

Madras HC dismisses writ petition challenging notification of Cyprus as Notified Jurisdictional Area under section 94-A

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In brief

The Madras High Court (HC) dismissed the writ petition filed by three petitioners challenging: (i) the constitutional validity of section 94-A of the Income-tax Act, 1961 (the Act); (ii) the validity of Notification No. 86/2013 dated 1 November 2013 issued by the Central Government (the Notification) under section 94-A of the Act notifying Cyprus as a notified jurisdictional area (NJA); and (iii) the validity of the Press Release titled Concerning the Double Taxation Avoidance Agreement (the tax treaty) between Cyprus and India dated 1 November 2013 issued by the Ministry of Finance, Government of India (the Press Release).

In detail

Facts

- The three (3) petitioners¹ had entered into an agreement dated 16 October 2014 to purchase equity shares and compulsorily convertible debentures (CCDs) (the securities) in A Limited, an Indian company, from B Limited, a company incorporated in Cyprus.
- B Limited incurred a capital loss on the transfer of the securities to the petitioners.
- The consideration was remitted to B Limited by the 3 petitioners without withholding any taxes on such remittance as required under section 94-A of the Act read with the Notification specifying Cyprus as an NJA.

- Each petitioner received a show cause notice inviting their attention to section 94-A(1) of the Act and the Notification, and asking them to show cause as to why they should not be treated as taxpayers in default, thereby warranting initiation of proceedings under sections 201(1)/201(1A) of the Act.
- The petitioners contended before the Tax Officer (TO) that B Limited had incurred a capital loss on the transfer of securities, and that they would have been obliged to withhold tax only if the payment made to B Limited was chargeable to tax under section 195 of the Act.
- The TO passed orders against each petitioner under sections 201(1)/

201(1A) of the Act and raised a notice of demand for payment of tax and interest due.

- In response, the petitioners filed an appeal before the CIT(A) and a writ petition before the Madras HC, challenging the validity of section 94-A, the notification and the Press Release. Simultaneously, they also filed writ petitions challenging the demand notices and the order passed under sections 201(1) and 201(1A) of the Act.

Issue before the High Court

- I. Did section 94-A confer sweeping powers on the Central Government (CG) to specify any country as an NJA in relation to transactions entered into by any taxpayer, irrespective of

¹ TS-197-HC-2016(Madras)

whether such country was one with whom a bilateral treaty had already been entered into?

II. Was the Notification *ultra vires* section 94-A of the Act, and where the tax treaty provided for a procedure for dispute resolution, i.e., the Mutual Agreement Procedure (MAP) contained in the tax treaty between India and Cyprus, could the Government of India take recourse to section 94-A of the Act?

III. Did the Press Release run contrary to the statutory provisions of section 94-A(5) of the Act?

Petitioners' contentions

I. The power of the CG to notify any country as an NJA under section 94-A(1) of the Act, without reference to the existence of a treaty with that country, was unconstitutional and suffered from the vice of excessive delegation.

The Petitioner contended that the tax treaty entered into by the CG was a law, and hence neither could Parliament make any law contrary to the tax treaty nor could the CG take any executive action to annul the effect of the tax treaty, so long as the tax treaty was in force.

Placing reliance on the decision of the Supreme Court (SC) in the case of *Azadi Bachao Andolan*² and the doctrine of '*Pacta Sunt Servanda*' contained in the Vienna Convention on the Law of Treaties, the petitioner contended that the provisions of the tax treaty should prevail over the provisions of the Act.

II. The notification which specified Cyprus as an NJA

was *ultra vires* section 94-A of the Act. Further, as per Article 28 of the tax treaty, which provides for 'Exchange of Information', a Contracting State would be excluded from the purview of this Article where there was an obligation on the Contracting State to supply information or documents which was not obtainable under the laws, or in the normal course of the administration of that, or of the other Contracting State³.

The CG should not have taken recourse to section 94-A of the Act when the tax treaty provided a procedure for dispute resolution in the form of MAP under Article 27.

III. The Press Release mentioned that "any payment" made to a person located in Cyprus would be liable for withholding of tax at 30%. However, section 94-A(5) of the Act used the expressions, "any sum", "income" and "amount" which had different connotations under the Act, and therefore, the Press Release ran contrary to the provisions of the Act.

High Court Ruling

I. Constitutional validity of section 94A of the Act

Based on certain SC judgments⁴, it was held that the Indian Constitution followed a dualistic doctrine with respect to international law. Hence, an international tax treaty could be enforced only so long as it was not in conflict with the domestic laws of the State. In this regard, the SC had also cited certain of its own earlier observations in the case of *Azadi Bachao Andolan*².

The HC observed that while section 90(1) of the Act dealt with

the delegation of powers to the CG to enter into an agreement, section 94-A(1) of the Act dealt with delegation of powers to specify a country as an NJA.

It observed that no question had arisen directly in the SC judgements in the case of *Azadi Bachao Andolan*² and in *Kulandagan Chettiar*⁵ as to whether or not the Parliament had the power to make a law in respect of a matter covered by a tax treaty. The observations in these two decisions, to the effect that the tax treaty would have effect even if they were in conflict with the provisions of the statute, could not be stretched too far to conclude that the Parliament did not have the power to make a law in respect of a matter covered by a tax treaty.

