# NATIONAL JUDICIAL ACADEMY


## WORKSHOP FOR HIGH COURT JUSTICES ON DIRECT TAXES [P-1342]

**(15TH & 16TH APRIL, 2023)**

## PROGRAMME REPORT

**PROGRAMME COORDINATORS:**

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## Objective of the Workshop

The National Judicial Academy (NJA) organized a two day Workshop for High Court Justices on Direct Taxes on 15th & 16th April, 2023 at NJA, Bhopal. The workshop was conceived to facilitate deliberations among participant justices on contemporary issues and recent developments in direct taxation in India and globally. It provided a forum for discussing normative issues pertaining to the evolution of direct taxes, interpretation in tax statutes and treaty law, major dispute areas and the role of the High Court; along with case studies and an overview of the constitutional provisions for finance bills.

### Session 1 - The Constitutional Authority to Tax

***Panel: Justice Dr. Anita Sumanth and Mr. N. Venkataraman***

The session commenced by traversing the history of taxation in ancient, medieval and modern India. It was suggested that in ancient times people were taxed on the basis of their occupation. In medieval times the Jizya tax was discussed and it was highlighted that religion became the basis of taxation. It was asserted that it was in the formalized structure of taxation the earnings or income became the basis of taxation. It was pointed that the philosophy of tax on the Income Tax website quotes Kalidas in Raghuvansh eulogizing King Dalip. It is as follows:

*"It was only for the good of his subjects that he collected taxes from them, just as the Sun draws moisture from the Earth to give it back a thousand fold"*

Subsequently, the discussion focused upon the basics of taxation. Article 265 and Article 366(28) of the Constitution was discussed. Essential ingredients of a valid tax legislation were enumerated as follows:

1. There must be legislative provision authorizing the levy and collection of tax;

2. The legislation must be within the competence of the enacting legislature. Such competence must be traceable to an Entry in Lists I or II of the Seventh Schedule of the Constitution;

3. The legislation must clearly specify the taxable event, the subject of the tax;

4. The legislation must specify the rate of tax;

5. The legislation must specify the inherence of the burden of tax, i.e., the person/entity who/which is liable to pay the tax;

6. The legislation must spell out the procedure for assessment, delineate the machinery adopted for assessment, and the authorities/hierarchies, for assessment and collection of the tax; and

7. The legislation may specify appellate/revisional remedies against orders of assessment.

Thereafter, the nuances of money bill was expounded in light of the decision in *Roger Mathews v. Union of India, (2020) 6 SCC 1*. It was iterated that the decision of the Lok Sabha Speaker is final

as to what constitutes a money bill. Article 110 and Article 122 of the Constitution was also explained. Further, as regards treaties it was stated that List I Entry 14 deals with treaties. Article 253 was highlighted to underscore treaty obligations. Thereafter, the scheme of the Income Tax Act, 1961 was delineated.

## Session 2 - Interpretation of Fiscal Statutes: Core Principles

***Panel: Justice G. Raghuram and Mr. Ramakrishnan Viraraghavan***

The session commenced by emphasizing that the foremost function of persons to whom the legislation is addressed, including the courts, is to elucidate what the legislation means and to honour the meaning so found. Some courts in some jurisdictions, including High Courts and the Supreme Court in India have other functions as well — of testing and pronouncing upon the validity of legislation qua provisions of the organic document, the Constitution. In either case, the judicial function is substantially similar. It was asserted that the principal function of a judge is to adjudicate particular controversies between specific disputants. In each case, the judge must support his conclusions by reference to and reliance upon legal rules that comport adequately with the existing legal order. Even if there is no directly applicable legal rule, the adjudicator cannot abdicate this responsibility, expressing helplessness. The judge must fine-tune, fashion, adjust or construct an appropriate rule to fit the controversy before him.

Further, the dichotomy of construction and interpretation of statutes was lucidly explained and the venerated work Constitutional Limitation of Thomas Cooley was cited:

*"Interpretation differs from construction in that the former is the art of finding out the true sense of any form of words; that is, the sense which the author intended to convey; and of enabling others to derive from them the same idea which the author intended to convey. Construction, on the other hand, is the drawing of conclusions, respecting subjects that lie beyond the direct expression of the text from elements known from and given in the text; conclusions which are in the spirit though not within the letter of the law"*

Thereafter, it was suggested that The statute must be read as a whole and contextually by elucidating on *Canada Sugar Refining Co. v. R - (1898) AC* wherein it was observed that *"every clause of a statute should be construed with reference to the context and other clauses of the Act, so as, as far as possible, to make a consistent enactment of the whole statute or series of statutes relating to the subject-matter".*

Lastly, the intention of the legislature, rules of interpretation, principle of harmonious construction, internal and external aids of interpretation were explained.

