2023:BHC-OS:6797-DB

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION NO. 1106 OF 2003

Mrs. Usha Eswar w/d. of Vallipuram G. Venkiteswaran having present address of C/o. M/s. G. M. Kapadia & Company Chartered Accountant, Raheja Chambers, 213, Nariman Point, Mumbai 400 023. .. Petitioner.

v/s.

1 Rajeshwari Menon Income Tax Officer, (IT)-1-(2) Mumbai, having her office at 122, Aayakar Bhavan, Maharshi Karve Road, Mumbai 400 020.

2 Mr. K. T. Zimik, Additional Director, International Taxation of Income Tax Range 1, Mumbai having his office at Aayakar Bhavan, Maharshi Karve Road, Mumbai 400 020.

3 Union of India The Central Government Administration, Aayakar Bhavan, Maharshi Karve Road, Mumbai 400 020. .. Respondents.

Mr. P. J. Pardiwalla, Sr. Advocate with Mr. B. D. Damodar i/b. Kanga & Co., for Petitioner.
Mr. Akhileshwar sharma, for Respondents-Revenue.

CORAM: K. R. SHRIRAM &
FIRDOSH P. POONIWALLA,JJ.
DATED : 7th JULY 2023.

ORAL JUDGMENT (Per K. R. SHRIRAM,J.):-

Petition was filed by the husband of the present Petitioner. Original Petitioner expired on 3rd December 2015. Pursuant to leave granted by the Court, Petition was amended. Reference herein to Petitioner refers to the original Petitioner.

2 Petitioner is challenging the legality and validity of notices issued under Section 148 of the Income Tax Act, 1961 (the 'Act') issued by Respondent No.1 for Assessment Years 1997-98, 1998-99, 1999-200 and 2000-2001. It is Petitioner's case that these notices had been issued without satisfying the jurisdiction condition necessary to make a re-assessment.

3 Petitioner was a non-resident Indian and was regularly assessed to tax in India in respect of income that accrued or arose to him in India or arisen in India or received by him in India. Petitioner was a resident of Dubai for several years and was carrying on business as a sole proprietor of two concerns. He had invested in shares and debentures issued by Indian Companies as well as units issued by mutual funds registered in India. Petitioner was a resident of United Arab Emirates (UAE) within the meaning of the said expression in the Double Taxation Avoidance Agreement entered into between India and UAE (DTAA).

4 In order to ensure finality and certainty as to the taxability of income that he earned from sources in India, Petitioner made an application to the Authority for Advance Ruling (AAR), seeking a ruling to the taxability as well as the rate at which tax payable on income earned by him by way of dividends, interest and capital gains from sources in

India. The application filed by Petitioner to the AAR was not made for any specific Assessment Year but was made seeking an answer to questions as to the taxibility of his income from dividends on shares in Indian Companies, interest and debentures received by him in India, income from units issued by mutual funds set up in India and capital gains in India from transfer of said assets.

5 AAR sought certain details which Petitioner provided. Documentary evidence was also submitted. AAR pronounced its ruling by order dated 13th December 1996. AAR came to the conclusion that Petitioner was resident of UAE in terms of article 4 of the DTAA. AAR also noted that Petitioner was not liable to any tax in the UAE since there was no levy of income tax on individual in the UAE. AAR following its earlier ruling in the case of ***Mohsinally A. Rafik***[1] concluded that Petitioner was a resident of UAE. In view of this conclusion, AAR applied the provisions of the Act and Articles 10, 11 and 13 of DTAA and held that taxability of capital gains on the transfer of movable assets set in India will be governed by Article 13 (3) of the DTAA and hence the same would not be taxable in India on or before 1st April 1994. AAR further held that in terms of Article 10 of the DTAA, the dividend income accruing to Petitioner from shares held in India would be taxed at the rate of 15% and the income accruing to Petitioner by way of interest on debentures and bonds as well as balance in the partnership firm could be taxable at the rate of 12.5% . The questions raised before the AAR and the answers thereto reads as under:-

> *"12. In the light of the above discussion, the Authority gives the following ruling on the questions raising in the application:*

1 (1995) 213 ITR 317 (AAR)

