

**Team Code -**

**BEFORE THE AUTHORITY FOR ADVANCE RULINGS  
NEW DELHI  
INDIA**

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**FEBRUARY 2015**

**AAR No. 100 OF 2015**

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**INTAXICATE INDIA PVT. LTD., BANGALORE (APPLICANT)**

**V.**

**COMMISSIONER OF INCOME-TAX, BANGALORE (RESPONDENT)**

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**MEMORANDUM ON BEHALF OF THE RESPONDENT**

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**13<sup>TH</sup> SURANA & SURANA NATIONAL CORPORATE LAW MOOT COURT**  
**COMPETITION, 2015**

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**LIST OF ABBREVIATIONS**


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&	--	And
S.	--	Section
AAR	--	Authority for advance rulings
Act	--	Income Tax Act, 1961
ACIT	--	Additional Commissioner of Income Tax
AIR	--	All India Reporter
All	--	Allahabad
AO	--	Assessing officer
Asst.	--	Assistant
Bom	--	Bombay
Cal	--	Calcutta
CBDT	--	Central Board of Direct Taxes
CIT	--	Commissioner of Income Tax
CTR	--	Current Tax Reporter
Co.	--	Company
DCIT	--	Deputy Commissioner of Income Tax
Del	--	Delhi
DIT	--	Department of Income Tax
DTR	--	Direct Tax Reports
Dy.	--	Deputy
ed.	--	Edition

Guj	--	Gujarat
Id.	--	Ibidem
IT	--	Income Tax
ITA	--	Income Tax Appeal
ITAT	--	Income Tax Appellant Tribunal
ITD	--	Income- Tax Tribunal Decision
ITO	--	Income Tax Officer
ITR	--	Income Tax Reporter
KAR	--	Karnataka
Ltd.	--	Limited
Mad	--	Madras
Mum	--	Mumbai
Nag	--	Nagpur
Ors.	--	Others
SC	--	Supreme Court
SCC	--	Supreme Court Cases
SOT	--	Some Other Orders of Tribunal
TTJ	--	Tax Tribunal Judgment
UOI	--	Union of India
u/s	--	Under Section
v.	--	versus

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**STATEMENT OF FACTS**

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- Intaxicate India Pvt. Ltd. (IIPL) (*hereinafter*, the Applicant Company), is a 100% subsidiary of Intaxicate Mauritius Ltd. (IML), a Mauritian company. IIPL is into financial services business and was a successful company due to well informed investment strategy.
- From 2000 to 2003 IIPL declared cash dividends and promptly withheld appropriate taxes on all the dividends as per India Mauritius tax treaty (*hereinafter*, the Tax Treaty).
- Post March 2003, IIPL issued millions of equity shares to IML being its sole shareholder at a meagre face value, and then bought them back at a premium, paid out of the current and accumulated profits. This arrangement continued till May 2013.
- After that, as a commercial strategy the company started issuing compulsorily convertible debentures (*hereinafter*, CCDs) to IML. In March 2014, IIPL redeemed much of the CCDs issued to IML and paid the principal amount, accumulated interests, premiums and compensation.
- IIPL filed its return of income for Assessment Year 2014-15 with the Indian income-tax department (ITD) (*hereinafter*, the Respondents). The ITD issued a show cause notice, alleging that the entire payment made by IIPL to IML on the redemption of the CCDs is nothing but interest payments and therefore, taxes should have been withheld by IIPL. The SCN also alleged that the buyback of shares for the past 10 years at huge premiums was nothing but repatriation of profits which is dividends in the name of capital gains to IML and therefore, dividend distribution tax (*hereinafter*, DDT) should have been paid by IIPL.
- IIPL instead of replying to the said notice filed an application with the Authority for Advanced Ruling (*hereinafter*, the Authority) requesting for a ruling on the transactions undertaken and to be undertaken that they were only sale of capital assets by IML and therefore, should be taxable only as per the Tax Treaty.
- Hence, the present application.

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**STATEMENT OF ISSUES**

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I. WHETHER THE PRESENT APPLICATION IS MAINTAINABLE BEFORE THE HON'BLE AUTHORITY.

II. WHETHER THE APPLICANT COMPANY WAS LIABLE TO PAY DIVIDEND DISTRIBUTION TAX ON PROFITS REPATRIATED TO ITS PARENT COMPANY FROM 2003 TO 2013.

III. WHETHER THE APPLICANT COMPANY WAS LIABLE TO WITHHOLD TAX U/S 195 OF THE ACT ON PAYMENT MADE FOR REDEMPTION OF COMPULSORILY CONVERTIBLE DEBENTURES.

