MOOT PROPOSITION

DRAFT PROBLEM

The Deputy Director of Income-tax, International Taxation 1(1), Chennai has filed an appeal to the Honourable High Court at Madras under section 260A of the Income-tax Act, 1961 against the order of the Income-tax Appellate Tribunal ('the Tribunal') passed in the case of IndiceTel India Ltd. ("the assessee") for the assessment year 2008-2009. The appeal has been admitted by the High Court and it is fixed for final hearing. For sake of brevity, the following substantial question of law as has been admitted by the High Court, is herein below enunciated:

"Whether on the facts and circumstances of the case and in law, the Tribunal was correct in holding that the capital gains in question were not taxable in India."

In relation to the matter at hand, the following Annexures form part of the record of the case:

Annexure A: The impugned order of the Tribunal

Annexure B: The appeal filed before the Tribunal by the assessee

Annexure C: The order of the CIT(A)-II

Annexure D: The appeal filed before the CIT(A)-II

Annexure E: The assessment order

Annexure A

IN THE **INCOME-TAX APPELLATE TRIBUNAL**, CHENNAI
BEFORE Mr. F.D.Legello, JUDICIAL MEMBER
AND Mr. Antony Vardon, ACCOUNTANT MEMBER
ITA No. 007/Che/2009
Assessment Year 2008-2009

M/s IndiceTel India
Ltd…….Appellant

Vs.

Dy. Director of Income-tax,
International Taxation
1(1)…….Respondent

Assessee represented by: Mr.Aziz Alam
Department represented by: Mr. Raman Gopalakrishnan
Per Bench:

The present appeal arises out of the order of the Commissioner of Income-tax (Appeals)-II. The solitary issue arising in this appeal is regarding the taxability or otherwise in India of the capital gains arising from sale of shares of a Canadian company INKO by a Tokyo company to a UK company, on account of the fact that INKO held shares in the assessee company through a Mauritian Company MCO.

We have perused the orders of the lower authorities, namely, the assessing officer and the CIT(A). Before us, the same arguments were taken as taken before these authorities. Having anxiously perused the orders of the authorities below, we find that the order of the CIT(A) needs to be reversed.

The facts of the case are that 66% of the shares of the assessee, an Indian company, are held by MCO, a Mauritian Company, which in turn is held 100% by INKO, a Canadian Company, and INKO in turn is held 100% by Mobile Aahlin, Tokyo. The shares of INKO are transferred by Mobile Aahlin to an unrelated company called Mobio based out of UK. There is no transfer of shares of the appellant.

Since the shares transferred are situated outside India, no capital gains thereon can be charged. There is also no merit in the Department's case that the appellant is an agent or permanent establishment of the Tokyo company. Even if the appellant is held to be an agent or PE of the Tokyo company, there are no business profits which are earned by the Tokyo company.

The gains in question are capital gains which have nothing to do with the concept of permanent establishment. In the result, the assessee's appeal is allowed and it is held that the capital gains are not taxable in India.

Sd/-
(F.D.Legello)
Judicial Member

Sd/-
(Antony Vardon)
Accountant Member

Chennai: Dt 21-12-2009
Copy to:

1. Parties
2. The CIT(A)-II;
3. The CIT
4. The DR, A-Bench

(True Copy)

By Order
Assistant Registrar
ITAT,Chennai

Annexure B

M/s IndiceTel India Ltd.
Assessment Year 2009-2010
Grounds of Appeal before The Income-tax Appellate Tribunal, Chennai

The Commissioner of Income-tax (Appeals)-II erred in confirming the view of the Deputy Director of Income-tax, International Taxation 1(1), Chennai ('the AO') that the capital gains in question were assessable in India. The appellant seeks leave to add to, amend or withdraw any of the aforesaid grounds of appeal.
Chennai:
For IndiceTel India Ltd.
Date: 25-8-2009
Director

Annexure C

IN THE OFFICE OF THE COMMISSIONER OF INCOME-TAX (APPEALS)-II, CHENNAI
Date of Order: 21.7.2009
Appeal No. : CIT(A)II/Int Tax 1(1)/187/2009-10

1. Date of the institution of appeal: 12.1.2005
2. Designation of the Officer who made the assessment : Deputy Director of Income-tax, International Taxation 1(1), Chennai
3. Assessment Year: 2008-2009
4. Name of The Appellant: IndiceTel India Ltd.
5. Income Assessed: Rs.10,044,883,980
6. Income-tax Demanded: Rs. 1,334,378,920
7. Section under which order appealed against was passed: Section 143(3) of the I.T. Act, 1961
8. Date of hearing: As per Order Sheet
9. Present for the appellant : Mr. Aziz Alam
10. Present for Department: None

APPELLATE ORDER AND GROUNDS OF DECISION

This is an appeal against order under section 143(3) dated 28-12-2004 passed by the Dy. Director of Income-tax, International Taxation 1(1), Chennai. Mr. Alam attended and discussed the case. In support of the solitary ground raised in this appeal, the learned Chartered Accountant raised several issues.

