark judgments *viz. Azadi Bachao Andolan and Sanofi's,* 354 ITR 316 (AP*)*. Leading international Tax Models and commentaries *viz.* OECD Model, Tax Convention on Income and on Capital, United Nations Model Double Taxation Convention between developed and developing countries etc. were touched upon. Availability and lack of adjudicating fora in India were examined. Synergy between domestic laws and Treaties were examined. Furthermore, important treaty concepts like residence and person were highlighted. It was mentioned that any person who is a resident to one of the treaty partners can get the benefit of a treaty. Different heads of income under Treaties like income from immovable Property, business income, shipping and airline business, pensions, government services etc. were examined in brief. Articles which are source based and which are resident based for the purpose of taxation were highlighted. The session explored on the concept of Permanent Establishment. Fixed Place, Agency. Service and Construction Permanent

Establishment were the different types of permanent establishment that were discussed. Lastly, principles of General Anti Avoidance Agreements (GAAR) and its position Treaty were examined.

DAY 2

Session 3 - Transfer Pricing: Basic Principles & Major Areas of Dispute

Speakers - Mr. Arvind P. Datar & Mr. N Venkatraman

The session commenced with the assertion that transfer pricing is inherently a fact intensive exercise and extremely subjective in nature. It involves hypothetical considerations and comparisons, and reasonable minds may differ on interpretation of considered hypothetical facts. Therefore, to make an objective assessment of a subjective law is a challenge before the courts.

Transfer Pricing comes under Chapter X of the Income Tax Act, 1961 titled 'Special Provisions Relating to Avoidance of Tax' particularly intended to combat erosion of tax base, from shifting profits from a high tax to a low tax jurisdiction by arrangements between associated enterprises. Such base erosion is sought to be tackled by considering the 'arm's length price' i.e. the price at which the relevant transaction would be carried on by unrelated parties. However, law does not prevent legitimate advantage of the provisions as was held in *CIT v. Raman & Co.*, AIR 1968 SC 49 and it is for the businessperson to arrange affairs according to their commercial wisdom; income tax is a tax on real income i.e. income tax applies to income which has actually been earned, and not income which could possibly have been earned. Transfer pricing provisions are attracted when companies/enterprises tend to engage in tax arbitrage which can result in erosion of tax base due to artificial shifting of profits between group entities.

The basic concept of transfer pricing in relation to 'related entities' and 'arm's length price' were explained. The session further went on to explore the recent development with respect to domestic transfer pricing provisions post the decision in *Glaxo Smithkline Pharmaceuticals Ltd. v. Union of India*. Transfer pricing transactions essentially cover

tangible property, intangible property (which includes marketing, advertising, data collection, copyright, patent, industrial design, human capital etc.), capital financing, market development, consultancy, scientific research, legal, accounting, business restructuring, etc.

The session further delved into the five methods to arrive at an Arm's Length Price which are (i) Comparable Uncontrolled Price (ii) Resale Price Method (iii) Cost Plus Method (iv) Profit Split Method and (v) Transactional Net Margin Method. Most of the disputes relating to the transfer pricing arise with respect to the choice of the method and the choice of comparable by the assesse. In this regard, it was stressed that courts are expected to see if the most appropriate method has been followed and the comparables have been properly adopted based on the circumstances of the particular case. Other emerging areas of dispute include royalty adjustments, intra good services payment, absence of comparable, corporate guarantees etc.

Further, the various remedies available to the assessee, such as regular appellate remedy (Commissioner, Tribunal, High Court etc.); Mutual Agreement Procedure (MAP); Advance Pricing Authority (APA); and Safe Harbour Rules were discussed.

Since the law on transfer pricing is highly subjective in nature the discussion enlisted certain safeguards to be taken note of:

- There must be chargeable income from an international/specified domestic transaction in the first place.
- Transfer pricing should not be taken to override commercial decisions of parties. That is to say, transfer pricing should not become a tool for discouraging legitimate commercial transactions. [CIT v. EKL Appliances Ltd. (Delhi HC)]
- Once assessee indicates how it has carried out its comparability analysis (through documentation, study reports, etc.) the onus is on the revenue to explain why assesse

comparability analysis is not appropriate, and further to determine the appropriate arm's length price by one of the methods. While making the comparability analysis, revenue must keep in mind the nature of assessees business and legitimate commercial considerations.