IV. WHETHER THE TRANSACTIONS OF BUY-BACK OF THE SHARES AND REDEMPTION OF COMPULSORILY CONVERTIBLE DEBENTURES ARE A MEANS TO AVOID TAX.

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**SUMMARY OF ARGUMENTS**

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1) The present application not maintainable before this authority because:

**Firstly**, the application is barred by the proceedings already pending.

**Secondly**, the authority cannot entertain the applications for transaction which, *prima facie*, are tax-avoidant

**Thirdly**, an application to determine the tax liability of resident company cannot be filed and,

**Fourthly**, the present application is not time barred

2) The Applicant Company was liable to pay Dividend Distribution Tax on profits repatriated to its parent company because:

**Firstly**, The premium paid was dividend because the buy-back of shares was not in accordance with S. 2(22) of the Act

**Secondly**, The payments were repatriation of profits which are dividend

**Thirdly**, The receipts on sale of shares did not constitute capital receipts for IML

3) The Applicant Company was liable to withhold taxes u/s 195 of the Act on payments made to IML for redemption of compulsorily convertible debentures because:

**Firstly**, the payment made for redemption was in the nature of interest

**Secondly**, the interest is chargeable under the Act as required by S. 195 of the Act

**Thirdly**, the amount paid for redemption does not qualify to be capital gains

**Fourthly**, the Applicant Company cannot claim deduction against business income.

4) The transactions of buy back of shares and redemption of debentures was a means to evade tax because:

**Firstly**, The transactions were used as colourable device to evade tax

**Secondly**, The substance of the transaction reveals the intention to evade tax

**Thirdly**, the purposive interpretation of the statute brings the transactions under tax evasion.

**And lastly**, the transactions had no business effect except to evade tax.

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**ARGUMENTS ADVANCED**

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**I. THE PRESENT APPLICATION IS NOT MAINTAINABLE BEFORE THIS HON'BLE AUTHORITY.**

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The present application is not maintainable before this Authority because *firstly*, it is barred by the proceedings pending before the Income Tax Authorities regarding similar questions, *secondly*, an application to determine the liability of the resident company cannot be filed before the Authority, *thirdly*, Authority cannot entertain the applications for transaction which, *prima facie*, are tax-avoidant and, lastly, the present application is time barred.

**[I.A.] The application is barred by the proceedings already pending before the Income Tax Authorities.**

According to S. 245R(2)(i) of the Act, an application is not allowed where question raised therein is already pending before any income-tax authority.<sup>1</sup> The present application is ought to be rejected as *firstly*, Assessee-in-Default proceedings have been initiated u/s 201 of the Act and *secondly*, filing of return of income also constitutes as pending proceeding.

*[I.A.1.] Assessee-in-Default proceedings have been initiated u/s 201 of the act.*

A Show-cause notice can be issued u/s 201 of the Act when the assessee has defaulted in his liability u/s 195 of the Act.<sup>2</sup> Issuance of such notice u/s 201 signifies initiation of proceedings under the section.<sup>3</sup> Here, after scrutinizing the return, the respondents immediately issued notice u/s 201 to have failed to withhold tax u/s 195. Thus, in the present matter, the proceedings of Assessee-in-Default were initiated as soon as the aforesaid notice was issued.

*[I.A.2.] Filing of return of income constitutes as pending proceedings.*

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<sup>1</sup> In re NetApp B.V., [2012] 347 ITR 461 (AAR) (upheld by Delhi High Court in NetApp B.V v. Authority for Advance Ruling, [2013] 357 ITR 102 (Delhi)).

<sup>2</sup> ITO v. M/s. Vodafone Essar Digilink Ltd., I.T.A. Nos. 239 and 250 to 252/JP/2012, Poompuhar Shipping Corporation Ltd. v. Assistant Director of Income Tax, International Taxation, [2014] 360 ITR 257 (Mad),

<sup>3</sup> Bovis Lend Lease (India) (P.) Ltd. v. ITO, International Taxation, 2010 (1) ITR (Trib) 87 (Bangalore).

Whenever a return is filed, the process of assessment commences<sup>4</sup> entailing with it all the possible questions which may arise.<sup>5</sup> These questions are then to be decided by the assessing authority.<sup>6</sup> Thus, the matter is considered as pending on the date of the application.<sup>7</sup> Consequently, the jurisdiction of the AAR is ousted.<sup>8</sup>

Here, the Applicant filed its return for Assessment Year 2014-15, hence, any issues relating to the transaction undertaken in the relevant previous year would then be decided by the Income Tax Authorities and any application to the Authority pertaining to the same is barred.

