

Tax Flash News

1 August 2023

The tax officer cannot reopen the assessment only on the basis of subsequent contradictory AAR ruling

Recently, the Bombay High Court in the case of Usha Eswar¹ (the taxpayer) dealt with the validity of reassessment notices issued under Section 148 of the Income-tax Act, 1961 (the Act). The notices were issued on the basis of subsequent Authority for Advance Ruling (AAR) ruling in a different taxpayer's case when there was a binding AAR ruling in the taxpayer's own case. The High Court set aside and struck down the reassessment notices² and held that the subsequent AAR ruling taking a contradictory view cannot bind the taxpayer. Further, Section 245(2) provides that the advance ruling shall be binding unless there is a change in law or facts on the basis of which the advance ruling has been pronounced. The High Court held that the subsequent AAR ruling relied on by the Assessing Officer (AO) to reopen the assessment cannot be considered as a ruling that changes the law. The reassessment procedure was invalid as the AO did not personally form the belief that income liable to tax has escaped assessment. The AO did not have any tangible material to conclude that there was an escapement of income.

Facts of the case

- The taxpayer, an Individual resident of Dubai, was carrying on business in Dubai as a sole proprietor of two concerns. The taxpayer invested in shares and debentures issued by Indian Companies as well as units issued by mutual funds registered in India. She was regularly assessed to tax in India in respect of income earned in India.
- To ensure certainty, the taxpayer made an application before the Authority for Advance Ruling (AAR) to determine the taxability of income earned by way of dividends, interest and capital gains from sources in India.

- On 13 December 1996, the AAR gave its ruling applying its earlier ruling in the case of M. A. Rafik³. The AAR applied the provisions of the Act and Articles 10, 11 and 13 of the India-UAE tax treaty and held that taxability of capital gains on the transfer of movable assets in India was not taxable in India. The AAR held that the dividend income was taxable at the rate of 15 per cent and interest income was taxable at the rate of 12.5 per cent. Subsequently, based on the AAR ruling, the taxpayer filed her return of income for various AYs and offered the income.
- Subsequently, the AO issued reassessment notices to the taxpayer since there were reasons to believe that income chargeable to tax had escaped assessment. The tax treaty benefit was wrongly given to the taxpayer. The AO observed that the claim was made on the basis of the ruling made by the AAR but it was relevant only for AY 1995-96.
- The AO also observed that the AAR in the taxpayer's case had pronounced its ruling on the basis of its earlier ruling in the case of M. A. Rafik. However, AAR in its subsequent ruling in the case of Cyril E. Pereira⁴, after considering M. A. Rafik's case, held that the tax treaty benefit was not available as the taxpayer was not liable to tax in UAE. Consequently, the AO held that the ratio of the subsequent ruling was applicable in the taxpayer's case and therefore, the taxpayer was not entitled for the tax treaty benefit.
- Soon after these notices were received, the taxpayer filed a writ petition to quash and set aside the notices.

¹ Mrs. Usha Eswar v. UOI (Writ Petition No. 1106 of 2003) – Taxsutra.com

² For Assessment Years 1997-98 to 2000-01

³ Mohsinally A. Rafik [1995] 213 ITR 317 (AAR)

⁴ Cyril E. Pereira [1999] 239 ITR 659 (AAR)

High Court's decision

- A similar case came up for consideration in Prudential Assurance Co. Ltd.⁵, where the Bombay High Court after considering the provisions of Section 245S and Section 245V held that:
 - The AAR ruling binds the applicant, commissioner and the tax authorities subordinate to him and shall apply in relation to the transaction in which the ruling was sought.
 - Therefore, the subsequent AAR ruling in the case of Fidelity Northstar Fund could not bind Prudential Assurance case nor can it displace the binding effect of the ruling rendered in the case of Prudential Assurance.
- Similarly, in the present case, the AO manifestly exceeded his jurisdiction while proposing to re-open taxpayer's assessment relying on the ruling of the AAR in the case of Cyril E. Pereira. In view of the clear mandate of Section 245S, the AAR ruling would apply and be binding on the applicant and the tax department in relation to the transaction for which it so sought. The AO had ignored this clear mandate.
- Further, Section 245S(2) provides that the ruling shall be binding unless there is a change in law or facts on the basis of which Advance Ruling has been pronounced. There was no change in law or facts that has taken place or mentioned in the reasons to believe. The subsequent ruling in Cyril E. Pereira cannot be stated to be covered under Section 245S(2) and it cannot be considered as a ruling that changes the law.
- In the case of Azadi Bachao Andolan⁶, the Supreme Court considered the India-Mauritius tax treaty where Article 4 was *pari materia* to the India-UAE tax treaty. In this regard, the decision in Cyril E. Pereira came to the Supreme Court for consideration. While considering the meaning of what is 'liable to tax' mentioned in Article 4 of the India-Mauritius tax treaty, the Supreme Court held that the contention of the tax department therein proceeded on the fallacious premise that 'liable to tax' is the same as payment of tax.
 - The Court held that the liability to taxation is a legal situation, whereas payment of tax is a fiscal fact. For the purpose of application of Article 4, what was relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax.
- If this were not so, the treaty would not have used the words 'liable to tax' but would have used some appropriate words like 'pays tax'.
- The phrase 'liable to tax' would mean that the person is actually paying tax. Otherwise, a person who had deductible losses or allowances, which reduces his tax bill to zero would find himself unable to enjoy the benefits of a tax treaty.
- The Supreme Court did not agree with the view in the case of Cyril E. Pereira.
- On the basis of the above observations, the Bombay High Court held that merely because the AAR in the case of another applicant has taken a different view, it cannot be a sufficient basis to have a reason to believe that income chargeable to tax has escaped assessment.
- Further, the AO in his reason to believe merely sets out the relevant facts and thereafter sought directions from his senior tax officer to re-open the assessment. Therefore, the AO had not personally formed the belief that income liable to tax has escaped assessment and has relinquished its jurisdiction. Therefore, the re-opening was invalid.
- The AO had ignored the relevant provisions of the law. Further, the AO did not have any tangible material to conclude that there was an escapement of income. Accordingly, reassessment notices were held as illegal and struck down.