RULING

(1) Whether the applicant, an individual residing in the UAE, is entitled to claim the benefit of the provisions of the tax treaty entered into between India and UAE?	*Yes, as the applicant is a resident of the UAE on the terms of clause (a) of paragraph 2 of Article 4 of the DTAA.*
(2) Whether in terms of Article 13(3) and Article 4 of the tax treaty between India and UAE, the applicant, and individual, a person of Indian Origin, residing in UAE, is liable to capital gains tax on the transfer effected in India of movable assets in the nature of shares, debentures and other securities?	*The taxability of capital gains on the realisation of the Indian movable assets referred to will be governed by article 13(3) rad with Article 4 of the agreement treating the applicant as a resident of the UAE. No such income arising on or after 1.4.1994 will be taxable in India. The difference in the source of the assets giving rise to the income is of no relevance in this regard.*
(3) Whether the applicant is liable to capital gains tax on the transfer effected in India of movable assets in the nature of shares, debentures and other securities in view of the provisions of section 112 of the Income-tax Act, 1961 and the provisions of the tax treaty between India & UAE?	
(4) Whether in terms of tax treaty between India and UAE, the applicant is liable to capital gains tax on the transer effected in India of movable assets in the nature of shares, debentures and other securities which are : *(a) acquired prior to the coming*	

	into effect of the tax treaty between India and UAE;	
	(b) after his becoming a non-resident but from out of non-repatriable funds in India.	
(5)	*Whether in terms of Article 10 of the tax treaty between India and UAE, the income received/receivable by applicant in India by way of dividend is liable to tax in India at 5/15 per cent as the case may be.*	*In terms of Article 10 of the DTAA, the dividend income accruing to the applicant from shares held in India will be liable to tax at 15%.*
(6)	*Whether in terms of Article 11 of the tax treaty between India and UAE, the income received/receivable by the applicant in India by way of interest on debentures/bounds/ balance in the capital account in partnership firm is liable to tax in India at 12.5 per cent?"*	*In terms of Article 11 of the DTAA, the income accruing to the applicant by way of interest on debentures/bounds & capital balance in partnership will be liable to tax at the rate of 12.5%.*

s/d	*s/d*	*s/d*
(BHUVANENDRA NIGAM)	*(JUSTICE S. RANGANATHAN)*	*(R. L. MEENA)"*
MEMBER	*CHAIRMAN*	*MEMBER*

6 Petitioner filed his return of income for Assessment Year 1997-98 on 19th March 1999 declaring a total income of Rs.26,18,005/-. In the return of income as filed, Petitioner claimed that he would be entitled to the benefits of DTAA and accordingly the capital gains that accrued to him was not offered for tax. The Dividends income and the interest income that was earned was offered for tax at the rate provided under the DTAA.

7 For A. Y. 1998-99, Petitioner filed his return of income on 30th March 2000. In accordance with the ruling of AAR, Petitioner claimed that no part of the capital gains accrued to him was chargeable to tax. As far the dividend income, it was offered to tax chargeable at the rate of 15% and the interest income at the rate of 12.5%. In the computation of income filed, a specific reference was made to the ruling obtained by him from AAR and a copy thereof was also enclosed.

8 Petitioner's return for A.Y. 1998-99 was processed under Section 143(1) of the Act and an intimation dated 19th December 2000 was issued, accepting income that was returned by Petitioner and the tax thereon levied at the rate provided for in DTAA.

9 For A.Y. 1999-2000, Petitioner filed his return of income on 28th March 2001 in the same manner as in the earlier year and at the tax rate under the DTAA as pronounced by the AAR.

10 For A. Y. 2000-01, Petitioner filed his return of income on 3rd August 2001. The computation of income filed along with return disclosed a total income of Rs.16,30,190/- on which the tax payable came to Rs.2,03,773/-. After claiming credit for tax deducted at source of Rs.2,07,806/-, Petitioner claims a refund of Rs.4033/-. Petitioner has also raised same contentions in the return as was done in the earlier years relying on the ruling of the AAR. The return filed by Petitioner for A. Y. 2000-01 was processed under Section 143(1) of the Act and the intimation dated 25th January 2002 was issued, determining the income at Rs.16,30,190/-. The tax thereon, however, was determined at Rs.4,63,057/- and after quantifying the interest chargeable under Sections 234-A, 234-B and 234-C a demand of Rs.6,43,100/- was raised.

11 For A. Y. 1997-98 and 1999-2000, at the time of filing Petition, Petitioner had not received any intimation under Section 143(1) of the Act. Whether Petitioner received later is not material at this point of time.

12 In response to the intimation dated 25th January 2002, for A.Y. 2000-01, Petitioner through his Chartered Accountant filed an application for rectification under Section 154 of the Act. The application was disposed by an order dated 29th November 2002, accepting the contention of Petitioner.

