IN THE HIGH COURT OF JUDICATURE AT BOMBAY

O. O. C. J.

WRIT PETITION (LODG.) NO.799 OF 2010

Mckinsey & Company Inc.
Indian Operations / Branches
('Mckinsey India')
India Branch Office,
21st floor, Express Towers,
Nariman Point, Mumbai 21. ..Petitioner.

Vs.

1. Union of India,
   Ministry of Finance,
   Government of India,
   New Delhi 110 001.

2. Deputy Director of Income Tax,
   (International Taxation)-4(1),
   133, Scindia House, 1st floor,
   Ballard Pier, N.M. Road,
   Mumbai 400 038.

3. Director of Income Tax
   (International Taxation),
   Scindia House, N.M. Road,
   Mumbai 400 038. ..Respondents.

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Mr. Porus Kaka with Mr. Dinesh Chawla and Ms Anushka Sharda i/b DSK Legal for the Petitioner.

Mr. Suresh Kumar for the Respondents.

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CORAM : DR. D.Y.CHANDRACHUD &
J.P. DEVADHAR, JJ.

13th April, 2010.

ORAL JUDGMENT (Per. DR.D.Y.CHANDRACHUD, J.):

1. Rule, made returnable forthwith. By consent of the learned counsel, taken up for hearing and final disposal.

2. The Petitioner is a non-resident company incorporated under the laws of the United States of America. The Petitioner operates in India with branches at New Delhi and Mumbai. According to the Petitioner it has received all the requisite approvals from the Government of India and the Reserve Bank. The Petitioner is engaged in the business of providing consultancy on strategic planning and related activities. The Petitioner has filed returns in India from Assessment Year 1993-94. On 8 January 2010 the Petitioner made an application under Section 195(3) of the Income Tax Act, 1961 for Assessment Year 2011-12 to the Second Respondent – the Deputy

Director of Income Tax, International Taxation – 4(1) – seeking a nil withholding certificate for payments received for services rendered to clients/ customers, group entities and for interest received on deposits made with banks. The Petitioner has received certificates under Section 195(3) for Assessment Year 1998-99 to Assessment Year 2010-11. During the course of the proceedings the Petitioner was called upon to furnish details, by a letter dated 27 January 2010. The Petitioner filed its response on 3 February 2010. On 24 March 2010 the Petitioner was called upon to show cause as to why its application for a nil withholding certificate under Section 195(3) should not be rejected. The Petitioner filed its response on 25 March 2010. By an order dated 29 March 2010, the Second Respondent has rejected the application of the Petitioner for the grant of a nil withholding certificate for Assessment Year 2011-12.

3. The impugned order rejecting the application of the Petitioner for the grant of a certificate under Section 195(3) contains in paragraph 3 the following reasons for declining the request :

> "In this connection, in your case, it is seen that for A.Yr. 2006-2007, the draft assessment order is completed and a demand has been raised to the tune of Rs.44,98,82,376/- (though the matter is pending before the DRP). In the past also for A.Y. 2005-2006, the gross demand raised was Rs. 26,23,47,269/- and after payments till 31.3.2009, the net balance outstanding demand is Rs.9,33,24,646/-, which is under MAP proceedings. This indicates that in the past you did not pay proper advance tax, therefore, your case needs to be examined with reference to Rule 29B especially the sub rule 4 laying down the condition regarding prejudicial to the interest of revenue. The TDS will ensure the nature of receipts and also be clear from the TDS certificates that all the receipts are accounted for by you and no demand will be outstanding in your case."

4. Counsel appearing on behalf of the Petitioner submitted that the impugned order is, ex facie, contrary to law. The submission before the Court is that (i) The order declining a certificate under Section 195(3) is contrary to the statutory provision since the Petitioner has complied with all the conditions requisite to the grant of a certificate under Rule 29-B; (ii) A certificate has been issued to the Petitioner consistently for the last twelve Assessment Years under Section 195(3) and there is no justification in law for the denial of a certificate for Assessment Year 2011-12; (iii) The denial of a