**[I.B.] The Authority cannot entertain the applications for transaction which, *prima facie*, are tax-avoidant.**

Clause (iii) of the proviso of S. 245R(2) restricts the Authority to entertain applications which pertain to transactions designed *prima facie* for tax avoidance.<sup>9</sup> Here, the transactions of buy-back of shares and redemption of debentures are colourable devices with no underlying purpose. The only motive was to change the nature of receipts to avoid tax. It changed its practice as and when the Indian income tax laws changed. Till 2003, it was declaring cash dividends to IML. Post introduction of DDT, it started repatriating profits through buy-back of shares. After introduction of BBDDT, it started issuing CCDs and then subsequently redeeming them within the lock-in-period. Thus, clearly the transactions are for avoiding tax. Hence, the bar under clause (iii) of the proviso of S. 245R(2) is attracted here.

**[I.C.] An application to determine the tax liability of the resident company cannot be filed before the Authority.**

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<sup>4</sup> Auto and Metal Engineers & Ors v. UOI, (1997) 7 SCC 734.

<sup>5</sup> In re: WaveField Inseis ASA [2012] 343 ITR 136 (AAR).

<sup>6</sup> *Supra* note 1.

<sup>7</sup> *Supra* note 1; Monte Harris v. CIT, [1996] 218 ITR 413 (AAR).

<sup>8</sup> *Supra* note 5.

<sup>9</sup> In Re: Advance Ruling No. P-9 of 1995, [1996] 220 ITR 377(AAR).

S. 115-O of the Income Tax Act levies DDT<sup>10</sup> on the company<sup>11</sup> declaring a dividend. Such dividend is not included in the total income of the shareholders.<sup>12</sup> Now, since application before AAR can only be filed for determining the tax liability of a non-resident,<sup>13</sup> the present application is not allowed as far as it relates it to the determination of Applicant Company's liability u/s 115-O.

**[I.D.] The present application is not time barred.**

S. 201 of the Act does not prescribe any time limit for deeming a defaulter as 'Assessee-in-Default'. Also, the provisions of Limitation Act do not apply with regards to matters under the Act.<sup>14</sup> In *CIT v HMT Ltd.*<sup>15</sup> and in *Bhura Exports Pvt Ltd v ITO*<sup>16</sup> it was held that:

*“no period of limitation can be read if there is no period of limitation specified for taking action u/s. 201(1).”*

Thus, where neither a period of limitation is prescribed in the statute nor the Limitation Act is applicable, there cannot be any prohibition of the period of limitation for taking action under the said statute.<sup>17</sup> Hence in the instant matter, the Show Cause Notice issued by the Respondents cannot be qualified as time barred to the extent that it pertains to the transactions of buying back the shares since 2003 till 2013.

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<sup>10</sup> DCIT v. Dhanalakshmi Paper Mills Ltd., (2007) 105 ITD 123 (Chennai).

<sup>11</sup> Hari Krishnakant Bhatt v. ITO, (2005) 278 ITR (Ahm).

<sup>12</sup> Godrej and Boyce Mfg. Co. Ltd. v. CIT, Range 10(2), [2010] 194 TAXMAN 203 (Bom).

<sup>13</sup> In re Hindustan Powerplus Ltd., [2004] 267 ITR 685 (AAR).

<sup>14</sup> Rao Bahadur Ravulu Subba Rao v CIT, Madras, AIR 1956 SC 604.

<sup>15</sup> [2011] 340 ITR 219.

<sup>16</sup> (2012) 246 CTR (Cal) 482.

<sup>17</sup> *Id.*



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**II. THE APPLICANT COMPANY WAS LIABLE TO PAY DIVIDEND DISTRIBUTION TAX ON  
PROFITS REPATRIATED TO ITS PARENT COMPANY FROM 2003 TO 2013.**

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The Applicant Company was liable to pay DDT on payments made for buy-back of shares from 2003 to 2013 because the payments were repatriation of profits which are dividends and, the receipts did not constitute capital receipts for IML.

**[II.A.] The premium paid was dividend because the buy-back of shares was not in accordance with S. 2(22) of the Act.**

A scheme of buy-back is valid u/s 2(22) of the Act when it is in accordance with S. 77A of the Companies Act 1956.<sup>18</sup> S. 77A allows buy back to be made from free reserves, securities premium or the proceeds of any shares or other specified securities. In the instant matter the premium is paid out of current and accumulated profits. Thus, the buy-back is not in accordance with S. 77A (S. 68 of Companies Act 2013), but there is still reduction of capital as per S. 100 of the Companies Act, 1956 (S. 66 of Companies Act 2013). Now, clause (iv) of S. 2(22) of the Act includes payment made for reduction of capital out of accumulated profits as dividend. Thus the said payments being out of current and accumulated profits would be construed to be paid for reduction of capital and not buy-back. Consequently, the payment would be dividend.