13 Subsequently, Petitioner received notices dated 2nd December 2002 for A. Y. 1998-99, 1999-2000 and 2000-2001 and notice dated 5th December 2002 for A. Y. 1997-98, under Section 148 of the Act by which Respondent No.1 stated there were reasons to believe that Petitioner's income for the relevant Assessment Years has escaped assessment and, therefore, it was proposed to re-assess Petitioner's income and Petitioner was called upon to file his return of income. Later, Petitioner received the reasons to believe that income chargeable to tax has escaped assessment for all the Assessment Years. The reasons were identical. It is stated in the reasons that according to Respondent No.1, income has escaped assessment inasmuch as the benefits of the DTAA were wrongly given to Petitioner. Respondent No.1 has noted that the claim was made on the basis of the ruling made by AAR but according to Respondent No.1, ruling was only relevant to A. Y. 1995-96. Respondent No.1 has also noted that the AAR in Petitioner's case has pronounced its ruling on the basis of its earlier ruling in the case of *M. A. Rafik (supra)*, but AAR in its subsequent ruling in the case of *Cyril E. Pereira*[2], after considering

2 [1999]239 ITR 659 (AAR)

and discussing its earlier ruling in the case of *M. A. Rafik (supra)*, came to the conclusion that the benefit of DTAA would not be applicable as the applicant therein was not chargeable to tax in UAE. In view thereof, Respondent No.1 has concluded that the ratio of the subsequent ruling would be applicable in the case of Petitioner and Petitioner would, therefore, not be entitled for the benefits applicable under the provisions of the DTAA. Soon after these notices were received, Petitioner filed this Petition, impugning the notices on various grounds, seeking following reliefs:-

> *"(a) that this Hon'ble Court may be pleased to issue a writ of certiorari or a writ in the nature of certiorari or any other appropriate writ, order or direction under Article 226 of the Constitution of India calling for the records of the Petitioner's case and after examining the legality and validity thereof to quash and set aside impugned notices dated 2.12.2002 and 5.12.2002 being Exhibits "N", "O", "P" and "Q" hereto;*
> *(b) that this Hon'ble Court may be pleased to issue a writ of mandamus or a writ in the nature of mandamus or any other appropriate writ, order or direction under Article 226 of the Constitution of India ordering and directing Respondent No.1 to withdraw forthwith the impugned notices dated 2.12.2002 and 5.12.2002 being Exhibits "N",, "O", "P" and "Q" hereto;*
> *(c) that this Hon'ble Court may be pleased to issue a writ of prohibition or a writ in the nature of prohibition or any other appropriate writ, order or direction under Article 226 of the Constitution of India prohibiting Respondent No.1 from taking any steps in furtherance of the impugned notices dated 2.12.2002 and 5.12.2002 being Exhibits, "N", "O", "P", and "Q" hereto;*
> *(d) pending the hearing and final disposal of the present petition the Respondents be restrained by an order and injunction from taking any further steps in pursuance of the impugned notices dated 2.12.2002 and 5.12.2002 being Exhibits, "N", "O", "P", and "Q" hereto;*

(e) for ad-interim reliefs in terms of prayer (d) above;
(f) for costs of and identical to the present petition;
(g) for such further and other reliefs as the nature and circumstances of the case may require."

14 Rule was issued on 23rd April 2003 and ad-interim relief in terms of prayer clause (d) granted.

15 Mr. Pardiwalla submitted as under:-

(a) prior to the issuance of the notices, the Assessing Officer must have reasons to believe that income chargeable to tax has escaped assessment. The belief must be formed on the basis of certain materials and the material which is relied on must have live link and make rational nexus to the formation. There are no objective material or facts on the basis of which a person properly instructed could have ever formed a belief that income chargeable to tax has escaped assessment.

(b) The expression *"reason to believe"* does not mean a purely subjective satisfaction on the part of the Assessing Officer. The reasons must be held in good faith and cannot be a mere pretence.

(c) Section 245-S of the Act provides that an advance ruling pronounced under Section 245-R of the Act by the AAR shall be binding on the applicant who had sought it in respect of the transactions in relation to which the ruling had been sought and on the Commissioner and the Income Tax Authorities subordinate to him, in respect of the applicant and the said transactions. Sub-section 2 of Section 245-S of the Act provides that such ruling is binding unless there is a change in law or facts on the basis of which the ruling was pronounced. Petitioner had made an

application to the AAR, seeking its ruling on the taxability in India in respect of the transactions Petitioner had entered into, viz: the investments made in the shares of Indian Companies, debentures issued by the entities situate in India and units issued by mutual funds set up in India. The authority had by its ruling dated 30th December 1996 pronounced on the question raised before it and such pronouncement was binding on Respondents. Where there is no change in the facts or law, Respondent No.1 could never ever had any reason to believe that Petitioner's income chargeable to tax has escaped assessment.

(d) Merely because AAR in the case of the another applicant has taken a different view in the matter, cannot be sufficient basis on which Respondent No.1 can ever have reason to believe that income chargeable to tax has escaped assessment.

(e) As held ***Prudential Assurance Co. Ltd., v/s. Director of Income Tax (International Taxation)***[3] *ex-facie* Section 245-S of the Act shows that ruling of the AAR binds the Applicant, Commissioner, Income Tax Authorities and the subordinate to him and shall apply in relation to the transaction in which ruling was sought. The ruling rendered in the another matter cannot bind Petitioner, nor could it displace the binding effect of the ruling rendered in the case of Petitioner. That ruling must continue to operate and be binding between Petitioner and the Revenue. Respondent No.1 has ignored this clear mandate of the statutory provisions.

