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Madras High Court dismisses writ petitions challenging the validity of section 94A of the Income-tax Act, 1961, Notification no. 86/2013 and Press Release issued by CBDT dated November 1, 2013 notifying Cyprus as non-cooperative jurisdiction

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# Synopsis

The Hon'ble Madras High Court ('HC') in the case of T. Rajkumar & others v. Union of India<sup>1</sup>, dismissed the writ petitions challenging the validity of section 94A of the Income-tax Act, 1961 ("the Act"), Notification no. 86/ 2013 and Press Release issued by the Central Board of Direct Taxes dated November 1, 2013, notifying Cyprus as a non-cooperative jurisdiction; the HC holds that '*section 94A of the Act was the need of the hour*'.

## Facts

- A Tripartite Agreement ('agreement') dated October 16, 2014 was entered into by and between (i) an Indian Company by name New Kovai Real Estate Private Limited, (ii) a company incorporated in Cyprus by name Skyngelor Limited and (iii) the petitioners.
- By the said agreement, the Cyprus Company which was holding equity shares and compulsorily convertible debentures in Kovai Real Estate Private Limited agreed to sell all the shares and debentures to the petitioners. Under clause 3 of the agreement, the payment of the purchase consideration was agreed to be done in 4 tranches.
- After three months of the execution of the agreement, the petitioners received independent but identical show cause notices dated January 29, 2015, inviting their attention to section 94A(1) of the Act and Notification No. 86/2013 dated November 1, 2013, and calling upon them to show cause as to why each one of them should not be treated as an assessee in default for non-withholding of tax at the highest rate, warranting the initiation of proceedings under section 201(1)/201(1A) of the Act.
- In response to the show cause notices, the petitioners appeared before the assessing officer and filed written submissions. The main contention of the petitioners, before the assessing officer, was that they would have had an obligation to deduct tax at source, only if the payments were chargeable to tax under section 195 of the Act. The petitioners

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<sup>1</sup> WP no. 17241 to 17243 & 17407 to 17412 of 2015, judgement delivered on April 12, 2016

claimed that they had in fact purchased the securities at a rate below their face value and that the Cyprus Company had suffered a loss.

- However, the assessing officer passed orders under section 201(1)/201(1A) of the Act, directing the petitioners to pay tax and interest, as determined. A notice of demand under section 156 was also issued.
- The petitioners immediately filed appeals under section 246A of the Act before the Commissioner of Income Tax (Appeals). Simultaneously, the petitioners also filed writ petitions challenging the validity of section 94A(1) of the Act and related notification and press release.

## Contentions of Petitioners

- Section 94A(1) of the Act has conferred sweeping powers upon the Central Government to specify any country as a notified jurisdictional area in relation to transactions entered into by any assessee, irrespective of whether such country is one, with whom a bilateral tax treaty (“Treaty”) has already been entered into or not.
- The Treaty entered into by the Government is virtually a law under Article 253 of The Constitution and hence, neither the Parliament can make any law that would go contrary to the Treaty nor can the Government take any executive action to annul the effect of the Treaty so long as the Treaty is in force.
- It was also contended that that the power of the Parliament to make laws conferred under Article 245(1), is made subject the provisions of The Constitution and hence, the said power is subordinate to Article 253, which confers power upon the Parliament to make laws for implementing any Treaty, Agreement or Convention with any other country.
- It was further contended that once India has entered into a Treaty with another country and such Treaty has also been notified under section 90 of the Act, the Treaty becomes a law under Article 253. Therefore, the Parliament is not competent to enact any law by invoking Article 245(1), as the power under Article 245(1) is subordinate to the power under Article 253.

- Placing reliance upon the decision of the Supreme Court in *Union of India Vs. Azadi Bachao Andolan*<sup>2</sup>, the petitioners contended that section 90 of the Act is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Treaty and the provisions of such an Agreement would operate, even if inconsistent with the provisions of the Act.
- It was further contended that since India has entered into a Treaty with the Republic of Cyprus and also since the same includes a provision for exchange of information and the Treaty is also notified under section 90 of the Act, the power conferred upon the Central Government by section 94A(1) of the Act to specify any country as a notified jurisdictional area, is unconstitutional and also suffers from the vice of excessive delegation.
- It was also contended that section 94A(1) of the Act does not contain a non-obstante clause, the same should be read in such a manner as to understand the power conferred thereunder, as one excluding those countries with which the Central Government had entered into an Agreement under section 90(1) of the Act.
- Further, it was contended that since India Cyprus Treaty has Mutual Agreement Procedure clause, the Government could not have taken recourse to section 94A(1) of the Act.