certificate in substance violates the provisions of the direct tax treaty between India and the U.S. since the effect of the impugned order is the imposition of a withholding tax with respect to matters which are pending at the Mutual Agreement Procedure (MAP) Level; (iv) The reasons which have been set out in the impugned order are, ex facie, perverse; (v) The Assessing Officer has relied upon a draft assessment order which has been passed for Assessment Year 2006-07. The order being a draft order, no demand could be raised on the basis of the order; (vi) The Assessing Officer has also relied upon an assessment order for Assessment Year 2005-06 which is also subject to a Mutual Agreement Procedure (MAP) initiated by the Petitioner; (vii) The nature of the receipts to which the Assessing Officer has made a reference has been duly considered both at the inter governmental level and in an order of the Assessing Officer. On these grounds, the exercise of jurisdiction by the Second Respondent to deny a certificate under Section 195(3) has been called into question.

5. An affidavit in reply has been filed by the Second

Respondent. Counsel appearing on behalf of the Revenue has supported the order of the Second Respondent and has made a reference to the reply which has been filed in response to the Petition.

6. Section 195(1) of the Income Tax Act, 1961 provides that any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest or any other sum chargeable under the provisions of the Act, other than income under the head of salaries, shall at the time of credit of such income to the account of the payee or at the time of payment, deduct income tax thereon at the rates in force. Sub section (3) provides that subject to the rules which are made under sub section (5) a person entitled to received a sum on which income tax has to be deducted under sub section (1) may make an application to the Assessing Officer for the grant of a certificate authorizing him to receive such sum without deduction of tax. Where any such certificate is granted, every person responsible for paying such sum to the person to whom the certificate is granted shall, so long as the certificate remains in force, make

payment of such sum without deducting tax thereon under sub section (1). A certificate under sub section (3) is liable to remain in force till the expiry of the period specified therein or, in the event that it is cancelled prior to that date, till the cancellation. Under sub section (5) the Central Board of Direct Taxes is empowered to make rules specifying the cases in which and the circumstances under which an application may be made for the grant of a certificate under sub section (3) and the conditions subject to which a certificate may be granted.

7. In exercise of the rule making power, Rule 29-B has been framed. Under sub rule (1) of Rule 29-B a person entitled to receive interest or any other sum on which income tax has to be deducted under Section 195(1) is permitted to make an application for the grant of a certificate under sub section (3) of Section 195 if he fulfills the conditions specified in sub rule (2), authorizing him to receive without deduction of tax such income as is referred to therein. A person who carries on business or profession in India through a

branch is permitted to make an application for the grant of a certificate under sub section (3) of Section 195 in respect of income received not being interest or dividends. Sub rule (2) of Rule 29-B stipulates the conditions which are required to be fulfilled before a certificate can be granted. Sub rule (2) is to the following effect :

> "(2) The conditions referred to in sub-rule (1) are the following, namely :-
>
> (i) the person concerned has been regularly assessed to income-tax in India and has furnished the returns of income for all assessment years for which such returns became due on or before the date on which the application under sub-rule (1) is made;
>
> (ii) he is not in default or deemed to be in default in respect of any tax (including advance tax and tax payable under section 140A), interest, penalty, fine or any other sum payable under the Act;
>
> (iii) he has not been subjected to penalty under clause (iii) of sub-section (1) of section 27;
>
> (iv) where the person concerned is not a banking company referred to in clause (i) of sub-rule (1) -
>
> (a) he has been carrying on business or profession in India continuously for a period of not less than five years immediately preceding the date of the application, and
>
> (b) the value of the fixed assets in India of such

> business or profession as shown in his books for the previous year which ended immediately before the date of the application or, where the accounts in respect of such previous year have not been made up before the said date, the previous year immediately preceding that year, exceeds fifty lakhs of rupees."

8. Under sub rule (4) the Assessing Officer is vested with the discretion to give a certificate authorizing the person concerned to receive the income without deduction of tax under Section 195(1) if he is satisfied that all the conditions laid down in sub rule (2) are fulfilled and the issuance of a certificate will not be prejudicial to the interests of the Revenue.