- Procedural safeguards must be adhered to such as requirement of a draft assessment order [Section 144(c), Income tax Act], appropriate references to transfer pricing officers etc.
- In appropriate cases, when *ex facie* proceedings are without jurisdiction (for example, when demonstrably no income at all has arisen and there is no relevant international transaction at all), the reference to the transfer pricing officer itself may be amenable to challenge in writ jurisdiction.

Session 4 - Appellate and Writ Jurisdiction of High Courts: Jurisdiction and Limitations

Speakers - Mr. Arvind P. Datar, Mr. N Venkatraman & Mr. Sujit Ghosh

The power of the High Court under statutory appellate provisions or writ remedies under Article 226 of the Constitution of India is very wide. While dealing with the appellate jurisdiction of the High Courts, five tests as to what constitutes 'substantial question of law' based on the decision in *Santosh Hazari v. Purushottam Tiwari* [(2001) 3 SCC 179] were discussed:

- It directly or indirectly affects substantial rights of the parties
- It is of general public importance
- It is an open question in the sense that the issue has not been settled by the Supreme Court
- It is not free from difficulty; or
- It calls for a discussion of an alternate view

- Conflict of views by ITAT/CESTAT [R. Subba Rao v. Nooni Veeraju AIR 1951 Mad 969 (FB)]

Typically, in tax matters Certiorari or Prohibition are the most sought after writs. It was stressed that the writ of prohibition is often found appropriate in such cases. Where the lower authority does not have jurisdiction a challenge can be made at the stage of show cause notice itself. In such a case alternate remedy shall not be a bar. [Isha Beevi v. TRO (1976) 1 SCC 70]

The discussion highlighted major litigation area in this regard to be the reopening of assessment. The judgment of *GKN Driveshafts v. ITO* [(2003) 1 SCC 72] was referred to wherein the Supreme Court stated that issuance of notice under Section 148 must be adhered to before reassessment proceedings to which the assessee is entitled to object, and only after disposal of the objections the authority can proceed further. Therefore, at the stage of objections the writ court may be approached.

The principle of *res judicata* and *estoppel* are not applicable to tax laws. However, it is important to note in this regard that consistent practice cannot be ignored. [Radha Saomi Satsang v. CIT AIR 1992 SC 377] That is to say, having availed a benefit under a scheme an assessee cannot approbate and reprobate at a later stage and seek to avail benefit of another scheme. [Indian Rayon 2008 (229) ELT 3 SC]. In *J.K Synthetics v. Union of India* [(1981) ELT 328 (Del)] it was opined that there are four grounds on which a drift from an earlier view can be made- (i) change in law; (ii) new rulings by High Courts/Supreme Court; (iii) new facts have come to light; or (iv) change in the method of business or manufacturing process.

It was also pointed out that the doctrines of election, estoppel, res judicata, or approbate and reprobate cannot take away constitutional or statutory right. That is to say, there can be no waiver of constitutional or statutory right of mandatory character.

Doctrine of imminent threat which permits maintainability of writ petitions without there being any overt act of the revenue was highlighted. In this regard, the Constitution Bench judgment of *State of Bombay v. United Motors,* (AIR 1953 SC 252) was discussed wherein challenge to the Bombay Sales Tax Act, 1952 on grounds of violation of Article 19 (1) (g) on its mere passing without there being any notice, assessment or demand was held to be maintainable. In another decision of *Himmatlal Harila Mehta v. State of MP,* (1954 SCR 1122) it was held that anticipatory threat by the authority of law using coercive machinery under the impugned legislation was sufficient infringement of one's fundamental rights and therefore gives the petitioner right to seek relief under Article 226.

The discussion further explored the issue of *forum conveniens* with specific reference to the decisions in *Nasiruddin v. STAT* [(1975) 2 SCC 671] and *Kusum Ingots* [(2004) 6 SCC 254] wherein it was opined that it is the convenience of the litigator *(dominus litus)* which is to be taken into consideration.