(f) In the case of *Cyril E. Pereira (supra)* relied upon in the reasons to believe, Mr. Pardiwalla submitted that the Apex Court in the case of

3 (2010) 191 Taxman 62 (Bom.)

Union of India v/s. Azadi Bachao Andolan & Another,[4] has stated that it was not persuaded to follow the view taken by the AAR in *Cyril E. Pereira (supra)* .

The Apex Court in *Azadi Bachao Andolan (supra)* has also held that the expression used in clause 4 of the DTAA was *"liable to taxation therein"* and not *"pays tax"*. The Apex Court has held that liable to tax is legal situation, whereas payment of tax is a fiscal fact. For the purpose of application of Article 4 of the DTAA, what is relevant is the legal situation namely – liability to taxation and not the fiscal fact or actual payment of tax. If these were not so, the DTAA would not have used the words *"liable to taxation"* but would have used some appropriate words like *"pays tax"*. Therefore, a person does not have to be actually paying tax to be *"liable to tax"*, otherwise, a person who had deductible losses or allowances, which reduced the tax bill to zero would find himself unable to enjoy the benefits of the convention. It also seems clear that a person who would otherwise be subject to comprehensive taxing who enjoys a specific exemption from tax is nevertheless liable to tax, if the exemption were repealed, or the person no longer qualified for the exemption, the person would be liable to comprehensive taxation.

Therefore, the notices issued to be quashed and set aside.

16 No reply has been filed by Respondent in the last over 20 years. Mr. Sharma appearing for Respondent did not deny the fact that Petitioner had obtained advance ruling on 30th December 1996 on an application that was made on 9th July 1996 and that as per the ruling, Petitioner was accepted as a resident of UAE. The ruling also determined the tax to be paid by Petitioner.

4 263 ITR 706

17 Mr. Sharma, however, submitted that ruling in Petitioner's case was by relying upon a ruling in the case of *M. A. Rafik (supra)*. Subsequently, the question of taxation and applicability of provisions in the case of individual under the DTAA has been considered by AAR in the case of *Cyril E. Pereira (supra)*. AAR also considered and discussed its own ruling in the case of *M. A. Rafik (supra)* and distinguished the ruling in *M.A. Rafik's* case. In the ruling of *Cyril E. Pereira (supra)*, AAR has held that if the tax law of UAE did not impose any tax liability on the individual concerned, he could not be considered as resident of the contracting state as envisaged in Article 4 of the DTAA. If contracting state does not levy any income tax on individuals or on certain source of income of the individual, that individual will be exposed to the risk of double taxation on the whole of his income or any part derived from the exempt sources. In view of this ratio of *Cyril E. Pereira (supra)*, Petitioner has no scope for invoking DTAA and seeking any benefits under the DTAA.

18 Mr. Sharma submitted that in view of the subsequent ruling in *Cyril E. Pereira (supra)*, there is a change in law. The subsequent ruling of the AAR would be covered under sub-section 2 of Section 245-S of the Act inasmuch as there is a change on the basis of which the advance ruling has been pronounced. In such a situation, ruling obtained earlier is not binding.

19 Therefore, the issue to be answered is :

> " Whether in view of the binding nature of the ruling pronounced under Section 245-R by AAR, which is binding on applicant and revenue in respect of applicant and the said transactions, can the Assessing Officer, relying on ruling in the case of another Applicant where AAR has taken a different view, form a reason to believe that income chargeable to tax has escaped assessment?"

20 As noted earlier, the only basis on which the Assessing Officer has formed a reason to believe that income has escaped assessment is that the benefits of the DTAA were wrongly given to Petitioner because the ruling in the case of the Petitioner by AAR was on the basis of an early ruling in the case of *M. A. Rafik (supra)*. The AAR, however, in the subsequent ruling in the case of *Cyril E. Pereira (supra)* after considering and discussing the ruling in *M. A. Rafik (supra),* came to the conclusion that the benefits of the DTAA would not be available as the Petitioner therein was not chargeable to tax in the UAE. In view thereof, Respondent No.1 concluded that the ratio of the subsequent ruling would be applicable in the case of Petitioner and Petitioner would, therefore, not be entitled to the benefit available under the DTAA.