9. The conditions which have been spelt out in sub rule (2) of Rule 29-B are that (i) The person concerned must be regularly assessed to income tax in India and ought to have furnished returns of income for Assessment Years for which the returns became due prior to the date on which an application under sub rule (1) is made; (ii) There should be no default or deemed default in respect of any tax, interest, penalty, fine or sum payable under the Act; (iii) No

penalty ought to have been imposed under Section 271(1)(iii) and (iv) Where the person is not a banking company, he ought to be carrying on business or profession in India continuously for atleast five years prior to the date of the application and the value of the fixed assets must be in excess of Rs.50 lacs for the previous year ending immediately prior to the date of the application.

10. Now it has not been disputed before the Court that the Petitioner has been regularly assessed to income tax in India and has furnished its returns of income for all the Assessment Years in question. The fact that the Petitioner has not been subjected to a penalty under Section 271(1)(iii); that the Petitioner carries on business for a period in excess of five years in India and that the value of its fixed assets is in excess of the threshold prescribed is not in dispute. The impugned order that was passed by the Second Respondent relies essentially on two circumstances for the denial of a certificate under Section 195(3). The first circumstance is that for Assessment Year 2006-07 a draft assessment order was completed

and a demand has been raised in the amount of Rs.44.98 lacs. Ex facie, the order itself makes it clear that what has been issued is a draft assessment order and that the matter in question is pending before the Dispute Resolution Procedure.

11. The second circumstance to which a reference has been made is that for Assessment Year 2005-06 a gross demand of Rs. 26.23 Crores was raised and after accounting for payments which were made until 31 March, 2009, the net balance outstanding was Rs. 9.33 Crores which is under the Mutual Agreement Procedure (MAP). In order to consider as to whether there is any basis or tenability in the second ground which has been set out in support of the order, a reference to the relevant provisions of the Memorandum of Understanding that was arrived at between the Government of India and the U.S. on 25 September, 2002 would be in order. Before referring to the Memorandum of Understanding it would be necessary to note that Section 90 of the Act inter alia empowers the Central Government to enter into an agreement with the Government of any

country outside India for the grant of relief in respect of income on which have been paid both income tax under the Act and income tax in that country, as the case may be, or income tax chargeable under the Act and under the corresponding law in force in that country, in order to promote mutual economic relations, trade and investment. The MOU which was entered into between the Government of India and the U.S. on 25 September 2002 is in pursuance of the Convention for the Avoidance of Double Taxation. The object of the MOU is to ensure the efficient processing of the Mutual Agreement Procedure (MAP) cases, which is to be facilitated by deferring assessment or by suspending collection of any amount of tax including related interest or penalties for taxable years which form the subject matter of MAP proceedings. Recital B to the MOU inter alia stipulates that the competent authorities have arranged and desired to agree with regard to amounts of tax covered under Article 2 of the Convention and potentially payable to the Government of India, that "the Assessing Officer will suspend collection until putting into effect a mutually agreed disposition on the MAP proceedings concerning the amounts

in question". The MOU provides that the tax authorities in the two countries would retain the right to demand security in order to avoid prejudice to the interest of their respective governments. Under clause (2) in India as security, a tax payer is required to provide an irrevocable bank guarantee of a scheduled bank to secure the claim of the Revenue pending the disposition of the MAP. Under Clause (6) of the MOU the taxes identified inter alia in recitals are to include but are not limited to tax demands and withholding tax. This Court has been informed during the course of the hearing that in respect of Assessment Year 2005-06 the Petitioner has invoked the Mutual Agreement Procedure and in pursuance of the provisions of the MOU a bank guarantee in the amount of Rs.15.67 Crores has been furnished. A copy of the bank guarantee is annexed to the proceedings in the petition.

12. There is merit in the submission which has been urged on behalf of the Petitioner that the order which has been passed by the Assessing Officer in the present case discloses a complete non

application of mind to the provisions of the inter governmental MOU dated 25 September 2002 and the governing principles stipulated in Rule 29-B. The Petitioner having invoked the Mutual Agreement Procedure (MAP), the consequence under the MOU between the Government of India and the Government of the U.S. is a suspension of the collection of tax demands and withholding taxes on income. The Petitioner invoked the provisions of Article 27 of the U.S. India Tax Treaty for Assessment Year 2005-06 by a communication dated 24 February, 2009. In a response dated 20 March, 2009 the Internal Revenue Service in the Department of Treasury of the U.S. Government acknowledged receipt of the application for competent authority assistance and stated that the Government of India was being requested to intervene to suspend collection actions on such portion until the proceeding was completed. The Petitioner was granted certificates under Section 195(3) both before and after the assessment order was passed for Assessment Year 2005-06. The Assessing Officer has declined to grant a certificate under Section 195(3) on the ground that the balance outstanding for Assessment

Year 2005-06 is Rs.9.33 Crores. The Assessing Officer has acknowledged the pendency of MAP proceedings. The basis on which a certificate under Section 195(3) was declined is, ex facie, contrary to law and amounts to a patent disregard of the binding provisions of the MOU between the Governments of India and the U.S.