## Session 3 - International Tax Treaty Law and Double Tax Avoidance Agreements: An Overview

***Panel: Mr. Balbir Singh and Mr. Porus F. Kaka***

The deliberations commenced by delving into the history and evolution of international tax treaties and double tax avoidance agreements. The object of the treaties were discussed with elucidation on *Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1, Sanofi Pasteur Holding SA v. Department of Revenue, (2013) 354 ITR 316 and Ram Jethmalani v. Union of India, (2011) 8 SCC 1.* Further, the 'exemption' and 'credit' method of double tax avoidance was lucidly explained. It was iterated that no individual or entity can be allowed to take benefit of tax exemption in both countries. Further, the basic principles of bilateral or multi-lateral tax treaties viz. Treaty i.) committments must be honored by the parties in good faith ii.) A party may not invoke the provisions of its internal law as justification for its failure to honor its treaty commitments iii.) A treaty should be interpreted in good faith in accordance with the ordinary meaning of its terms, in their context and in light of its object and purpose were discussed.

Thereafter, 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. Lastly, the concept of Permanent Establishment was explored in light of *Assistant Director of Income Tax-I v. E-Funds IT Solution Inc., (2018) 13 SCC 294* and *Formula One World Championship Ltd. v. Commissioner of Income Tax, (2017) 15 SCC 602*.

## Session – 4: Transfer Pricing- Basic Principles & Challenges: Role of High Courts

***Panel: Mr. Ajay Bahl and Mr. K. Vaitheeswaran***

The session commenced by highlighting that transfer pricing is a fairly technical piece of tax legislation which not many encounter with. What is significant to understand is why there is a law for transfer pricing and what the allied uniqueness is. It was stressed that with globalization markets have become easily accessible to global corporations which is in a way making the borders disappeared. The Evolution from local partners to agents to liaison offices to branch offices to joint ventures and to subsidiaries is accumulating. There is an increased traffic of supply of goods and services across borders. Therefore, the governments have woken up to the realities of business, profits and tax jurisdictions. The necessity to examine and regulate cross border transactions from an income tax perspective arose primarily out of the assumption that related party transactions are generally suspect. The philosophy is that if a transaction is between related parties or companies then it is always possible to structure the pricing in a manner to maximise profits in a low tax or no tax jurisdiction. Therefore, the need for transfer pricing law. While discussing the related regulations on transfer pricing Chapter X of the Income Tax Act, 1961(ITA) that covers special provisions relating to avoidance of tax was discussed. It was highlighted that Section 92, ITA

provides that any income arising from an international transaction shall be computed having regard to the arm's length price (ALP). While discussing whether tax avoidance motive has to be established before invoking transfer pricing? It was accentuated that there is no reference to tax avoidance in Section 92(1), ITA. Even the Memorandum to Finance Bill, 2002 states that the intention underlying the provision is to prevent avoidance of tax by shifting taxable income to a jurisdiction outside India through abuse of transfer pricing. Section 92(3), ITA indicates that the provision would not be applicable if it results in reduction of taxable income or increase in loss. In *Coca Cola India Inc. Vs. ACIT (2009) 309 ITR 194*, while upholding the constitutional validity of the provisions the high court held that there is no statutory requirement of establishing that there is a transfer of profits outside India or that there is evasion of tax.

Subsequently, transfer pricing methods were discussed. Which includes ALP that is applied to determine the transfer price of the transactions between Associated Enterprises (AE). Determination of ALP is based on comparable transactions under comparable circumstances. It was highlighted that Section 92C, ITA provides that ALP shall be determined by any of the following methods being the most appropriate method

- Comparable Uncontrolled Price method (CUP)
- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Profit Split Method (PSM)
- Transactional Net Margin Method (TNMM)
- Such other methods prescribed by the CBDT

It is significant to know that the board has yet not prescribed any method. Taxpayer has the option to select any of the method as the most appropriate method. The TP authorities can review the selection and ask the taxpayer to substantiate the selection. The burden of proof that the selected method is the most appropriate method is initially on the taxpayer. Some of the case laws discussed in this regard are- *CIT Vs. Denso Haryana Pvt. Ltd. (2010) 328 ITR 14 (Del.); Reliable Cashew Co. Pvt. Ltd. Vs. ACIT (2015) 62 taxmann.com 282 (Chennai Trib)*

While discussing the interplay between domestic law and tax treaties the scope and relevance of Article 9 of the India- USA Double Tax Avoidance Agreement (DTAA) was highlighted. It was emphasised that all transactions between AEs should be conducted on an arm's length basis because the objective is to eliminate all conditions and factors which influence the transactions between related partied. This is the genesis of transfer pricing. It was underscored that the definition of AE under Artcile 9 DTAA is *pari materia* with the definition of "Associated Enterprises" as provided for in Section 92A(1) of the Income-tax Act, 1961 and applies across most Tax Treaties. Reference was made to *DIT (International Taxation) v. Morgan Stanley & Co. Inc., (2007) 7 SCC 1* in which it was observed that MSAS (Indian arm of US based MS group) cannot be said to be Permanent Establishment (PE) of its USA arm so far as the Indian arm is

carrying out only the back office operations of USA arm. Further, such Indian arm cannot be regarded as agency PE of USA arm, where Indian arm did not have any authority to enter into or conclude the contracts and the implementation of those contracts, so far as the extent back office functions would be carried out in India. Therefore, MSAS would not constitute an agency PE. Under Article 5(3) (e) of the DTAA between India and USA, activities which are preparatory or auxiliary in character and USA based which are carried out at a fixed place of business will not constitute a PE much less a fixed PE.