Further, India had not ratified the Vienna Convention. Even if the rule of '*Pacta Sunt Servanda*' was invoked, the petitioners would not be in a favourable position, since the Convention obliged both the contracting parties to perform their obligations in good faith. One of the four purposes for which a tax treaty could be entered into by the CG under section 90(1) of the Act was for the exchange of information. If one of the parties to the tax treaty failed to provide necessary information, then it was in breach of the obligation under Article 26 of the Vienna Convention. Consequently, the Vienna Convention could not be invoked to prevent the other contracting party from taking recourse to domestic law to address the issue. It could not be argued that section 94-A(1) of the Act had diluted section 90(1) of the Act; instead, it was diluted by one of the contracting parties for its failure to provide requested information, since the purpose of the CG entering into a tax treaty

² Union of India v. Azadi Bachao Andolan [2004 (10) SCC 1]

³ Article 28(3)(b) of the tax treaty

⁴ Jolly George Varghese v. The Bank of Cochin [AIR 1980 SC 470], State of West Bengal v. Kesoram Industries Limited [2004 (10) SCC 201]

⁵ CIT v. P.V.A.L.Kulandagan Chettiar [2004 (6) SCC 235]

under section 90(1) of the Act was defeated by the lack of exchange of information.

Further, relying on certain resolutions adopted by the leaders of G20 Nations in a Summit at London on 2 April 2009, and to the Explanatory Notes to the provisions of the Finance Act 2011 which had introduced section 94A, the HC noted that section 94-A was inserted to give effect to the resolution passed by the G20 Nations, to take action against non-cooperative jurisdictions, including tax havens. Furthermore, the HC observed that India was not the only country which had taken defensive measures to prevent the abuse of the benefits conferred by tax treaties. It therefore dismissed the writ petition challenging the constitutional validity of section 94-A of the Act.

II. Validity of the Notification dated 1 November, 2013

The language of section 94-A of the Act left no room for doubt about the power conferred to the CG to issue a Notification. Further, this power conferred could not be said to be uncontrolled and unbridled, as the CG could exercise the power only in circumstances where there was lack of effective exchange of information.

Article 28 of the tax treaty contained an obligation for exchange of information between the two countries, and the notification was issued by the Indian CG on account of the Cyprus Government's failure to honour its commitment under the tax treaty. When one of the parties committed a default by failing to provide information, it was not open to the beneficiary of such a default to contend that the other contracting party should honour its obligations.

The HC observed that the lack of exchange of information, which led

to the issuance of the Notification, would not fall under the categories mentioned in paragraph 3(b) of Article 28 of the tax treaty, i.e., which was not obtainable under the laws, or in the normal course of administration. Information relating to evasion of tax could not fall under this category.

Paragraph 3 of Article 27 of the tax treaty, which prescribed a MAP in case of disputes, dealt only with "difficulties or doubts arising as to the interpretation or application of the agreement", and did not deal with the failure of one of the contracting parties to honour its commitment. Furthermore, the MAP provisions under the tax treaty did not oust the jurisdiction of Parliament to enact a law, and of the Executive to issue a notification in exercise of the power conferred by such a law.

The HC further held that the phrase used in section 94-A(1) of the Act was "any country or territory", which could not be read to mean "any country or territory other than those covered by section 90(1)", and hence the provisions of this section should also apply to countries with whom India has a tax treaty.

III. Validity of the Press Release dated 1 November 2013

The HC accepted that the words, "sum", "amount", "income" and "payment" had different connotations. However, it noted that section 94-A(5) of the Act was worded from the point of view of the recipient of any "sum", "income" or "amount", whereas the Press Release was worded from the point of view of the person making the payment. Though the Circulars issued by the Central Board of Direct Taxes (CBDT) under section 119 of the Act had statutory force, the Press Releases issued by the CBDT for the information of the public did not have the same force. Further, a Press Release was not a legal document but only a note intended for the benefit of the

common man. Therefore, the question of assailing the Press Release did not arise.

The HC observed that the petitioners should have withheld tax on the payment made to B Limited for the purchase of the securities in A Limited, and thereafter taken legal recourse for claim of refund against the income-tax department.

Conclusion

The HC held that section 94-A was the need of the hour, and thereby dismissed the writ petitions filed challenging the constitutional validity of section 94-A of the Act.

The takeaways

This is an important judgement upholding the validity of section 94-A of the Act and the Notification issued thereunder, the principles of which may have an impact on payments made to Cypriot entities.

One important aspect to be kept in mind is that the HC has not gone into the merits of the case in relation to the interpretation of the use of the words, "sum or income or amount on which tax is deductible under Chapter XVII-B" in section 94-A(5) while dismissing the aforesaid petition.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax & Regulatory Services – Financial Services

Gautam Mehra, *Mumbai*
+91-22 6689 1154
gautam.mehra@in.pwc.com

Nitin Karve, *Mumbai*
+91-22 6689 1477
nitin.karve@in.pwc.com

Our Offices

Ahmedabad

President Plaza
1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
+91-79 3091 7000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Andhra Pradesh
Phone +91-40 44246000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City, Gurgaon
Haryana -122002
+91-124 330 6000

Bangalore

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 7000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata - 700 091, West Bengal
+91-033 2357 9101/
4400 1111

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
+91-20 4100 4444

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai 600 006
+91 44 4228 5000

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road (Station Road),
Bandra (West), Mumbai - 400 050
+91-22 6689 1000

For more information

Contact us at
pwctr.knowledgemanagement@in.pwc.com

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