

EY Tax Alert

Delhi High Court holds proceedings on representative assessee invalid when principal taxpayer ceases to exist

Executive summary

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This tax alert summarizes a recent ruling of the Delhi High Court (HC) in the case of Cairnhill CIPEF Ltd.¹ (Taxpayer). In this case, the issue before the HC was whether a person can be treated as a Representative Assessee (RA) of a non-resident (NR) for the purpose of tax recovery under the Indian Tax Laws (ITL) if the said NR had ceased to exist.

In this case, Taxpayer (BuyerCo) had purchased shares of an Indian listed company from a Mauritian Entity (SellerCo) in tax year 2015-16. Capital gains arising on such transfer were claimed to be exempt from taxation in India under the India-Mauritius Tax Treaty by SellerCo and such claim was also accepted by the tax authority in the original assessment carried out in the hands of SellerCo. Subsequently, SellerCo was liquidated and had ceased to exist. Later, the Commissioner of Income Tax (CIT) had passed orders to treat BuyerCo as an RA of SellerCo and revised the original assessment order to levy tax on BuyerCo on the said capital gains by denying treaty benefit.

On BuyerCo challenging the order of CIT, the HC held that BuyerCo cannot be regarded as an RA as the SellerCo was not in existence on the date when revisionary proceedings were initiated. The expression "agent" in the ITL suggests that there is a principal in existence, on whose behalf the agent acts, which is not fulfilled in the present case.

¹ Cairnhill CIPEF Ltd. [TS-736-HC-2023(DEL)]; dated 7 December 2023

Background

- ▶ The Indian Tax Laws (ITL) contain specific provisions regarding assessments and tax recovery in special cases involving minors, trusts, NRs, etc.
- ▶ In such cases, tax may be levied and recovered from a representative of such principal taxpayer (Representative Assessee) “*in like manner and to the same extent*” as it would be leviable on the principal so represented.
- ▶ In respect of a principal, being an NR, such Representative Assessee (RA) is defined to mean the agent of the NR and includes any person who is treated as an “agent” under the ITL.
- ▶ For this purpose, the ITL treats the following persons as agent and consequently an RA of the NR:
 - ▶ Any person in India employed by or on behalf of the NR;
 - ▶ Any person in India having a business connection with the NR;
 - ▶ Any person in India through or from whom NR receives income (directly or indirectly);
 - ▶ Any person in India who is trustee of the NR; or
 - ▶ Any person (whether resident or NR) who has acquired a capital asset in India.
- ▶ In this respect, the ITL requires the tax authority to give the person proposed to be treated as an RA of the NR, an opportunity of being heard prior to determination of status as RA.

Facts

- ▶ Taxpayer (BuyerCo), along with its Group Entities, acquired certain shares of an Indian listed company (I Co) from a Mauritius Company (SellerCo) during the tax year (TY) 2015-16.
- ▶ In the return of income (ROI) filed by SellerCo, the gains on sale of shares of I Co were disclosed as being exempt from tax in India by virtue of the beneficial provisions of the India-Mauritius Tax Treaty². Such claim of exemption was also accepted by the tax authority vide assessment order passed on 12 December 2018.

- ▶ Soon thereafter, SellerCo was liquidated and it ceased to exist on 19 December 2018.
- ▶ In March 2021 (viz. subsequent to SellerCo ceasing to exist), the CIT passed orders treating the BuyerCo as an RA of SellerCo and revising the original assessment order passed on SellerCo (dated 12 December 2018) and imposed liability on capital gains accruing on transfer of I Co shares³ upon BuyerCo.
- ▶ Being aggrieved, BuyerCo preferred an appeal before the Income Tax Appellate Tribunal (Tribunal), whereupon Tribunal ruled in favor of BuyerCo and held that proceedings cannot be undertaken in the status of RA as SellerCo itself had ceased to exist.
- ▶ Aggrieved, tax authority appealed before the HC and contended that a person can be regarded as an RA even in cases where the principal is not in existence. Thus, once such provisions are invoked, the original assessment carried out in the hands of SellerCo can be revised in the hands of BuyerCo.

HC ruling

HC held in favour of the Taxpayer. The HC ruled that BuyerCo cannot be regarded as an RA as the SellerCo was not in existence on the date when revisionary proceedings were initiated. Further, in the usual and normal course, the expression “agent” suggests that there is a principal in existence, on whose behalf the agent acts. The ITL provisions are wedded to this principle. This requirement is not fulfilled in the present case.

² Article 13(4)

³ The exact merits/ rationale basis which such capital gains were sought to be taxed is not presently clear from the ruling.

Comments

The instant ruling lays down a fundamental proposition that the existence of the principal is a pre-requisite to regard another person as its agent. The HC extended this general principle while interpreting the scope of definition of 'agent' under the ITL.

Separately, it may be noted that the present ruling has been rendered in peculiar facts of the case where the original assessment was conducted on the SellerCo when it was in existence but ceased to exist post such assessment without pendency of any proceedings. Application of ratio of the ruling to different fact pattern may require specific analysis.

It may be of relevance to note the Bombay HC ruling in the case of Abdullabhai Abdul Kadar⁴ which was rendered in the context of the Income-tax Act 1922 which had similar provisions as the ITL. The Bombay HC in that case was concerned with a similar fact pattern and the HC made a distinction between contractual agency relationship and statutory agency under the ITL. The HC held that, while contractual relationship may be terminated on demise/non-existence of principal, statutory agent declaration is transaction-linked which does not get vitiated if principal ceases to exist on the date of appointment of a person as RA. The present Delhi HC decision has not considered the Bombay HC decision and was rendered without noticing the same.

Thus, while the ruling is binding on taxpayers in Delhi HC jurisdiction, the issue may be debatable.

⁴[1952] 22 ITR 241 (Bombay)

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