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EY Tax Alert

Delhi HC rules Indian downstream subsidiary cannot be treated as 'representative assessee' in unconnected transaction



Executive summary

This Tax Alert summarizes a recent decision of the Delhi High Court (HC) in the case of General Electric Company (Taxpayer) & Anr v. DDIT [W.P. (C) 9100 of 2007] on the issue of the validity of show cause notice (SCN) issued by the Tax Authority to an Indian downstream subsidiary (IndiCo). The SCN proposed to treat IndiCo as a 'representative assessee' (RA) of a US parent company (USCo), the ultimate holding company of IndiCo. The SCN to treat IndiCo as an RA was in respect of a transaction to divest 60% of interest in an overseas intermediate holding company (IHC) (Transaction) which, through downstream companies, held shares in various other companies, including IndiCo. The basis of the SCN was that the Transaction gave rise to capital gains tax liability in India in the hands of USCo. Accordingly, the Tax Authority proposed to recover taxes alleged to be payable by USCo from IndiCo as an RA. USCo and its downstream Mauritian subsidiary (MauCo) (which was the immediate holding company of IndiCo) filed a writ petition before the HC challenging the validity of the SCN. The HC allowed the writ petition and ruled that the SCN was invalid since IndiCo had no connection with the income, if any, alleged to be arising to USCo from this Transaction. It held that a person can be an RA in respect of which the alleged agent has a business connection and/or from or through whom directly/indirectly income is received by a non-resident (NR).

Background and facts

- ▶ The Indian Tax Laws (ITL) contain specific provisions for treating a person as an RA of an NR taxpayer under specified circumstances for the purpose of levy and recovery of tax due from an NR. A person can be treated as an RA of an NR taxpayer in several circumstances, including if he has a business connection with an NR or if the NR is in receipt of any income directly or indirectly from such person or if such person acquires capital asset in India from the NR. If the Tax Authority recovers taxes payable by an NR taxpayer from its RA, the RA can, in turn, recover the tax from the NR taxpayer.
- ▶ USCo has business interests all over the world. It is also regularly assessed to tax in respect of its income taxable in India.
- ▶ MauCo was held by USCo through IHCs. MauCo, in turn, is the immediate parent of IndiCo.
- ▶ IndiCo is in the business of providing Business Process Outsourcing (BPO) services, including to USCo and group companies. Over a period of time, IndiCo's business grew and diversified. Apart from IndiCo, USCo also has several other downstream subsidiaries engaged in the BPO business across the world.
- ▶ Certain NR investors evinced interest in acquiring 60% stake in USCo's worldwide BPO business.
- ▶ With a view to facilitate divestment of 60% stake in USCo's worldwide BPO business, the IHCs

carried out a restructuring exercise of consolidating the holding in several downstream subsidiaries engaged in the BPO business under one common holding company in Luxembourg (LuxCo).

- ▶ As a result of this group restructuring exercise, indirect holding of IndiCo also got consolidated under LuxCo. The NR investors then acquired 60% stake in LuxCo, pursuant to the Transaction.
- ▶ The Tax Authority issued an SCN to IndiCo proposing to treat IndiCo as an RA of USCo.
- ▶ Aggrieved by the issuance of the SCN, USCo and MauCo, together, filed a writ petition before the HC challenging the validity of the SCN.

Taxpayer's contentions

- ▶ The SCN, proposing to treat IndiCo as an RA of USCo, is invalid for two reasons: (a) USCo did not earn any taxable income in India by virtue of the Transaction outside India (b) Even assuming USCo had taxable income in India by virtue of the Transaction, IndiCo had no connection with the income earned, if any, by USCo from the said Transaction. Consequentially, IndiCo cannot be treated as USCo's RA for taxation of such income.
- ▶ It is well-settled by a series of judicial precedents that, in terms of the relevant provisions of the ITL, a person can be treated as an RA of an NR taxpayer only if such person has some connection

with the income arising to the NR for which tax is sought to be recovered from the RA. In other words, a person cannot be treated as an RA for income independently arising to an NR merely because such person may have other independent or unrelated business connection with the NR.

- ▶ In the present case, even if it is admitted that IndiCo has a business connection with USCo by virtue of rendering BPO services, it cannot be treated as an RA of USCo in respect of the Transaction, since IndiCo has no connection with the income earned, if any, by USCo from the Transaction.

Tax Authority's contentions

- ▶ The writ petition filed by USCo and MauCo is premature and not maintainable. The issue of the SCN is merely for the purpose of gathering facts and providing an opportunity to IndiCo before treating it as USCo's RA. USCo and MauCo cannot be aggrieved by such an action.
- ▶ Even if IndiCo is treated as an RA by passing a final order, IndiCo has a statutory remedy of filing appeal before the first appellate authority and then to the Tribunal before approaching the HC.
- ▶ Since it is not disputed that IndiCo has a business connection with USCo in respect of BPO services, the Tax Authority is well within its right to issue an SCN to IndiCo.

HC's ruling

- ▶ At the outset, the HC clarified that it was not adjudicating upon the issue of taxability of the Transaction in India and that the issue before the HC was limited to examining the validity of the SCN proposing to treat IndiCo as an RA of USCo in respect of the Transaction.
- ▶ While USCo and MauCo argued that USCo had no business connection with IndiCo, the HC chose to proceed on the basis that allegations in the SCN to that effect were correct. Even so, the HC allowed the writ petition and held that the SCN issued to IndiCo was invalid for the following reasons:
 - ▶ Once it is accepted that there is a business connection between IndiCo and USCo, IndiCo can be treated as USCo's RA. However, IndiCo cannot be treated as an RA for income arising to USCo, independent and unconnected with IndiCo.
 - ▶ Harmonious reading of the ITL provisions and laws, as explained by several judicial precedents^[1], would show that:
 - ▶ In order to become liable as an RA, a person must be so situated so as to fall within the specific provisions and definition of an RA.
 - ▶ The income must be of a specified nature and, also, of such a nature in respect of which a person can be treated as a RA.

^[1] CIT v. Currimbhoy Ebrahim and Sons [AIR 1936 PC 1]
Ramanarayan Rajmal v. CIT [(1953) 24 ITR 442]
C R Nagappa v. CIT [(1969) 73 ITR 626]
CIT v. Toshoku Ltd. [(1980) 125 ITR 525]
CIT v. Fertilisers & Chemicals (Travancore) Ltd. [(1987) 166 ITR 823]

- ▶ RA has a statutory right to withhold sums towards a potential tax liability.
- ▶ Since the liability of an RA is limited to the income of an NR passing through it, there can be multiple RAs in respect of a single NR taxpayer, each being taxed on the profits or gains relatable to such an RA.
- ▶ In order to assess a particular income in the hands of an RA, the Tax Authority has to establish that the RA has some connection with the income earned by the NR which is sought to be taxed at the hands of the RA. In the present case, there is no 'live link' between USCo and IndiCo in respect of the Transaction and, hence, IndiCo cannot be treated as USCo's RA for the Transaction.
- ▶ Since the basic conditions for treating IndiCo as an RA of USCo were not satisfied in this case, the writ petition challenging the issue of the SCN is maintainable.

Comments

This HC ruling reaffirms the well-settled legal position in respect of the circumstances in which a person can be treated as an RA of an NR taxpayer. It provides guidance that a person cannot be treated as an RA for an unconnected transaction of an NR taxpayer although such person may have other business connection with the NR.

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