**[II.B.] The payments were repatriation of profits which are dividend.**

*In Re A*,<sup>19</sup> a transaction similar to the impugned one was ruled to be a colourable device for avoiding tax. The Hon'ble Authority ruled that:

*“When the proposed transaction is found to be colourable, it is not a transaction in the eye of law...the arrangement can only be treated as a distribution of profits by a company to its shareholders which does attract S. 115-0 of the Act. The exemption (u/s 2(22) of the act)*

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<sup>18</sup> In Re: A, [2012] 343 ITR 455 (AAR).

<sup>19</sup> *Id.*

*is only in respect of a genuine buy-back of shares. On our finding that the proposed buy-back is colourable, the distribution in question will satisfy the definition of dividend under the Act and, consequently, taxable as such.”*

Thus, payment was taxed as Dividend. Here, also the Applicant Company was repatriating profits under the guise of capital gains. The premium paid on buy-back was actually, dividend. Hence, the Applicant Company is liable to pay DDT u/s 115-O.

**[II.C.] The receipts on sale of shares did not constitute capital receipts for IML.**

When original purchase of shares is made with an intention to resell on an enhanced price, the transaction is of trading nature and any receipt on such sale is revenue receipt and not capital receipt.<sup>20</sup> Also, where there is repetition and continuity of the transaction, the transaction is said to be of business nature.<sup>21</sup> In the present matter also, IML was regularly buying and selling the shares from 2003 to 2013. The shares were bought at a meager value but sold at a very high premium. Thus, the transaction here also qualifies to be of trading nature and the consequently receipts are therefore revenue and not capital ones.

Hence, the amount paid was essentially dividend, and in the present matter cannot be construed as capital receipts. Thus, the Applicant Company was liable to pay DDT.

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**III. THE APPLICANT COMPANY WAS LIABLE TO WITHHOLD TAXES U/S 195 OF THE ACT ON  
PAYMENTS MADE TO IML FOR REDEMPTION OF COMPULSORILY CONVERTIBLE  
DEBENTURES.**

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The Applicant Company is liable to withhold tax u/s 195 because the payments were in the nature of interest chargeable under the act and not capital gains. The transaction of redemption was entered into to camouflage the income from interest as capital gains.

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<sup>20</sup> Raja Bahadur Visheshwara Singh (Decd.) & Ors. AIR 1961 SC 1062.

<sup>21</sup> CIT, Nagpur v. Sulej Cotton Mills Supply Agency Ltd., (1975) 2 SCC 538; Dalhousie Investment Trust Co. Ltd. v. CIT (Central), Calcutta, (1968) 68 ITR 486 (SC).

**[III.A.] The payment made for redemption was in the nature of interest.**

All the three components of the sale-consideration amount to interest income. Also, because CCDs are debt and until converted, the income paid on them is interest.

*[III.A.1] Determination of components of sale consideration as interest.*

*[III.A.1.i] Accumulated interest as interest.*

The Applicant Company was liable to pay fixed rate of returns periodically to IML during the lock-in period. The terms of issue provided that if such interest was not paid periodically, it would accumulate. Thus, interest would accrue to IML periodically. It is merely the physical payment which is delayed. Also, income under the Act is assessable when it accrues or arises,<sup>22</sup> even if the same is not actually received.<sup>23</sup> Thus, the accumulated interest, on account of accruing periodically, would be interest and not capital receipt, thus, taxable as income.

*[III.A.1.ii] Premium as interest.*

Premium ordinarily means increased value.<sup>24</sup> Article 11.5 of the Tax Treaty defines interest to include *income from bonds or debentures, including premiums and prizes attaching to such bonds or debentures*. Thus, any type of income that becomes payable on a debenture, specifically including premium, is interest. Also, in *CIT, International Taxation v. Samsung Electronics Co. Ltd.*<sup>25</sup> the High Court of Karnataka held that:

*“In view of S. 90 of the Act, agreements with foreign countries would override provisions of the Act. Once it was held that payment made to non-resident companies would amount to ‘royalty’ within meaning of Article 12 of DTAA with respective country, it was*

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<sup>22</sup> India Finance and Construction Co. Pvt. Ltd. v. B.N. Panda, DCIT & Anr., [1993] 200 ITR 710.