I have carefully gone through the assessment order and the reasoning given by the AO for holding that the capital gains are taxable in India. I have also given a careful consideration to the arguments made

before me by the learned Counsel for the assessee. I am convinced that the appeal must be rejected. I give below my reasons for holding that the instant gains are assessable to tax in India.

At the outset, I must state that all the reasons given by the AO for holding the capital gains to be assessable in India are logical. I give the following additional reasons:

1. Though the transfer is ostensibly of the shares of INKO, the essence of the transaction is transfer of the business of the assessee. Since this business is situated in India, it is a capital asset of the Tokyo company situated in India on the transfer of which capital gains arise in India.

2. In my view, the assessee has been correctly held to be an agent of the Tokyo company. When the assessee carries on the entire business of the Tokyo company, how can it be held that there is no business connection between the two? It is well settled that the expression "business connection" means something more than "business". A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in India which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India. "Business connection" may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in the taxable territories, which facilitates or assists the carrying on of that business. See R.D. Aggarwal's case 56 ITR 20 (SC).

3. It will also be seen that Mobioe and the Indian group which continues to own the balance shares in the assessee have entered into a partnership agreement in relation to the telecom business of the assessee. Therefore, the transfer of shares in MCO and the partnership agreement between the parties when seen together lead to an irresistible conclusion that the real transaction is question is only a transfer of business. The assessee's counsel vehemently argued before me that in view of Azadi Bachao Andolan's case 263 ITR 706 (SC), the form of the transaction cannot be ignored. However, the principle underlying section 92B(2) is that if a transaction between two independent enterprises is governed by another transaction between two associated enterprises, then the transaction between the independent enterprises will also be deemed to be a transaction between associated enterprises. It is the role of the judiciary to carry out the legislature's intention. Therefore, it is necessary for me to be governed by the substance of the transaction and hold that the capital gains are assessable in India. The question then arises whether the assessee could be made liable for the same. Here also I agree with the conclusion of the AO though I would like to give my own additional reasons for the said conclusion. The transferor is a Tokyo based company. The transferee is based in UK. Both these entities are outside India and therefore it is impossible for the Indian tax authorities to collect from these entities either by way of direct assessment or by way of deduction of tax at source the legitimate tax dues of this transaction. In this age where ease of communication and networking is the order of the day, it is very easy for multinational corporations to spin a complex web of entities in order to carry out a tax planning. The principles of tax laws have to keep pace with these developments and hence a substantial level of flexibility is not only desirable but also inevitable. Recognising this need, one has to take a dynamic and pragmatic view of the provisions and make the machinery so effective that the legitimate dues to the exchequer are collected by enforcement of the machinery available with the country. **Therefore, I hold that the AO was right in invoking the provisions of section 163 and holding that the assessee is an agent of the Tokyo company and also its agency permanent establishment in India. Since the definition of business connection in section 9 has been expanded to include the concept of agency permanent establishment, the conclusion is inevitable that the assessee is liable to discharge the tax obligations of its principal parent**. **As a result, the appeal is dismissed and the addition of Rs. 10,000,000,000 made by the AO is sustained.**

COMMISSIONER OF INCOME-TAX (APPEALS)-II, CHENNAI

Copy to:-

1. The appellant with DN
2. The C.I.T., City IV, Chennai
3. DDIT, Intl Taxation 1(1), Chennai
4. CIT(A)-II, Chennai

Annexure D

M/s IndiceTel India Ltd.

Assessment Year 2008-2009

Grounds of Appeal before the CIT(A)

The Dy. Director of Income-tax 1(1), International Taxation, Chennai erred in taxing the gains arising from sales of shares in the appellant company in the hands of the appellant itself. The appellant seeks leave to add to, amend or withdraw any of the aforesaid ground of appeal.

Chennai
For M/s IndiceTel India Ltd.
Dated: 12.1.2010
Authorised Signatory
M/s IndiceTel India Ltd.
Assessment Year 2008-2009

Statement of Facts

The appellant seeks leave to substantiate the above ground at the time of hearing.