## Session- 5: Appellate and Writ Jurisdiction of High Courts in Tax Matters: Jurisdictional Challenges and Limitations

***Panel: Mr. Kavin Gulati & Mr. Sujit Ghosh***

The session commenced by highlighting that the appellate jurisdiction in income tax matters starts from the commissioner level and in some cases it is straight to the higher forum. Thereafter, revisional jurisdiction of the commissioner under section 263, ITA was discussed by referring to *CIT v. Amitabh Bachchan, (2016) 11 SCC 748.* In the said case, it was held that unlike the power of reopening an assessment under Section 147 of the Act, the power of revision under Section 263 is not contingent on the giving of a notice to show cause. What is required under Section 263 is that the said provision is an opportunity of hearing to the assessee. The two requirements are different: the first would comprehend a prior notice detailing the specific grounds on which revision of the assessment order is tentatively being proposed. Such a notice is not required. What is contemplated by Section 263, is an opportunity of hearing to be afforded to the assessee. Failure to give such an opportunity would render the revisional order legally fragile not on the ground of lack of jurisdiction but on the ground of violation of principles of natural justice.

Reference was made to the recent judgment in, *The Commissioner of Income Tax vs. M/s. Paville Projects Pvt Ltd.* The Court while relying on the decision of the Apex Court in *Malabar Industrial Co. Ltd. vs. CIT (2000),* observed that Commissioner of Income Tax can exercise revision powers under Section 263 of the Income Tax Act over the erroneous orders of the Assessing Officer which cause prejudice to the interest of the revenue-If due to an erroneous order of the Income Tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial to the interests of the Revenue.

It was stressed that a revisional order is appealable and it is possible that someone can file a writ by stating that during the course of hearing the revisional authority did not giving the proper opportunity of hearing, not sharing documents, there is malice involved or there is failure to take notice of an Apex court decision that holds in favour of the assesse but still a notice has been issued. These are the threshold reasons due to which assesse may choose to file a writ petition. The writ court in each case examines whether jurisdictional error has been committed or not. Thought revisional jurisdiction is very wide. There is only one condition that is if the notice has

been issued then the revisional authority will do a proper hearing by following the principles of natural justice. There is no requirement to note done the reasons prior to invoking the jurisdiction.

Further, it was highlighted that the scope of an appeal under section 260A ITA is limited and restricted to adjudication of substantial question of law. In *Santosh Hazari v. Purushottam Tiwari, (2001) 3 SCC 179,* the Supreme Court while dealing with the appellate jurisdiction of the high on 'substantial question of law' laid down five tests as to what constitutes 'substantial question of law' viz., (a) It directly or indirectly affects substantial rights of the parties; (b) It is of general public importance; (c) It is an open question in the sense that the issue has not been settled by the Supreme Court; (d) It is not free from difficulty; or (e) It calls for a discussion of an alternate view. In *Naresh Shridhar Mirajkar and Ors. v. State of Maharashtra and Anr., 1966 SCR (3) 744* it was held that an alternative statutory remedy does not operate as a bar to maintainability of a writ petition in at least four contingencies, namely: violation of fundamental rights; violation of principle of natural justice;order or notice is wholly without jurisdiction; or vires of act is challenged.

The session further reconnoitered how the Supreme Court adopted writ jurisdiction in cases with alternative remedy. In *Paradip Port Trust v. Sales Tax Officer and Others, (1998) 4 SCC 90* it was held that even though an alternative remedy is available against the assessment order there are appropriate pristine questions of law involved which should be decided at the earliest and remanded the matter to the respective High Courts to be decided on merits. Whereas in *Commissioner of Income Tax & Ors. v. Chhabil Dass Agarwal, (2014) 1 SCC 603* the supreme Court held that a writ can never lie against an assessment order.
Subsequently, the doctrine of imminent threat which permits maintainability of writ petitions was elaborated upon. In *State of Bombay v. United Motors, AIR 1953 SC 252* 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.

While discussing the contours of jurisdictional fact. It was highlighted that in *Raza Textiles Ltd. v. Income Tax Officer, Rampur, AIR 1973 SC 1362* it was held that the question whether the jurisdiction fact has been rightly decided or not is open for examination by the High Court in a writ of Certiorari. Likewise, in *Carona Ltd. v. Parvathy Swaminathan & Sons, (2007) 8 SCC 559* it was observed that it is well settled that by erroneously assuming existence of a jurisdictional fact a subordinate court or tribunal cannot confer upon itself jurisdiction which it otherwise does not possess. Reference was also made to *Nusli Nieville Wadia v. Ivory Properties & Ors. AIR 2019 SC 5125,*that addressed the indistinct link between lack of jurisdiction and error of jurisdiction.