<sup>23</sup> Morvi Industries Ltd. v. CIT (Central) Calcutta, (1972) 4 SCC 451.

<sup>24</sup> P RAMANTHA AIYAR, THE LAW LEXICON, 1501 (2<sup>nd</sup> ed., 2007).

<sup>25</sup> [2012] 345 ITR 494 (KAR).

*clear that payment would amount to royalty. There was obligation on part of Respondents to deduct tax at source u/s 195 of Act.”*

Thus, once premium is interest as per Article 11 of the Tax Treaty, it would be construed as interest for the purpose of S. 195 of the Act.

[III.A.1.iii] Compensation as interest.

Compensation partakes the nature of income which it replaces. There is no incompatibility between ‘interest proper’ and ‘interest by way of damages’ for income tax purposes. It can be properly described and taxable as interest. It may be liquidated or unliquidated.<sup>26</sup>

Also, in *London & Thames Haven v. Attwool*<sup>27</sup>, the principle was laid down as:

*“Where a trader receives from another person compensation for the failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits arising in any year...the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation.”*

On another instance, the lump sum compensation paid on termination of lease for the loss of outstanding rents was assessable as income.<sup>28</sup> Here, compensation replaces the future interest on CCDs, thus, it would be in nature of interest and taxable as such.

*[III.A.2] The sale-consideration being determinant on fixed rate of returns is interest.*

Whenever there are fixed rate of return on investments, these are in the nature of interest on debt. Furthermore, as per the recent policy of RBI<sup>29</sup> an assured rate of return on exit will

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<sup>26</sup> *Riches v. Westminster Bank Ltd.* [1947] 15 ITR (Supp.) 86.

<sup>27</sup> [1968] 70 ITR 460 (Cal).

<sup>28</sup> *Spezzano v. The Queen*, 2007 DTC 5580.

<sup>29</sup> RBI/2013-2014/436 A.P. (DIR Series) Circular No. 86, January 9, 2014.

signify the investment in the nature of debt and thus, the resultant income as interest. In the present matter, IML was promised fixed rate of returns as the time of issue. This fixed rate of return will be construed as interest.

*[III.A.3] CCDs are in the nature of debt for the Applicant Company.*

CCDs in the present matter are similar to debt. Therefore, Applicant Company paid interest upon it.

*[III.A.3.i] The debentures here are not compulsorily convertible.*

Conversion of CCDs has to necessarily happen at the time of discharge of the debt obligations. The debt obligations inherent in the debentures are compulsorily repaid in the form of equity of the entity.<sup>30</sup> However in the present case post completion of the lock-in period, the parent company i.e. IML ***had the option of converting them into equity shares.*** Therefore, the debentures were not compulsorily convertible. Also, as per FDI policy of India, investment in optionally and partly convertible debentures will not constitute FDI but External Commercial Borrowing (ECB). Hence, what in essence is ECB at a fixed rate of interest, has been contrived to look like CCD.

Consequently, here since the debentures are optionally convertible, the funds received by the Applicant Company would be deemed to be borrowed money over which interest would be payable to the parent company, IML.

*[III.A.3.ii] The repayment of CCDs is through shares.*

Debentures are acknowledgement of debt such that issuance of debentures is a mode of borrowing money.<sup>31</sup> The debentures do not lose their legal character as debt if instead of

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<sup>30</sup> In Re: Issuance of Optionally Fully Convertible Debentures by Sahara India Real Estate Corporation Limited (Now Known as Sahara Commodity Services Corporation Limited) and Sahara Housing Investment Corporation Limited, WTM/KMA/CFD/392/06/2011.

<sup>31</sup> CIT v. Shree Rajasthan Syntex Ltd., [2004] 269 ITR 461 (Raj).

paying back in cash, it is discharged by conversion into shares of the company.<sup>32</sup> Thus, the repayment of debt need not necessarily be in cash, it may be in kind.<sup>33</sup> Hence, CCDs issued by the Applicant Company would be deemed as debt borrowed from IML.

[III.A.3.iii] CCDs are not in the nature of equity shares.

The money raised by the debentures becomes a part of the company's capital structure; it does not become share capital.<sup>34</sup> In *DGIR v. Deepak Fertilizers & Petrochemicals Corporation Ltd.*,<sup>35</sup> the full bench of MRTPC has observed that:

*“There is a hiatus between the issue of debentures and their conversion...CCDs shall retain the basic elements of ordinary debentures until they are converted...”*

Also, in case of liquidation the CCDs would be paid back like normal debentures and not like equity shares.<sup>36</sup> Hence, until the debentures are converted into equity they are debt.

