AAR couldn't reject application without explaining how transaction via Mauritius route was made for tax avoidance

Summary – The High Court of Bombay in a recent case of NEO Path Ltd., (the Assessee) held that AAR could not reject application filed by assessee, a Mauritius based company, seeking advance ruling on question as to whether capital gain arising on sale of shares of Indian company to another foreign company was taxable in India in terms of article 13(4) of India-Mauritius DTAA taking a view that said transaction was prima facie designed for tax avoidance without assigning any reasons thereof.

ORDER

1. Our order dated 10th December, 2014 put the parties to notice that this Petition would be disposed of finally at the stage of admission on 27th December, 2014.

2. This Petition under Article 226 of the Constitution of India takes exception to the order dated 30th April, 2014 passed by the Authority for Advancing Ruling Income Tax [the Authority]. By the impugned order dated 30th April, 2014, the Authority declined to entertain the Petitioner's application for Advance Ruling by holding that the application seeking an Advance Ruling is in respect of a transaction designed prima facie for tax avoidance in terms of Section 245 -R (2)(iii) of the Income Tax Act, 1961 (the Act). This primarily on the basis of the revenue's stand that two Indian residents namely one Mr. Dhruv Khaitan and Mr. Piyush Khaitan (Indian residents) are the ultimate beneficiaries of the sale of the shares by the Petitioner.

3. The basic grievance of the Petitioner to the impugned order dated 30th April, 2014 is that it has been passed without considering its submission and to that extent is an order without reasons. The Petitioners also attempted to make submissions on merits of their application before us. However, we did not permit the Petitioner to make submission on merits, as in writ jurisdiction we are essentially concerned with the decision making process and not with the merits of the decision. Therefore, we have not considered the merits of the rival submissions made with regard to the dispute. This is best left done by the Authority constituted under the Act.

4. The Petitioner is a Company incorporated in Mauritius in February, 2000. The Petitioner is a tax resident in Mauritius. In terms of Article 13(4) of the Double Tax Avoidance Agreement (DTAA) between India and Mauritius, it is claimed that capital gains tax on sale of shares is not chargeable to tax in India. On 26th August, 2010, the Petitioner sold 15,890,326 equity shares of the Indian Company to one Atos Origin (Singapore) Pte. Ltd. (Singapore Company) - a company incorporated and resident in Singapore for a consideration of US$ 110,000,000. Consequent to the sale of the above equity shares, the

Petitioner realized long term capital gains of US$ 75,589,903. The Singapore Company at the time of paying the above sale consideration of US$ 75,589,903 for 15,890,326 equity shares of the Indian Company to the Petitioner had deducted tax at source of US$ 15,960,808 (equivalent Indian Rupees to Rs.739,304,627) and paid the same to the credit of Government of India as tax deducted at source on long term capital gains.

5. On the aforesaid facts, the Petitioner in its application for advance ruling before the Authority under Section 245 -Q(I) of the Act raised the following question:—

"Whether the Applicant, a tax resident of Mauritius, is not chargeable to capital gains tax in India under Article 13(4) of the DTAA between India and Mauritius in respect of transfer of 15,890,326 shares of Venture Infotek Global Private Limited, an Indian company, to Atos Origin (Singapore) Pte. Ltd., a corporation, organized and existing under the laws of Singapore."

6. Before considering the rival submissions, it would be useful to reproduce Section 245-R (2) which reads as under:—

"245R (1) …. …. ….

(2) The Authority may, after examining the application and the records called for by order, either allow or reject the application;

Provided that the Authority shall not allow the application where the question raised in the application-

(*i*) …. …. ….

(*ii*) …. …. ….

(*iii*) relates to a transaction or issue which is designed prima facie for the avoidance of income-tax [except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of section 245 N [or in the case of an applicant falling in sub-clause (iiia) of clause (b) of section 245N]

Provided further that no application shall be rejected under this sub-section unless an opportunity has been given to the applicant of being heard;

Provided also that where the application is rejected, reasons for such rejection shall be given in the order."

7. On 3rd January, 2011, the Petitioner filed its application for Advance Ruling on the above question before the Authority. The Revenue by its letter dated 30th July, 2012 objected to the application being entertained as it was contended by the Revenue that the control and management of the Petitioner is in

India and therefore not entitled to DTAA. Further, it was contended that the entire transaction was entered into for avoidance of tax.

8. The Petitioners responded to the Revenue's objections by pointing out that the control of the Petitioner's company is in Mauritius and out of a strength of 8 only 2 Directors on Board were Indian Residents. Besides, the source of funds of the Petitioner was from various equity investors and not from the two Indian Residents. It was also pointed out by the Petitioner before the Authority, that there was no design to avoid any income tax which would have been payable by the two Indian residents primarily because even according to the Revenue, they are ultimate beneficiaries of Innevworth Holdings Ltd. (IHL) to only approximately 40% of the shares in the Petitioner as held by IHL. The balance approximately 60% of the shares in the Petitioner is as held by New Wave Holdings Ltd. (NHL) an Mauritius entity whose ultimate beneficiaries is Kubera Cross Border Funds Ltd., whose fund is traded on the London Stock Exchange.

