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HC gives option to Vodafone to again file writ if DRP decision 'patently illegal'

Background:

The much-awaited ruling of the Bombay High Court (HC) in the context of the writ application filed by Vodafone India Services Pvt Ltd[1] (VISPL or the taxpayer) has been released. The taxpayer had challenged the following transfer pricing (TP) adjustments made by the Revenue:

- alleged undervaluation of shares issued by VISPL in favour of its associated enterprise (AE); and
- imputing of notional interest on such alleged undervaluation of shares, by treating the shortfall as loan advanced by VISPL to its AE.

The taxpayer challenged these adjustments as being patently illegal and without jurisdiction. This was on the ground that the purported undervaluation could never have been brought under the ambit of taxation by taking course to TP, as the same was on capital account.

HC's Decision:

In its ruling, the HC has not delved into the merits of the case and has disposed the writ, with a direction to the taxpayer to first file its objections before the Dispute Resolution Panel (DRP) on the basic issue of jurisdiction, i.e., whether TP provisions under Chapter X of the Income-tax Act, 1961 (the Act) apply at all.

The HC has further directed that in case the decision of the DRP on this preliminary issue remains prejudiced against the taxpayer, then the taxpayer can challenge such decision in a writ, provided the taxpayer makes out a case, at that stage, that such decision is patently illegal. The HC has directed that the taxpayer would have the option to then file a writ regardless of the availability of alternate remedy before the Income-tax Appellate Tribunal.

Some pertinent observations made by HC:

In arriving at the above decision, the HC has made several pertinent observations, which are briefly outlined below:

- The taxpayer had, from the very outset, raised the primary objection that the alleged undervaluation could never have been brought into the ambit of taxation by applying TP provisions,

as no income arose. However, neither the Assessing Officer (AO) nor the Transfer Pricing Officer (TPO) dealt with this primary objection. Further, the taxpayer, in its wisdom, had not raised such primary objection before the DRP, and had preferred the same only before the HC in its writ application. The HC, accordingly, distinguished the cases of Hindalco Industries[2] and the previous Bombay HC ruling in case of VISPL[3] (of September 2013), and decided against dismissing the writ on the ground of availability of alternate remedy.

- In view of section 92(1) of the Act, there must be income arising and/or affected or potentially arising and/or affected by an international transaction to apply Chapter X. This jurisdictional issue had to be dealt with by either by the TPO or the AO when specifically raised by the taxpayer. Further, it had to be dealt with before determination of arm's length price (ALP), or else the entire exercise of determining ALP becomes academic.

- Where the taxpayer specifically objects to jurisdiction to tax under Chapter X (*possibly in its Form 3CEB as was done in the instant case*), then it would be for the AO to first decide this issue, before referring the transaction to the TPO. This would be a factor in determining whether it was 'necessary or expedient' to refer the matter to the TPO. Therefore, in such a situation, the grant of a personal hearing by the AO to the taxpayer before referring the matter to the TPO had to be read into section 92CA(1) of the Act. On this point, the HC disagreed with the view taken by Gujarat High Court in the case of Veer Gems[4]. The HC added that the CBDT circular regarding distribution of files based on value (i.e., Rs 15 crores) could not detract from the AO's obligation to follow principles of natural justice. In case the AO failed to discharge such obligation, then such a preliminary or fundamental objection would need to be heard and adjudicated by the DRP.

- The HC distinguished the present case from the AAR ruling in the case of Castleton Investments[5], because in that case, the issue was whether income arising from an international transaction was chargeable to tax or not, in view of the DTAA between India and Mauritius. There was no dispute therein that income arose from the international transaction. However, in the present case, the preliminary objection raised by the taxpayer was that no income *per se* arose from the international transaction and Chapter X was thus not applicable.

- The process before the DRP is a continuation of the assessment proceedings, as only thereafter would a final appealable assessment order come into existence. Thus, the DRP is very much competent to deal with the fundamental objection raised by the taxpayer on *per se* taxability of the alleged undervaluation of shares issued by the taxpayer. The proceeding before the DRP was not an appeal proceeding but a correction mechanism in the nature of a second look at the proposed assessment order by high functionaries of the Revenue, keeping in mind the interest of the taxpayer.

- Reacting to VISPL's objection regarding the constitution of the DRP, the HC did not perceive it to be an unfair constitution even if one of the members on the DRP panel was of the same rank as the authority who approved the TPO's order, so long as it was not the same person.

- The HC empathized with the taxpayer and acknowledged that it would be natural for the taxpayer to feel harassed as, despite specifically raising the objection of non-applicability of Chapter X, the AO did not give any opportunity of being heard before making a reference to the TPO, and neither the TPO nor the AO dealt with this preliminary objection. The HC urged the Revenue to be more sensitive to the just demands of the taxpayer and to not treat the taxpayer as an adversary who had to be taxed, no matter what.

PwC's observations:

- At the outset it is pertinent to highlight a critical difference – in the instant case, the HC has

'disposed' the writ giving directions, as against its earlier decision in case of VISPL itself, wherein the writ had been 'dismissed'. This fundamental difference between the 'writ dismissal' and the 'writ disposal' is notable.

- On the fundamental jurisdictional issue, the HC has held that it should be dealt with before determination of ALP, or else the entire exercise of determining ALP becomes academic, and therefore redundant. This is well understood in theory. However, practically, in an environment where the Revenue is seeking to levy income tax even on share capital, this is an extremely reassuring and positive comment made by the HC.
- Further, on the jurisdictional issue, the HC's emphasis on the need for the AO to grant the taxpayer an opportunity of being heard (before referring a transaction to the TPO), is an attempt to protect the taxpayer from undue harassment, and to prevent the Revenue from indulging in an empty formality of applying TP, when there is no income.
- It is also heartening to see the HC attempting to sensitise the Revenue to taxpayers' just demands and reiterating the need to proceed fairly rather than with a pre-determined mindset of indiscriminately taxing the taxpayer.
- Further, in a tax world which was dealing with the aftermath of 'Castleton' (post 'Vanenburg'[6]), the HC's differentiation of the present case from the Castleton ruling is indeed a welcome precedent.
- Finally, a clear message that emanates from this verdict, for any taxpayer, is that it should stand strong in the positions it takes. The positions taken should be maintained throughout and objections thereto should be consistently raised before the AO/TPO, and even in the compliance documentation/ certification. This was recognized and appreciated by the HC in the instant case, and was one of the key reasons for the HC deciding against a dismissal of the writ.

1. Vodafone India Services (P) Ltd. *v.* UOI [2013] 39 taxmann.com 201 (Bombay)
2. Hindalco Industries Ltd. *v.* ACIT [2012] 211 Taxman 315 (Bombay)
3. Vodafone India Services (P) Ltd. *v.* UOI [2013] 37 taxmann.com 250 (Bombay)
4. Veer Gems *v.* ACIT [2013] 351 ITR 35 (Gujarat)
5. Castleton Investments, In re. [2012] 24 taxmann.com 150 (AAR)
6. Vanenburg Group B.V., In re.[2007] 289 ITR 464 (AAR)

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