21 A similar case came up for consideration in *Prudential Assurance Co. Ltd.(supra).* That was a case where Petitioner (herein after referred to as Prudential) was a company incorporated in the UK and engaged in the business of insurance. Prudential was registered as a sub-account of a Foreign Institutional Investor (FII) with the Securities and Exchange Board of India (SEBI). The AAR in the case of Prudential held that the purchase and sale of shares by Prudential was in the ordinary course of its business and the income which resulted from that constituted business profits and not capital gains. One of the issues which the AAR addressed was whether the gains arising from realization of portfolio investments in India,would be treated as part of business profits and would hence be covered by the provisions of Article 7 of the Agreement of Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to taxes entered into between India and UK. On this question, AAR held that gains arising from the realization of the portfolio

investments in India would be treated as part of company's business, amount receivable by Prudential from shares transfer in India would not be taxable in India because Petitioner did not have a Permanent Establishment (PE) in India. Investments in shares were carried out by Prudential from moneys collected from the policy holders for the purpose of generating profits so that it can fulfill its commitments and, hence, it not being a case of capital gains, AAR ruled that the provisions of Article 7 would apply and profits earned from the sale of shares in India would not be liable to tax in India as business income.

After the assessment was made under Section 143 (3) of the Act, the Assessing Officer issued notice under Section 148 of the Act, proposing to re-open the assessment on the ground that the contention of the assessee that *"the income arising in the nature of business income is contrary to the judicial relation in a similar case and that it had been held that the income arising on the share transactions would have to be treated as in the nature of capital gains."* Prudential responded and submitted a note containing its comments on the position of law as to whether income generated in India constituted capital gains or business income. Prudential also relied upon the ruling of the AAR in another matter. After considering the explanation of Prudential, the Assessing Officer accepted the returned income of Petitioner in view of the ruling of the AAR in the case of Prudential. This was for A. Y. 2004-05.

For A.Y. 2005-06, the Assessing Officer as part of the inquiry, called upon Prudential to submit comments on position of law as to whether the income of FIIs in India would be capital gains or business income with reference to the latest judicial decisions. Prudential responded and also annexed a copy of the order passed by AAR in the case of Prudential.

Prudential also submitted an explanatory note on the questions raised. The Assessing Officer once again called upon Prudential to make further disclosures and to explain as to why Prudential should not be considered as having a PE in India and to state as to why the activity involving the sale and purchase of shares should be regarded as trading activity and not as investment. An order of reassessment under Section 143 (3) of the Act for A. Y. 2005-06 was passed after considering Prudential's response.

The dispute that came up before the Court for consideration arose out of a notice issued by the Director of Income Tax (International Taxation), calling upon Prudential to show cause as to why the assessments for A. Y. 2004-05 and 2005-06 should not be set aside under Section 263 of the Act on the ground that they were erroneous and prejudicial to the interest of Revenue. The basis of forming such an opinion was in the ruling in the case of ***Fidelity Northstar Fund*** [5] , (another assessee) it was held that the profits derived on account of purchase and sale of equities and capital gains constitute capital gains and would be chargeable to tax accordingly. It was stated in the notice issued under Section 263 of the Act that it was seen from the Assessment Orders, the profits on account of purchase/sale of equities was held as *"business income"* by the Assessing Officer as per the AARs ruling in Prudential's case but the AAR in another ruling in the case of *Fidelity Northstar Fund (supra)* has held that the profits derived on account of purchase and sale of the equities is *"capital gains"* and chargeable to tax accordingly. The notice also stated that it has been observed by AAR that FIIs were not permitted to trade in equities and in view thereof, the subsequent ruling of AAR is applicable to the facts of Prudential's case. Accordingly, the

5 (2007) 288 ITR 641 (New Delhi)

provisions of Section 245-S (2) of the Act are clearly applicable to Prudential's case for A.Y. 2004-05 and 2005-06 and the profits derived on account of purchase/ sale of shares is chargeable to tax as *"capital gains".*

The Court came to the conclusion after considering the provisions of Section 245-S of the Act and the rules made under Section 245-V regulating the procedure before AAR, once a ruling has been pronounced by AAR, the binding effect of the ruling can only be displaced in accordance with the procedure which has been stipulated in law. In the case of AAR finding that the ruling pronounced by it was obtained by fraud or misrepresentation of facts, the authority – AAR may declare such a ruling to be *void ab-initio*.

The Court also concluded that the basis on which Commissioner invoked the jurisdiction under Section 263 was that in the subsequent ruling, in the case of *Fidelity Northstar Funds (supra)*, AAR held that profits derived on account of the purchase and sale of equities are capital gains and are chargeable to tax accordingly. By doing that, the Commissioner has manifestly exceeded his jurisdiction because the ruling in the case of the *Fidelity Northstar Funds (supra)* would not apply to Prudential. The Court held that Section 245-S of the Act shows that the ruling by the AAR binds the Applicant, Commissioner and the Income Tax Authorities subordinate to him and shall apply in relation to the transaction in which the ruling was sought and, therefore, the ruling rendered in the case of *Fidelity Northstar Fund (supra)* by AAR could not bind Prudential nor can it displace the binding effect of the ruling rendered in the case of Prudential. The Court held that the Commissioner had ignored this clear mandate of the statutory provisions that the ruling would apply and be binding only on the Applicant and the Revenue in

relation to the transaction for which it is sought. The ruling in the *Fidelity Northstar Fund (supra)* cannot, as a matter of plain intendment and meaning of Section 245-S of the Act displace the binding character of the advanced ruling rendered between Prudential and the Revenue unless the binding ruling in the case of Prudential displaced by the requisite procedure under law. Paras 8, 9 and 10 of Prudential (supra) reads as under:-