13. Counsel appearing on behalf of the Petitioner has also urged before the Court that the effort of the Assessing Officer to refer to the nature of the receipts is misconceived since this has been dealt with in the assessment order passed for Assessment Year 2003 on 24 March 2006 by the Assessing Officer. The assessment order, in paragraph 2.1, records that the competent authorities of India and the U.S. have concluded by mutual agreement, on the application filed by the assessee that the income of the assessee from its Indian operations should be computed on net income basis in India. The Assessing Officer has also made a reference to the fact that the conclusion of the competent authorities and the terms of the settlement have been documented by a letter dated 16 December

2005 issued by the Government of India in the Ministry of Finance, Department of Revenue. The assessee received a letter dated 24 January 2006 from the Department of Treasury, Internal Revenue Service, Washington D.C. a copy of which was stated to be filed before the Assessing Officer on 16 February 2006. We need not delve any further into this aspect of the matter.

14. We have indicated the circumstances on the basis of which this Court has arrived at the conclusion that the basis on which a certificate has been declined to the Petitioner under Section 195(3) is manifestly misconceived. The impugned order ignores relevant provisions of law, more particularly of Rule 29-B, does not take into account the legal implications out of the MOU dated 25 September 2002 between the Government of U.S. and the Government of India and disregards issues which were settled in the past as a result of the Mutual Agreement Procedure between the two governments.

15. Counsel appearing on behalf of the Revenue has relied

upon an order passed by this Court in **Maharashtra State Electricity Distribution Company Limited v. Commissioner of Income Tax** (Writ Petition 256 of 2009 decided by a Division Bench on 27 April, 2009). The order of the Division Bench records that the alternative remedy that was available in that case was a statutory appeal under Section 246(1) and it was in that circumstance that this Court considered it appropriate not to exercise the extra ordinary writ jurisdiction. No statutory appeal is available against the order that is impugned in the present case. That apart, the exhaustion of alternative remedies is a matter of judicial discretion. In a case such as the present, the record before the Court clearly discloses that the denial of a certificate under Section 195(3) is without considering the relevant provisions of law and has been based on considerations which are extraneous to a lawful exercise of power.

16. Counsel appearing on behalf of the Petitioner urged that in these circumstances it would be appropriate and proper for this Court to direct the grant of a certificate under Section 195(3).

Having heard counsel appearing on behalf of the assessee and counsel appearing on behalf of the Revenue, we are of the view that the appropriate course of action for this Court would be to quash and set aside the impugned order declining the grant of a certificate and to direct the Assessing Officer to pass a fresh order in accordance with law after furnishing an opportunity of being heard to the Petitioner. The Court has been apprised of the fact that the denial of a certificate under Section 195(3), despite the grant of such a certificate for nearly twelve years in the immediate past would have serious ramifications to the business operations of the Petitioner. The earlier certificate that was granted to the Petitioner for Assessment Year 2010-11 on 13 March 2009 has come to an end on 31 March 2010. Having regard to this circumstance, we direct that the Assessing Officer shall pass fresh orders within a period of one week from today. The Court has been informed by counsel appearing on behalf of the Revenue that the Assessing Officer holding regular charge is on medical leave until the middle of May 2010 and that charge of the office is being held by another officer. We clarify that the order which is to be passed in

compliance with the directions issued by this Court may be passed by the officer holding charge in the matter.

17. Rule is accordingly made absolute in the aforesaid terms and in terms of the directions set out earlier. The impugned order dated 29 March 2010 is quashed and set aside.

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

(Dr. D.Y.Chandrachud, J.)

(J.P. Devadhar, J.)