news flash

August 2012

TWO RECENT RULINGS

SUPREME COURT - CHALLENGING AAR RULINGS

Columbia Sportswear Company Vs. Director of Income Tax, Bangalore[1]

The Supreme Court of India has delivered an important judgment which interalia deals with the issue of challenging the decisions of the Authority of Advance Rulings ("**AAR**") by way of writ petitions/Special Leave Petitions ("**SLP**").

The AAR was introduced by way of inclusion of section 245S of the Income Tax Act ("**the Act**") by the Finance Act, 1993 for the purposes of providing certainty of decision to the specified categories of tax payers and to help them ascertain their tax liability with respect to certain types of transactions. Section 245S of the Act provides that a ruling of the AAR is binding on the applicant as well as the income tax authorities for a particular transaction in respect of which the AAR ruling is sought. On a strict interpretation of this section, no appeal should lie to any higher appellate authority and the ruling should be treated final.

However, it cannot be denied that a school of thought believed that at least one level of appeal is necessary against an AAR ruling so that any patent infirmities in the decisions can be addressed. This thought further gained momentum when many rulings of the AAR were being challenged with taxpayers filing writ petitions and SLPs before the High Courts and Supreme Court respectively on grounds of irreparable loss and injury resulting from an infringement of their rights under the provisions of the Indian Constitution[2]. This resulted in further uncertainty with respect to whether a ruling of the AAR can be challenged and if yes, the appropriate forum to challenge a ruling of the AAR.

The above stated uncertainty has been brought to a rest with the recent decision of Supreme Court in the case of *Columbia Sportswear Company Vs. Director of Income Tax, Bangalore* ("**the Case**"), wherein the apex court has held that–

[1] Special Leave Petition (C) No. 31543 of 2011
[2] Societe Generale Vs. CIT [251 ITR 657 SC]; DIT International Taxation Mumbai Vs M/S Morgan Stanley & Co Inc. [2007-TII-01-SC-TP]; UAE Exchange Centre Ltd. v. UOI, 2009-TIOL-84-HC-DEL-IT

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1. An AAR is a tribunal within the meaning of the expression in Articles 136 and 227 of the Indian Constitution;
2. Section 245S of the Act does not bar the jurisdiction of the Supreme Court under Article 136 or the jurisdiction of the High Court under Articles 226 and 227 of the Indian Constitution to entertain a challenge to the advance ruling of the AAR;
3. To hold that an advance ruling of an AAR should not be permitted to be challenged before the High Court under Articles 226 and 227 of the Indian Constitution would be to negate the basic structure of the Constitution;
4. The power of the Supreme Court to entertain a SLP under Article 136 of the Indian Constitution is discretionary in nature and hence, even if good grounds are made out in the SLP for challenge to an advance ruling given by an AAR, the apex court may still refuse to grant special leave on the ground that the challenge to the advance ruling of the AAR can also be made to the High Court under Article 226 and/or Article 227 of the Indian Constitution.
5. It does not encourage an aggrieved party to appeal directly to the Supreme Court against the order of the tribunal exercising judicial functions unless it appears to the court that a question of great importance arises.

As can be seen from the above, the apex court through its decision in the Case has clarified the uncertainty in the procedural laws by clearly stating that the ruling of an AAR can be challenged before a High Court by filing a writ petition under Articles 226/227 of the Constitution. Further, that an SLP challenging a ruling of an AAR will be considered for admission in the Supreme Court only if it involves a question of principle of great importance or a similar question is already pending before the Supreme Court.

While on one hand this decision seems to have settled a controversial issue, on the other hand it appears to have defeated one of the primary reasons for the establishment of the AAR in the very first place (i.e. the certainty of its decision) by reducing the AAR to the level of the Income Tax Appellate Tribunals. This may therefore lead to more protracted litigation.

INCOME TAX APPELLATE TRIBUNAL - SCOPE OF FEES FOR TECHNICAL SERVICES CLARIFIED

TUV Bayren (India) Ltd Vs Deputy Commissioner of Income Tax Circle-2(1), Mumbai[3]

The Mumbai Income Tax Appellate Tribunal ("**ITAT**") in its recent decision in the case of *TUV Bayren (India) Ltd Vs Deputy Commissioner Of Income Tax Circle-2(1), Mumbai* ("**TUV Bayren Case**") has held that the audit services and activities carried out by the assessee comes within the realm of 'professional services' and not within the meaning of 'Fees for Technical Services' ("**FTS**") as provided in Article 12(4) of the India –Germany Double Tax Avoidance Agreement ("**India-Germany Tax Treaty**") and Section 9(1)(vii) of the Act.

FTS under the provisions of the Act has been defined to mean any consideration (including any lump sum consideration) for the rendering of any *managerial, technical or consultancy services* (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

In the present case, the issue was whether the services of audit in relation to issuance of ISO 9000 certification will fall within the scope of FTS. The ITAT explaining the meaning of the three components of FTS namely, technical, managerial and consultancy services has defined the scope of the services as follows–

- Technical services require expertise in technology and providing the client such technical expertise.
- A managerial service is used in the context of running and management of the business of the client.
- Consultancy is to be understood as advisory services wherein necessary advise and consultation is given to its clients for the purpose of client's business.

Based on the above, the Hon'ble Tribunal has held that the entire nature of services and activities carried out by the assessee comes within the realm of 'professional services' and that the assessee's income is to be computed in view of the Article 7(1) of the India-Germany Tax Treaty and resultantly as per sections 28 to 43 of the Act.

Thus the ITAT has narrowed down the scope of services to be covered under FTS. It has been clarified by ITAT that professional services cannot be treated as consultancy services and hence do not fall under the purview of FTS. Accordingly, this decision of the ITAT has provided tax relief to a large group of professionals. However, it may be noted that the aforesaid decision is

[3] 2012-TII-105-ITAT-Mum-Intl

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only a Mumbai ITAT judgment and therefore only binding on authorities below the ITAT in Mumbai.

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