> *"8:- … … … …*
>
> *Sections 245S stipulates that an advance ruling pronounced by the Authority under section 245R shall be binding only on (a) The Applicant who had sought it; (b) In respect of the transaction in relation to which the ruling had been sought; and (c) On the Commissioner, and the Income-tax authorities subordinate to him, in respect of the applicant and the said transaction. In other words, upon an advance ruling being rendered under section 245R, the ruling binds the applicant, the Commissioner and the authorities subordinate to him and the ruling would apply to the transaction in relation to which it was sought. Sub-section (2) of section 245S postulates that the ruling shall be binding unless there is a change in law or facts on the basis of which the procedure before the Authority. These rules which are called the Authority for Advance Ruling (Procedure) Rules, 1996 inter alia deal with the modification of an order passed by the Authority. Rule 18 provides that where the Authority suo motu or on a representation made to it by the applicant or the Commissioner or otherwise, but before the ruling pronounced by the Authority has been given effect to by the Assessing Officer is satisfied, that there is a change in law or facts on the basis of which the ruling was pronounced, it may be order modify such ruling in such respects as it considers appropriate, after allowing the applicant and the Commissioner a reasonable opportunity of being heard.*

Once a ruling has been pronounced by the Authority, the binding effect of the ruling can only be displaced in accordance with the procedure which has been stipulated in law. At this stage, it would also be necessary to note that under section 245T, where the Authority finds on a representation made to it by the Commissioner or otherwise, that an advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, the Authority may declare such ruling to be void ab initio and thereupon all the provisions of the Act shall apply to the applicant as it such advance ruling had never been made, after excluding the period beginning with the date of such advance ruling and ending with the date on which the order under section 245T has been passed.

9:- The sole basis on which the Commissioner invoked the jurisdiction under Section 263 is that the Authority had in its ruling in the case of Fidelity Northstar Fund (supra) held that the profits derived on account of the purchase and sale of equities are capital gains and are chargeable to tax accordingly. The Commissioner notes that in that ruling the Authority held that FIIs are not permitted to trade in equities. According to the Commissioner, the subsequent ruling of the AAR which clarifies the position on the subject as to the taxability of and the nature of income would be applicable to the facts of the petitioner's case. Hence, it has bee held that the provisions of section 245S(2) are applicable to the case of the petitioner for assessment years 2004-05 and 2005-06 and the profits derived on account of the purchase/sale of shares would be chargeable to tax as capital gains.

There is merit in the submission which has been urged on behalf of the petitioner that the Commissioner has manifestly exceeded his jurisdiction in relying upon the ruling of the AAR in the case of Fidelity Northstar Fund (supra) as a ruling which would apply to the petitioner. Ex facie, section 245S shows that a ruling of the AAR binds the applicant, the Commissioner and the Income-tax Authorities subordinate to him and shall apply in relation

to the transaction in which the ruling was sought. The ruling rendered in the case of Fidelity Northstar Fund (supra) by AAR cannot bind the petitioner nor can it displace the binding effect of the ruling rendered in the case of the petitioners. There is no dispute before this Court that the transaction in respect of which the petitioners sought a ruling and in respect of which the AAR had issued a ruling to the petitioners is of the same nature as that for assessment years 2004-05 and 2005-06. Evidently, the Commissioner has ignored the clear mandate of the statutory provision that a ruling would apply and be binding only on the applicant and the Revenue in relation to the transaction for which it is sought. The ruling in Fidelity cannot possibly, as a matter of the plain intendment and meaning of section 245S displace the binding character of the advance ruling rendered between the Petitioner and the Revenue.