[III.A.3.iv] Return on convertible debentures is interest.

Interest is payable in respect of debts.<sup>37</sup> Article 11.5 of the Tax Treaty defines interest to include income from debentures. Consequently, since the convertible debentures, too, are a mode of borrowing money the return payable on them is termed as interest. The authority has observed *In re: LMN India Ltd.*<sup>38</sup> that:

*“...the applicant executes the debenture bonds and till they are converted into shares, the applicant keeps paying interest on the amount covered by bonds...there is no escape from*

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<sup>32</sup> In Re: LMN India Ltd., [2008] 175 TAXMAN 139 (AAR); Eastern Investments Ltd. vs. CIT, West Bengal, AIR 1951 SC 278.

<sup>33</sup> CWT vs. Spencer & Co., (1973) 4 SCC 204; In Re: GE Strategic Investments India, Ruling no. 769 of 2007.

<sup>34</sup> R.D. Goyal & Anr. v. Reliance Industries Ltd., (2003) 1 SCC 81; DGIR v. Deepak Fertilizers & Petrochemicals Corporation Ltd. (1994) 81 Comp Cas 342 (MRTPC)(FB).

<sup>35</sup> *Id.*

<sup>36</sup> *Supra* note 34.

<sup>37</sup> Bikram Singh v. Land Acquisition Collector, (1997) 139 CTR (SC) 475; Circular no. 202, dated 5-6-1976, Finance Act, 1976, Central Board of Direct Taxes.

<sup>38</sup> In Re: LMN India Ltd., *Supra* note 32.

*the conclusion that what is paid as interest is towards that debt...In our view, the ingredients of S. 2(28A) are clearly satisfied.”*

Therefore, until the debentures are converted into shares interest is payable upon them.

**[III.B.] The interest is chargeable under the Act as required by S. 195 of the Act.**

The income payable by way of interest by a resident to a non-resident would be deemed to have accrued or arisen to such non-resident in India as per S.9(1)(v)(b) r/w S. 5(2) and S. 4(1) and 4(2) of the Act, and will be part of his total income chargeable to Income Tax which shall be deducted at source under the provisions of the Act.<sup>39</sup>

Now, since the amount paid on redemption is interest and is chargeable under the Act in India, the Applicant Company is liable to deduct tax at source u/s 195(1) of the Act.

**[III.C.] The amount paid for redemption does not qualify to be capital gains.**

The amount paid on redemption is not capital gains in the hands of IML because there is no commercial justification for such gains and the receipts were of trading nature for IML.

*[III.C.1.] There is no commercial justification for capital gains to arise.*

Terms used in tax legislation are often construed as referring to business or commercial concepts. A tax mitigation scheme provided by an enactment can be availed when there is legal as well as commercial justification for the transaction undertaken. Various court rulings across India<sup>40</sup> and the UK<sup>41</sup> are consistent with the fact that where in a preordained series of transactions an intermediary step has been inserted which has no business purpose other than the avoidance of tax, then the transaction would not be free from tax liability.<sup>42</sup>

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<sup>39</sup> CIT v. Vijay Ship Breaking Corporation, [2003] 261 ITR 113.

<sup>40</sup> Patel Chemical Works v. ITO, [2000] 74 ITD 322 (Ahd); Unimed Technologies Ltd. v. DCIT, [2000] 73 ITD 150 (Ahd); Jamnalal Sons Ltd.v. Inspecting Assistant Commissioner, [1989] 29 ITD 164 (Mum).

<sup>41</sup> Inland Revenue v. Burmah Oil, 1982 SC (HL) 114, cited in McDowell & Co. Ltd. v. CTO, [1985] 154 ITR 148; Fitzwilliam (Countess) & Ors. v. Commissioners of Inland Revenue, [1993] 2 All ER 184.

<sup>42</sup> Carreras v. Stamp Commissioners, [2004] STC 1377.

In *Carreras v. Stamp Commissioners*,<sup>43</sup> the court ascertaining the commercial purpose of a transaction of issuance and redemption of debentures held it to be taxable when in the relevant statute it was tax-exempt. The exchange and redemption was concluded to be a single transaction having no commercial purpose or significance. Lord Hoffman observed:

*“...the court must first construe the relevant enactment in order to ascertain its meaning; it must then analyse the series of transactions in question, regarded as a whole, so as to ascertain its true effect in law; and finally it must apply the enactment as construed to the true effect of the series of transactions and so decide whether or not the enactment was intended to cover it.”*

Thus, the courts’ duty is to determine the legal nature of the transactions in question and then relate them to the fiscal legislation.<sup>44</sup>

It is submitted that Art. 13.4 of the Tax Treaty exempts the taxation of capital gains, derived from the alienation of property, in the source state. In the present matter, the debentures were issued only to redeem so that the resultant capital gains are exempt from tax in India. The entire scheme from issue to redemption was pre-ordained to repatriate tax-free profits. The Applicant Company is already a subsidiary IML, there was no legal effect of issuance and redemption of debentures. Thus, what in essence were repatriation of tax-free profits were engineered to look like capital gains. Hence, there were no real capital gains to IML.