9. Thereafter, written submissions were filed by the Revenue on 25th March, 2014 and reply thereto was filed by the Petitioners on 10th April, 2014. The Petitioner's submission sought to meet the Revenue's contention as under:—

Sr. No.	Revenue's submission	Assessee's submission
1	At the time of the sale of the shares of Indican Company, Mr. Piyush Khaitan was the beneficiary registered outside India. The entire structure outside India came to exist post the incorporation of the Indian Company.	The statement that Mr. Piyush Khaitan is the beneficiary through a complex structure of companies is not correct. The holding structure outside India is a decade old and a legitimate structure, which came into existence on account of various globally renowned private equity investors investing in the Petitioner.
2	As per the details submitted by the Petitioner, the board of directors of the Petitioner, consisted of Mr. Dhruv Khaitan and Mr. Piyush Khaitan as directors of the Petitioner.	The statement of Respondent that the Board of Directors of the Petitioner consists only of Mr. Dhruv Khaitan and Mr. Piyush Khaitan is factually wrong as the Board of Directors consist of eight directors, Mr. Dhruv Khaitan and Mr. Piyush Khaitan being two of the eight directors.
3	Mr. Dhruv Khaitan is the chairman and Mr. Piyush Khaitan is the vice chairman and Managing Director of the Petitioner.	The statement that Mr. Dhruv Khaitan is the chairman and Mr. Piyush Khaitan is the vice chairman of the Petitioner is factually incorrect and the Petitioner has no chairman or vice

		chairman.
4	Mr. Dhruv Khaitan and Mr. Piyush Khaitan were having control over the entire operation of the Petitioner Company. Mr. Piyush Khaitan was the only person having the General Power of Attorney.	The statement that Mr. Dhruv Khaitan and Mr. Piyush Khaitan were having control over the operatins of the Petitioner and that Mr. Piyush Khaitan was having the General Power of Attorney of the Petitioner is also incorrect. The control of the Petitioner was with the Board of Directors of the Petitioner and no Power of Attorney was given by the Petitioner in favour of Mr. Piyush Khaitan.
5	No high value cheque could be issued without the signature of Mr. Dhruv Khaitan and Mr. Piyush Khaitan.	The authority to sign cheques was in respect of the Indian Company and not the Petitioner Company.
6	Both Mr. Dhruv Khaitan and Mr. Piyush Khaitan are referred as founders of Indian Company in the share holders agreement dated 31st March, 2009.	The fact that Mr. Piyush Khaitan and Mr. Dhruv Khaitan are referred to as the founders of Indian Company has no bearing to decide the issue before the Respondent No.2.
7	Mr. Piyush Khaitan holds one share of Indian Company in his capacity as nominee of the Petitioner.	The fact that Mr. Piyush Khaitan holds one share of Indian Company as nominee of the Petitioner has no bearing to decide the issue before the Respondent No.2.
8	Kubera is only a fund. The ultimate beneficiaries of Kubera have not been disclosed and it would be a matter of further enquiry by the Revenue.	The statement that the ultimate beneficiaries of Kubera had not been disclosed and it would be a matter of further enquiry is again factually erroneous as it has been disclosed in more than one place that Kubera is a foreign private equity fund which is listed on the Alternate Investment Market in London Stock Exchange. Further, Kubera has also invested in various other companies in India.
9	The Petitioner relinquished the share application amount of Rs.95.30 Crores lying with Indian Company as grant to it.	The statement of the Revenue that the share application money of Rs.95.30 Crores given by the Petitioner to Indian Company was relinquished and treated as a grant is factually incorrect as the

		share application money of Rs.6.09 Crores was originally treated as a grant but on learning that it cannot be treated as a grant, the share application money was refunded by Indian Company to the Petitioner.
10	Various amalgamations and mergers through which the structure was created were never intimated to the regulatory authority.	As the mergers were of foreign entities and therefore, were not required to seek approval of RBI. However, pursuant to the discussion with Singapore Company for sale, application was made with RBI for approval and RBI has granted post facto approval.

10. The impugned order negatived the Petitioner's contention that there is no design to avoid any income tax on the ground that it is not necessary that the said design should be present at its inception. This is on the basis of general statement of law that it is permissible for the authorities to pierce through the smoke scream and focus on intention. However, the facts and submissions of law put-forth by the Petitioner to meet the objections of the Revenue have not at all been considered. Similarly, so far as prima facie case is concerned, the impugned order besides adverting to the legal position has not given any reason as to why in the present facts, the entire issue/ transaction had been designed prima facie for the purposes of avoiding income tax. The facts arising in this case for consideration have to be examined in the light of the prevailing law. The issue raised are fairly contentious. However, the impugned order after setting out the law in respect of what is exactly meant by words *'control and management'* and the understanding of the word *'prima facie'* concluded by holding as under:—

"In our considered view, the factual scenario projected by the Revenue clearly establishes that the transaction in question was designed prima facie for avoidance of income tax. Accordingly, we decline to entertain the application, which is accordingly, rejected."