… … … … … … … …

10:- For the aforesaid reasons, we are of the view that on both counts the invocation of the jurisdiction under section 263 was improper. Firstly, the Commissioner has ex facie made a determination contrary to the plain language of section 245S when he holds that the ruling of the AAR in the case of Fidelity Northstar Fund (supra) would apply to the case of the assesee. Unless the binding ruling in the case of the petitioner is displaced by pursuing requisite procedures under the laws, that ruling must continue to operate and be binding between the petitioner and the revenue. Secondly, and in any event, the Commissioner could not have possibly come to the conclusion that the view of the Assessing Officer has followed a binding ruling of the AAR….. …. …. …. … … … …"

22 In our view, the Assessing Officer has manifestly exceeded his jurisdiction while proposing to re-open Petitioner's assessment relying on ruling of AAR in the case of *Cyril E. Pereira (supra)*. The ruling in *Cyril E. Pereira (supra)* while considering the provisions of Section 245-S of the Act cannot bind Petitioner nor can it displace the binding effect of ruling

in Petitioner's case. There was no dispute before the Court that the transaction in respect of which Petitioner sought a ruling and in respect of which AAR had issued ruling to Petitioner is of the same nature as that for the Assessment Years in question. In view of the clear mandate of Section 245-S of the Act that a ruling would apply and be binding only on the Applicant and the Revenue in relation to the transaction for which it so sought, it is clearly evident that the Assessing Officer has ignored this clear mandate. The ruling in *Cyril E. Pereira (supra)* cannot as a matter of plain intendment and meaning of Section 245-S of the Act displace the binding character of the ruling rendered between Petitioner and the Revenue. Section 245-S of the Act states that advance pronouncement binds the authority under Section 245-R of the Act. It was binding on the Applicant who had sought in respect of the transactions in relation to which the ruling had been sought and on the Commissioner and the Income Tax Authority subordinate to him in respect of Applicant and the said transaction. Sub-section 2 of Section 245-S of the Act constitutes that the ruling shall be binding unless there is 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 before us or mentioned in the reasons to believe. The subsequent ruling in *Cyril E. Pereira (supra)* cannot be stated to be covered under sub-section (2) of section 245-S of the Act. It cannot be considered as a ruling that changes the law.

For the reasons mentioned above, the impugned notices have to be quashed and set aside.

23 We still will have to note that in *Azadi Bachao Andolan (supra),* the Apex Court was considering the Double Taxation Avoidance

Agreement between India and Mauritius (Treaty) In that treaty also, Article 4 was *pari materia* to the Indo-UAE DTAA. Article 4 of the Treaty reads as under:-

> *"Article 4: Residents:*
> *1. For the purpose of this Convention, the term "resident of a Contracting State" means any person who under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of similar nature.*
> *… … … … … … … … … …"*

The High Court had held that the Income Tax Officer was entitled to lift the Corporate veil in order to see whether a Company is actually a resident of Mauritius or not, and whether the Company is paying income tax in Mauritius or not. In this regard, the decision in *Cyril E. Pereira (supra)* came to be considered by the Apex Court. While considering the meaning of what is *"is liable to taxation"* mentioned in Article 4 of the Indo- Mauritius DTAA, the Apex Court held that the contention of Respondent therein proceeded on the fallacious premise that liability to taxation 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 of the Treaty, 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 *"liability to taxation"* but would have used the some appropriate words like *"pays tax"*. The Court held that as per wording of the Treaty, it is not possible to accept the contention that offshore companies incorporated and registered under the Mauritius Offshore Business Activities Act, 1992 (MOBA) are not liable to taxation under the Mauritius Income Tax Act; nor is it possible to accept the contention that

such companies would not be *"resident"* in Mauritius within the meaning of Article 3 r/w Article 4 of the Treaty. The Court also relied on a manual on the OECD Model Convention on Income and on Capital, where author points out that the phrase *"liable to tax"* used in the first sentence of Article 4.1 would mean that the person does not have to be actually paying tax to be *"liable to 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 the convention. The Court has also observed that the ruling of the AAR in *M.A. Rafik (supra)* holds that an assessee was entitled to the benefits of the DTAA but the AAR subsequently reversed this position in the case of *Cyril E. Pereira (supra)* and they were not persuaded to accept the view in *Cyril E. Pereira (supra).* The relevant portions in *Azadi Bachao Andolan (supra)* read as under:-

> *" … … … … … … … … …*
> *In our view, the contention of the respondents proceeds on the fallacious premise that liability to taxation is the same as payment of tax. Liability to taxation is a legal situation; payment of tax is a fiscal fact. For the purpose of application of article 4 of the DTAC, what is 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 DTAC would not have used the words, "liable to taxation", but would have used some appropriate words like "pays tax". On the language of the DTAC, it is not possible to accept the contention of the respondents that offshore companies incorporated and registered under the MOBA are not "liable to taxation" under the Mauritius Income Tax; nor is it possible to accept the contention that such companies would not be "resident" in Mauritius within the meaning of article 3 read with article 4 of the DTAC.*
>
> *There is a further reason in support of our view. The expression "liable to taxation" has been adopted from the*

Organization for Economic Co-operation and Development Council (OECD) Model Convention 1977. The OECD commentary on article 4, defining "resident", says : "Conventions for the avoidance of double taxation do not normally concern themselves with the domestic laws of the Contracting States laying down the conditions under which a person is to be treated fiscally as "resident" and, consequently, is fully liable to tax in that State". The expression used is "liable to tax therein", by reason of various factors. This definition has been carried over even in article 4 dealing with "resident" in the OECD Model Convention 1992.