Our comments

The meaning of the expression 'liable to tax' under Article 4 to determine residential status and the availability of a tax treaty benefit has been a subject matter of controversy before the Courts. The Courts in several cases including Azadi Bachao Andolan have held that to determine if a person is 'liable to tax', it is immaterial that the person actually pays tax or not. Also, merely because an exemption is granted, it cannot be regarded that the person is not 'liable to tax'.

Subsequently, Article 4 of the India-UAE tax treaty has been amended to specifically provide that for an 'individual' to be a resident of UAE, it should be present in the UAE for at least 183 days in the calendar year concerned.

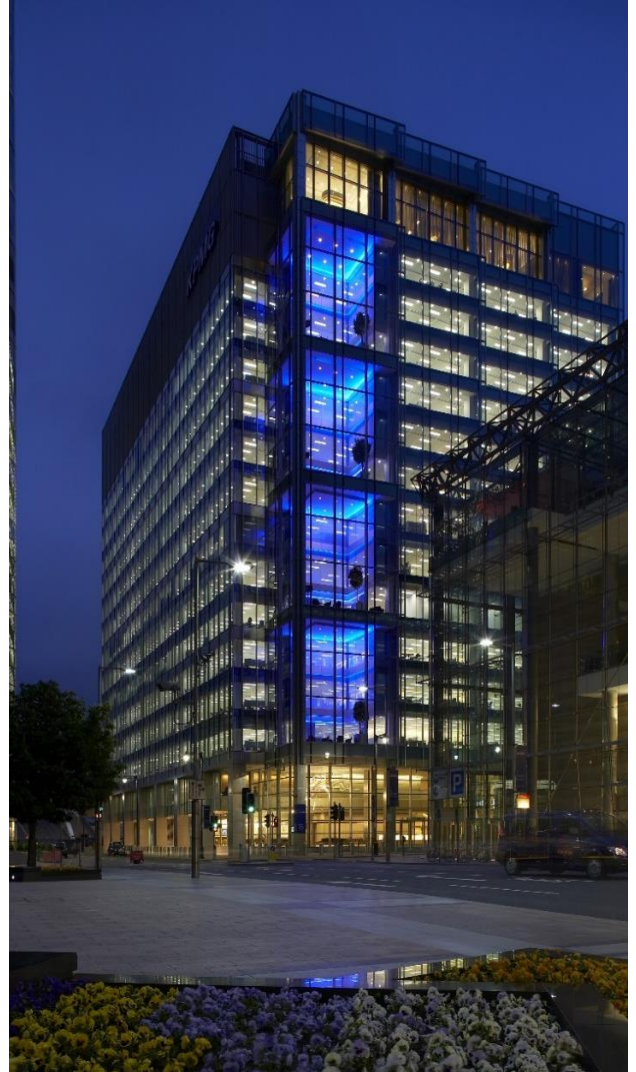
Further the Finance Act, 2021 has amended Section 2 to include clause 29A which provides that 'liable to tax', in relation to a person and with reference to a country, means that there is an income-tax liability on such a person under the law of that country for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country.

⁵ Prudential Assurance Co. Ltd. v. DIT [2010] 191 Taxman 62 (Bom)

⁶ UOI v. Azadi Bachao Andolan [2000] 263 ITR 706 (SC)

It is important to note that along with the introduction of new provisions of the Board for Advance Rulings (BAR), Section 245S was amended where the specific binding nature of AAR ruling on transaction, applicant and income tax authorities has been done away with.

The High Court in this case has reiterated an important principle that merely because the AAR in the case of another applicant has taken a different view, it cannot be a sufficient basis to form a reason to believe that income chargeable to tax has escaped assessment. The AO should have tangible material to reopen the assessment.



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