11. We find that the impugned order has after recording the submission of the Petitioner and the Revenue concluded that the view canvassed by the Revenue establishes a prima facie design to avoid tax. The impugned order gives no reasons which would indicate why the Petitioner's contention is not acceptable. We do appreciate that very detailed reasons need not be given for a prima facie view but some consideration must be evident from the order. This reasoning is absent in the impugned order.

12. The Supreme Court in *CCT* v. *Shukla Brothers* 2010 (4) SCC 785 has said that the doctrine of audi alteram partem has three basic essentials i.e. grant of hearing to the person likely to be affected, fair and transparent procedure to be provided by the authority and the authority must dispose of the issue before him by a reasoned/ speaking order. The Court also held that recording of reasons is an essential feature of providing justice and in fact is the soul of orders. Further, the Supreme Court in *Kranti*

Associates (P) Ltd v. *Masood Alam Khan* [2010] 9 SCC 496 has summarized the principles for recording reasons as under:

'(*a*) In India the judicial trend has always been to record reasons, even in administrative decisions, if such decisions affect anyone prejudicially.

(*b*) A quasi-judicial authority must record reasons in support of its conclusion.

(*c*) Insistence on recording of reasons is meant to serve the wider principle of justice that justice must not only be done it must also appear to be done as well.

(*d*) Recording of reasons also operates as a valid restraint of any possible arbitrary exercise of judicial and quasi-judicial or even administrative power.

(*e*) Reasons reassure that discretion has been exercised by the decision maker on relevant grounds and by disregarding extraneous considerations.

(*f*) Reasons have virtually become as indispensable a competent of a decision making process as observing principles of natural justice by judicial, quasi-judicial and even by administrative bodies.

(*g*) Reasons facilitate the process of judicial review by superior Courts.

(*h*) The ongoing judicial trend in all countries committed to rule of law and constitutional governance is in favour of reasoned decisions based on relevant facts. This is virtually the life blood of judicial decision making justifying the principle that reason is the soul of justice.

(*i*) Judicial or even quasi-judicial opinions these days can be as different as the judges and authorities who deliver them. All these decisions serve one common purpose which is to demonstrate by reason that the relevant factors have been objectively considered. This is important for sustaining the litigants' faith in the justice delivery system.

(*j*) Insistence on reason is a requirement for both judicial accountability and transparency.

(*k*) If a Judge or a quasi-judicial authority is not candid enough about his/her decision making process then it is impossible to know whether the person deciding is faithful to the doctrine of precedent or to principles of incrementalism.

(*l*) Reasons in support of decisions must be cogent, clear and succinct. A pretence of reasons

or 'rubber stamp reasons' is not to be equated with a valid decision making process.

(*m*) It cannot be doubted that transparency is the sine qua non of restraint on abuse or judicial powers. Transparency in decision making not only makes the judges and decision makers less prone to errors but also makes them subject to broader scrutiny.

(*n*) Since the requirement to record reasons emanates from the broad doctrine of fairness in decision making, the said requirement is now virtually a component of human rights and was considered part of Strasbourg Jurisprudence. See (1994) 19 EHRR 553, at 562 para 29 and *Anya* v. *University of oxford* 2001 EWCA Civ. 405, wherein the court referred to Article 6 of European Convention of Human Rights which requires, "adequate and intelligent reasons must be given for judicial decisions."

(*o*) In all common law jurisdictions judgments play a vital role in setting up precedents for the future. Therefore, for development of law, requirement of giving reasons for the decision is of the essence and is virtually a part of "Due Process."'

13. In view of the above, we find that the impugned order suffers from the vice of being an order without reasons. Therefore, the impugned order is quashed and set aside. The Authority shall consider de novo the application of the Petitioner dated 3rd January, 2011.

14. All contentions left open including the contention raised by Mr. Singh, learned Counsel appearing for the Revenue during his submission by inviting attention to page 8 of the impugned order wherein it is recorded at para (g) as follows:—

"Kubera is only a fund. The ultimate beneficiaries of Kubera have not been disclosed and it would be a matter of further enquiry by the Revenue."

15. It is made clear that the authorities would not be influenced by any observations made by us in this order as we have not considered the merits of the issue involved. We have set aside the impugned order on the limited issue of the same being in breach of principle of natural justice and restored it to the Authority for fresh disposal in accordance with law.

16. Accordingly, Petition is disposed ofin the above terms. No order as to costs.