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NOT A TAX TARGET: INDIAN (TARGET) COMPANY NOT TAXABLE AS AN AGENT IN SHARE TRANSFER

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The Madras High Court (Court) recently ruled in favour of the Taxpayer (*M/s WABCO India Limited v. The Deputy Commissioner of Income-tax*, W.A.No. 884 of 2018 and C.M.P Nos. 8825 and 7726 of 2018.) holding that the Taxpayer could not be taxed in India when it had no role to play in a share transfer that took place outside India.

Background

The Taxpayer is an Indian listed company, engaged in the business of designing, manufacturing and marketing conventional braking products and systems. Being a listed company, 75% of its shareholding was held by Clayton Dewandre Holdings Ltd. (Seller), a Netherlands based entity and the remainder 25% is held by public shareholders at large.

In the Indian financial year 2013-14, the Seller transferred its 75% shareholding in the Taxpayer to Wabco Asia Private Limited, Singapore (Purchaser). As consideration, the Purchaser issued its own shares to the Seller. A Share Transfer Agreement (Agreement) was executed between the Seller and the Purchaser wherein the Taxpayer was not made a party.

Concept of 'representative assesse': From a tax administration perspective, the (Indian) Income Tax Act, 1962 (IT Act) has certain tax recovery provisions whereby an agent of the non-resident's may be taxed on behalf of the latter – as a 'representative assessee'. Persons who may be regarded as and agent have been specifically defined in the IT Act (*Sections 160(iv) read with 163, IT Act*).

Tax Proceedings against the Seller: The sale of shares of the Taxpayer resulted in capital gains for the Seller. As a result, the Seller was assessed pursuant and a draft assessment order was served on the Seller under the IT Act which was subsequently finalised.

Tax Proceedings against the Taxpayer: The Taxpayer was issued a Show Cause Notice (Notice) under Section 163(1)(c) of the IT Act (issued to a person in India from or through whom the non-resident is in receipt of any income, directly or indirectly) which stated that:

- The Seller received a capital gain in India pursuant to the sale of its shares in the Taxpayer to the Purchaser;

- During scrutiny assessment of the Seller, its place of effective management was established to be in United Kingdom and that it wilfully engaged in a paper arrangement to obtain the benefits of the India – Netherlands Tax Treaty (Treaty); and

- Since the capital gains had "directly arisen as a result of the consideration received from" the Taxpayer, the Taxpayer was proposed to be treated as an agent of the Seller in relation to the Seller's capital gains tax for the Indian financial year 2013-14.

In response to the Notice, the Taxpayer approached the Court *vide* a writ petition filed under Article 226 of the Constitution of India.

While the Taxpayer argued that the Notice was without jurisdiction since the Seller was not in receipt of any income from the Taxpayer, the Single Bench of the Court dismissed the writ petition stating that it was open to the Taxpayer to respond to the Notice without any prejudice in *lieu* of approaching the Court.

Issue under Consideration

The Court formulated the key issue for the matter – *whether the Taxpayer's writ petition ought to have been dismissed on the sole ground that it had a right to reply to the Notice without ascertaining the jurisdiction of the tax officer to issue the Notice?*

Ruling of the Court

Dismissal of the Taxpayer's Writ Petition: The Court held that the Taxpayer's writ petition ought not to have been dismissed in the first instance merely since the Taxpayer had a right to respond to the Notice. The Court set out the basic, established tenets of when it may exercise its discretion to entertain an appellant's writ petition pursuant to the plenary powers granted to it under the Constitution:

- Notice is without jurisdiction;

- Conditions precedent for a notice are absent; and / or

- Acts alleged in the Notice do no disclose any case for action against the appellant since the Notice must necessarily disclose the Taxpayer's liability.

The Court, relying on judicial precedents, emphasised that a *quasi*-judicial authority like the tax officer cannot erroneously decide a jurisdictional fact and proceed to impose a levy on a taxpayer. While the Court has the discretion to entertain a writ petition, it would normally refrain from doing so if there is an effective and efficacious remedy available to the appellant.

Can the Taxpayer be regarded as the Seller's agent?: The Court relied on established judicial precedents to reiterate that if the non-resident taxpayer has been assessed, then a parallel proceeding may not be initiated on its Indian agent in respect of the same income.

A harmonious reading of the provisions of the IT Act would show that:

- In order to be liable as a 'representative assessee', a taxpayer must fall within the definition of a 'representative assessee' under the IT Act;
- The income must be taxable under the source rules provided in the IT Act;
- The income must be in connection with the taxpayer who is treated as a 'representative assessee';
- The 'representative assessee' has a statutory right to withhold sums towards a potential tax liability; and
- Since the liability of a 'representative assessee' is limited to profit, there can be multiple representative assesses of a single non-resident.

Completely concurring with the principles laid down by the Delhi High Court in the case of *General Electric*, the Court held that in respect of the share transfer to a third party outside India, the Indian company cannot be taxed when it had no role in the transfer. The Indian company cannot be regarded as an agent in relation to the capital gains on the share transfer merely because the shares related to it.

Comment

This pronouncement certainly clarifies the tax position in offshore deals where there is an Indian target company. It is a shot in the arm for non-resident sellers in the M&A space who often transact in Indian shares. Contractual provisions on the Indian target being a 'representative assessee' and the corresponding Indian tax withholding obligations on it is a crucial negotiating point between parties.

However, the Court did not discuss the tax implications arising from the share swap, Treaty eligibility. An important fact to note is that despite being issued a 'nil' withholding certificate by the tax authorities, the Seller was assessed to capital gains tax in India on account of ineligibility to avail the Treaty benefits. Recently, the Central Board of Direct Taxes had issued a directive to issue such certificates within the specified timeline. While the binding value of a withholding certificate is still an open issue, the legal principles of taxing a 'representative assessee' are clearly pronounced in this ruling.

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