In Manual on the OECD Model Tax Convention on Income and on Capital, at paragraph 4B.05, while commenting on article 4 of the OECD Double Tax Convention, Philip Baker points out that the phrase "liable to tax" used in the first sentence of article 4.1 of the Model Convention has raised a number of issues, and observes:

"It seems clear that a person does not have to be actually paying tax to be "liable to tax" - otherwise a person who had deductible losses or allowances, which reduced his tax bill to zero would find himself unable to enjoy the benefits of the convention. It also seems clear that a person who would otherwise be subject to comprehensive taxing but who enjoys a specific exemption from tax is nevertheless liable to tax, if the exemption were repealed, or the person no longer qualified for the exemption, the person would be liable to comprehensive taxation."

Interestingly, Baker refers to the decision of the Indian Authority for Advance Ruling in Mohsinally Alimohammed Rafik, In re [1995] 213 ITR 317 (AAR). An assessee who resided in Dubai claimed the benefits of the UAE – India Convention of April 29, 1992, even though there was no personal income tax in Dubai to which he might be liable. The Authority concluded that he was entitled to the benefits of the convention. The Authority subsequently reversed this position in the case of "Cyril Pereira", In re [1999] 239 ITR 650 (AAR) where a contrary view was taken.

The respondents placed great reliance on the decision by the Authority for Advance Rulings constituted under section 245-O of the Income-tax Act, 1961, in Cyril Eugene Pereira's case [1999] 239 ITR 650 (AAR). Section 245S of t he Act provides that the Advance Ruling pronounced by the authority under section 245R shall be binding only:

(a) on the applicant who had sought it;
(b) in respect of the transaction in relation to which the ruling had been sought; and
(c) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction."

It is, therefore, obvious that, apart from whatever its persuasive value, it would be of no help to us. Having perused the order of the Advance Rulings Authority, we regret that we are not persuaded.

There is substance in the contention of Mr. Salve learned counsel for one of the appellants, that the expression "resident" is employed in the DTAC as a term of limitation, for otherwise a person who may not be "liable to tax" in a Contracting State by reason of domicile, residence, place of management or any other criterion of a similar nature may also claim the benefit of the DTAC. Since the purpose of the DTAC is to eliminate double taxation, the treaty takes into account only persons who are "liable to taxation" in the Contracting States. Consequently, the benefits thereunder are not available to persons who are not liable to taxation and the words "liable to taxation" are intended to act as words of limitation.

… … … … …

It is, therefore, not possible for us to accept the contentions so strenuously urged on behalf of the respondents that avoidance of double taxation can arise only when tax is actually paid in one of the Contracting States."

24 The Apex Court concluded that it was not possible to accept that Avoidance of Double Taxation can arise only when tax is actually paid

in one of the contracting states. Therefore, the view taken in *Cyril E. Pereira (supra)* is an erroneous view.

25 In our view, merely because the AAR in the case of another Applicant has taken a different view, cannot be sufficient basis on which Respondent No.1 could ever have any reason to believe that income chargeable to tax has escaped assessment.

26 Moreover, we also note that Respondent No.1 has in the reason to believe merely sets out the relevant facts and thereafter sought directions from Respondent No.2 to re-open the assessment. In concluding paragraph, the reasons to believe reads as under:-

> *"In the light of the fact that the assessee has obtained Advance ruling for A. Y. 1995-96, A. Y. 1996-97 you are likely kindly requested to give directions to reopen the assessment for the above assessment years u/s. 147 of the I. T. Act 1961. Kindly accord Section 151 of the Act."*

Therefore, it can also be stated that Respondent No.1 has not personally formed the belief that income liable to tax has escaped assessment and has abdicated her jurisdiction. The re-opening therefore is invalid.

27 Respondent No.2 has plainly ignored the relevant provisions of law. We cannot hold that the Assessing Officer had any tangible material to come to the conclusion that there was an escapement of income. Hence, the power to re-open the assessment could not have been exercised.

28 Further, it is also averred in the Petition that in so far as notices for A.Y. 1998-99, 1999-200 and 2000-01, the notices are dated 2nd

December 2002 whilst the endorsement on the reasons diverting issuance of the notice is on 5th December 2002. There is no denial by Respondents. Therefore, on the ground also these 3 notices have to be held as illegal and struck down.

29 Rule is accordingly made absolute by quashing and setting aside the impugned notices dated 2nd December 2002 and 5th December 2022.

30 In the circumstances of the case, there shall be no order as to costs.

(FIRDOSH P. POONIWALLA,J.) **(K. R. SHRIRAM,J.)**