*[III.C.2.] The amount received on redemption does not constitute capital gain.*

When securities are bought and sold at a higher price frequently, the transactions are deemed as adventure in the nature of trade.<sup>45</sup> The profits thus derived are construed as revenue receipt and not capital receipt because the investor is then taken as a dealer in securities.<sup>46</sup>

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<sup>43</sup> *Id.*

<sup>44</sup> *W. T. Ramsay v. Inland Revenue Commissioners*, [1982] AC 300, 326 cited in *McDowell and Co. Ltd. v. Commercial Tax Officer*, (1985) 3 SCC 230; *CIT v. Shiv Raj Gupta*, ITA No. 41/2002.

<sup>45</sup> *Supra* note 21.



Here, Applicant Company issued debentures because all the probable returns from shares were made taxable. The issue and redemption of debentures within 10 months had no underlying purpose. The intention of the company was to deal with debentures in the similar way in which it was dealing in shares from 2003 to 2013.

Hence, there were no capital gains attracting the provisions of Art. 13.4 of the Tax Treaty.

**[III.D.] The Applicant Company cannot claim deduction against business income.**

The Applicant Company cannot claim deduction because the same is disallowed u/s 40(a)(i) of the Act and much of its income is tax-exempt.

*[III.D.1.] The deduction against business income is disallowed u/s 40(a)(i).*

The Applicant Company cannot claim deduction against its business income on account of its failure to withhold taxes u/s 195 of the Act and thus attracting the application of S. 40(a)(i).<sup>47</sup>

*[III.D.2.] There is no tax neutrality as claimed by taxpayer as much of its income was tax exempt*

The applicant company is engaged in investing in real estate, infrastructure and related companies. The companies involved in such industries are provided various tax sops by the government of India which includes tax incentives. Therefore, the applicant company cannot claim a deduction of expenses which were used to earn tax-free income.<sup>48</sup>

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**IV. THE TRANSACTIONS OF BUY BACK OF SHARES AND REDEMPTION OF DEBENTURES WAS A MEANS TO EVADE TAX.**

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The transactions of buy back and redemption were tax-evading because the transactions were colourable devices having no business purpose apart from forgoing tax.

**[IV.A.] The transactions were used as colourable device to evade tax.**

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<sup>46</sup> *Supra* note 20.

<sup>47</sup> *Sassoon J. David and Co. Pvt. Ltd., Bombay v. CIT*, Bombay (1979) 3 SCC 524.

<sup>48</sup> *Yatish Trading Co. (P.) Ltd. v. ACIT*, [2011] 129 ITD 237 (Mum).

Methods which are resorted to impair the true construction of the statute to avail non-sacrosanct advantage of law are termed as colourable devices.<sup>49</sup> Thus, where statute is followed strictly, but the actual spirit behind it is marred, the instance is one of a colourable device.<sup>50</sup>

The Supreme Court in *CIT v. Sakarlal Balabhai*,<sup>51</sup> has stated that:

*“Tax avoidance postulates that the assessee is in receipt of amount which is really and in truth his income liable to tax but on which he avoids payment of tax by some artifice or device. Such artifice or device may...mask the true character of the income by disguising it as a capital receipt”*

The Hon’ble Court in the case of *McDowell & Co. Ltd. v. CTO*,<sup>52</sup> observed that:

*“Colourable device cannot be a part of tax planning.”*

Here, the premium on buy-back and redemption was paid to cloak the payment of dividend and interest, only for deriving undue benefits of Art. 13.4 of the Tax Treaty.

#### **[IV.B.] The substance of the transaction reveals the intention to evade tax.**

Doctrine of substance over form can be invoked<sup>53</sup> where each transaction in a scheme is legally correct but their entire operation is a means to defraud the revenue.<sup>54</sup> Also, in revenue cases and while administering tax laws<sup>55</sup> regard must be paid to the substance of the

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<sup>49</sup> Shourjo Chatterjee, *Tax Planning v/s Tax Evasion*, ₹ Trail, A Journal of Revenue Audit, 26 (January-March 2011).