Chennai
For M/s IndiceTel India Ltd.
Date: 12.1.2010
Authorised Signatory

Annexure E

INCOME-TAX DEPARTMENT

1. Name of the Assessee: M/s IndiceTel India Ltd.
2. Address: No.10, Sterling Road, Chennai
3. P.A.N. / G.I.R. No.: RRRNG 1234 M
4. District / Ward / Circle No.: Dy. Director of Income-tax 1(1), International Taxation, Chennai
5. Status: Company
6. Assessment Year: 2008-2009
7. Whether resident / resident but not ordinarily resident / non-resident: Non Resident
8. Method of accounting: Mercantile
9. Previous Year: 31.3.2008
10. Date of order: 28.12.2009
11. Section and sub-section under: 143(3) which the assessment is made

ASSESSMENT ORDER

The return of income declaring total income of Rs. 34,567,890 was filed on 29-10-2009. The return was processed under section 143(1) of the Income-tax Act, 1961 ('the Act'). Thereafter, the case was selected for scrutiny by issuing notices under section 142(1) and 143(2) of the Act. During the assessment proceedings, Mr.Alam, Chartered Accountant attended on behalf of the assessee and furnished the various details called for.

The assessee is incorporated in India as a company having limited liability.

The assessee is a leading telecom operator operating in several states in India. The shares of the assessee are indirectly held 66% by Mobile Aahlin, Tokyo. The balance shares of the assessee are held by an Indian group. During the year under consideration, it is noticed that the business interest of Mobile Aahlin in the assessee company has been transferred to Mobio, UK. To examine whether the said transfer attracts tax in India, the assessee, Mobile Aahlin and Mobio were called upon to explain why the said transaction did not attract tax in India. The assessee has replied stating that it is not involved in the stake sale and the deal is between two independent parties, Mobile Aahlin and Mobio, both of which are resident outside India.

Mobile Aahlin has explained that it has merely sold shares of INKO, a company based in Canada to Mobio, UK. The said INKO holds shares in MCO, a Mauritius company and MCO in turn holds shares in the assessee. Since the shares of INKO were not situated in India, there is no question of capital gains tax being attracted in India. Mobio has also substantially reiterated these submissions and further added that since no liability to Indian tax is attracted by the transaction, there is no question of withholding tax. The undersigned is of the opinion that the arguments made by the assessee and others must be rejected, for the following reasons:

4. The essence of the **transaction is transfer of the business of the assessee** from Mobile Aahlin to Mobio. **Since this business is situated in India, Indian tax ought to be levied on the transaction**.

5. It will also be seen that Mobio and the Indian group which continues to own the balance shares in the assessee have entered into a partnership agreement in relation to the telecom business of the assessee. Therefore, the transfer of shares in INKO cannot be viewed as an isolated transaction. Rather, the entire transaction is required to be seen as a whole. The tax authorities have to be governed by substance of the transaction and not the form.

6. The shares of INKO, which is commercially dormant and a non-entity for all practical purposes except for the shares it holds in the assessee through MCO, are sold for a whopping consideration which has resulted in a capital gains of Rs. 10,000,000,000. **The transaction is a colourable device** and the intermediate entities need to be ignored. It is a **fit case for lifting of the corporate veil**. If this is done, it becomes clear that the real transaction is sale of the business of the assessee, which is an asset located in India. Therefore, the transaction clearly attracts capital gains tax in India.

7. Since the transferor of shares is based in Tokyo, there is no question of any DTAA applying. Therefore, the transaction would be governed by the provisions of the Income-tax Act, 1961 only.

8. The assessee was also given opportunity to show cause why it should not be treated as an agent of Mobile Aahlin under section 163 of the Act. The assessee has stated that Mobile Aahlin does not earn any income from the assessee and therefore the assessee cannot be regarded as an agent of the Tokyo company. This contention is not acceptable. The entire business which is effectively owned by Mobile Aahlin is run by the assessee. **Since the assessee is an agent, it should also be regarded as an agency permanent establishment of Mobile Aahlin.** Therefore, even if any DTAA applies, in view of the permanent establishment, the profits from sale of the business would be taxable in India in the hands of the assessee.

In view of the above remarks, the total income of the assessee company is computed as under:

Computation of Total Income:

Income as per the return of income filed:	44,883,980
Add: Capital gains from transfer of share (as agent/PE):	10,000,000,000
TOTAL INCOME:	10,044,883,980
	==========

Assessed under 143(3) of the Act. Charge tax at the rates applicable to foreign companies. Charge interest under section 234A, 234B and 234C as applicable. Issue Demand Notice / Challan accordingly.

Copy to assessee
Deputy Director of Income-tax, 1-1
International Taxation, Chennai