<sup>50</sup> Lokesh Gautam, Savita, *Income Tax Planning: A Study of Tax Saving Instruments*, International Journal of Management and Social Sciences Research, Vol. No. 2, 83 (May 2013).

<sup>51</sup> [1968] 69 ITR 186 (Guj.).

<sup>52</sup> (1985) 3 SCC 230.

<sup>53</sup> *Juggilal Kampalat v. CIT, U.P.*, AIR 1969 SC 932.

<sup>54</sup> *Life Insurance Corporation of India v. Escorts Limited and Ors.*, (1986) 1 SCC 264.

<sup>55</sup> *Smt. C. Kamala v. CIT*, [1978] 114 ITR 159 (Kar.)

transaction rather than to its mere form.<sup>56</sup> Therefore, to ascertain the true character of a payment the veil can be lifted.<sup>57</sup> In the present matter, though the buy-back and redemption were legally correct but when seen in context of the status of Indian tax laws, the picture of the intention to evade tax comes to light. The mode of buying-back the shares was used to cloak the payment of dividends which were made taxable in 2003. Then again when BBDT was introduced, the method of issuance and redemption of debentures was resorted to. The Applicant Company could have also paid interest on debentures but it redeemed them in order to accrue capital gains to IML which are exempted to be taxed in India by virtue of Article 13.4 of the Tax Treaty. Thus, the substance of the payments is dividend and interest which have been given the colour of capital gains.

**[IV.C.] The purposive interpretation of the statute brings the transactions under the regime of tax evasion.**

Since tax laws are social statutes, the courts are not confined to literal interpretation, these may be considered in the context, scheme and purpose of the relevant act.<sup>58</sup> Also, where a document or transaction forms part of a nexus or series of transactions, intended to be carried as a whole, the fiscal consequences of such transaction should be ascertained by considering the result of the series as a whole<sup>59</sup> and not by dissecting the scheme and considering each individual transaction separately.<sup>60</sup>

In the present matter the entire scheme of transaction from issue of shares to buy-back and from issue of debentures to redemption should be seen as one whole transaction. The buy-

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<sup>56</sup> CIT v. Kikabhai Premchand, [1953] 24 ITR 506 (SC).

<sup>57</sup> UOI v. Gosdia Shipping (Pvt.) Ltd., (1978) 3 SCC 23.

<sup>58</sup> I.R.C. v. Wesleyan and General Assurance Society (1948) 30 T.C.11, 16 , cited in Wallfort Shares & Stock Brokers Ltd. & Ors. v. ITO, [2005] 96 ITD 1 (Mum).

<sup>59</sup> *Supra* note 44.

<sup>60</sup> Furniss (Inspector of Taxes) v. Dawson (1984) 1 All ER 530, cited in Vodafone International Holdings B.V. v. UOI & Anr., (2012) 6 SCC 613.

back and redemption was pre-contemplated in order to repatriate tax free profits by availing the benefits of Tax Treaty. DDT and BBDT were introduced in order to tax the profits being repatriated. But the Applicant Company, in order to defeat the purpose of the law was changing its practice time and again. Thus, the payment made on buy back and redemption should be taxed keeping in view the purpose of the statute.

**[IV.D.] The transactions had no business effect except to evade tax.**

A transaction which does not appreciably affect the beneficial interest of the assessee except to reduce his tax is disregarded by law.<sup>61</sup> In the present matter, the impugned transactions undertaken by the Applicant Company had no business effect apart from evasion of tax.

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<sup>61</sup> Gilbert v. Commissioner, [1957] 248 F 2d 399; Knetsch v. United States, 364 U.S. 361, 366 (1960), cited in Neroth Oil Mills Company Limited v. CIT, [1987] 33 TAXMAN 249 (Ker).

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**PRAYER FOR RELIEF**

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In light of the facts stated, issues raised, authorities cited and arguments advanced may this Hon'ble Authority be pleased to:

1. Reject the application.

***Adjudge and declare that:***

2. ***Firstly***, the Applicant Company is liable to pay the Dividend Distribution Tax on premium paid for buy-back of shares.
3. ***Secondly***, the Applicant Company is liable to withhold tax u/s 195 of the Act on payment made for redemption of Compulsorily Convertible Debentures.
4. ***Lastly***, the transactions of buy-back of the shares and redemption of Compulsorily Convertible Debentures are a means to evade tax.

**AND/OR**

Pass any other order that it deems fit in the interest of justice, equity and good conscience.

All of which is most humbly prayed.

**PLACE: NEW DELHI**

**COUNSELS FOR THE RESPONDENTS**

**DATE: FEBRUARY 14, 2015**