## Ruling of Madras HC

- The HC held that section 90 of the Act, does not say either expressly or by necessary implication that the law made by Parliament would stand eclipsed or excluded, to the extent it is inconsistent with the terms of the Treaty.
- The HC observed, based on the various decisions of the Supreme Court, that Indian Constitution follows dualistic doctrine with respect to international law (i.e. rule of international law apply within a State only as a result of their adoption by the local law of the State), and hence, it must be taken that an international Treaty can be enforced only so long as it is not in conflict with the municipal laws of the State.
- The HC held that section 90(1) of the Act, which empowers the Central Government to enter into a Treaty with the Government of a foreign country and section 94A of the Act, which empowers the Central Government to specify any country as a notified jurisdictional area, deal with the delegation of powers. While section 90(1) of the Act deals with the

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<sup>2</sup> [2004 (10) SCC 1]

delegation of power to enter into a Treaty, section 94A(1) of the Act deals with the delegation of power to specify a country as a notified jurisdictional area. Therefore, even if a conflict is imagined to be in existence, it is not between a Treaty on the one hand and a Municipal Law on the other hand, and it could, at the most, be a conflict between the manner in which, the delegated power conferred under one provision is exercised and a similar power under another provision is exercised.

- The HC further held that it is impossible to think that the supremacy of the Parliament could be compromised by the Executive entering into a Treaty. The very fact that Article 253 confers power upon the Parliament to make any law for implementing any treaty, coupled with the fact that section 90(1) of the Act enables the Central Government to enter into a Treaty, would show that the Parliament is supreme.
- The Supreme Court in earlier decisions in *Azadi Bachao Andolan* (supra) and in *P.V.A.L. Kulandagan Chettiar*<sup>3</sup> had held that the provisions of sections 4 and 5 of the Act are subject to the provisions of Treaty, and that if a tax liability is imposed by the Act, the Treaty may be resorted to either for reducing the tax liability or for altogether avoiding the liability. Noting this, the HC concluded that no question arose directly either in these cases as to whether or not the Parliament has the power to make a law in respect of a matter covered by a Treaty. Accordingly, the HC held that the observations found in these two decisions, to the effect that the provisions of the Treaty will have effect even if they are in conflict with the provisions of the statute cannot be stretched too far to conclude that the Parliament does not have the power to make a law in respect of a matter covered by a Treaty.
- The HC further observed that the Constitution imposes only two limitations upon the power of the Parliament to make a law. They are (i) that such a law cannot infringe any of the Fundamental Rights or erode the basic structure of the Constitution and (ii) that it must be within its legislative competence. To say that there is one more limitation on the power of the Parliament, in the form of a treaty entered into by the Executive, is to recognize a limitation not imposed by the Constitution.
- The HC also rejected the argument of the petitioners relying on Article 26 of the Vienna Convention that the principle of "Pacta Sunt Servanda" would be applicable, i.e. every Treaty in force is binding upon the parties to it and must be performed in good faith and a party may not invoke the provisions of its internal law as a justification for its failure to perform a Treaty. The HC observed that this Article obliges both the contracting parties to

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<sup>3</sup> [2004 (6) SCC 235]

perform their obligations in good faith and if one of the parties to the Treaty fails to provide necessary information, then such a party is in breach of the obligation under Article 26 of the Vienna Convention (Cyprus in the instant case).

- The HC observed that if the purpose of the Central Government entering into a Treaty under section 90(1) of the Act is defeated by the lack of effective exchange of information, then section 90(1)(c) of the Act is actually diluted by one of the contracting parties and not by section 94A(1) of the Act.
- The HC also quoted from G20 leaders' April 2009 statement wherein it was resolved to take action against non-cooperative jurisdictions, including "tax havens". The HC also appreciated that many countries have become guarded in their approach towards Treaty. It was further pointed out before the HC that Spain and Russia had also similarly blacklisted Cyprus, which was subsequently withdrawn once Cyprus started cooperating for exchange of information.
- Relying further on the Explanatory Notes to the provisions of the Finance Act, 2011 (in relation to section 94A of the Act), the HC held that there is no merit in challenging the constitutional validity of section 94A(1) of the Act.
- In relation to India Cyprus Treaty, the HC held that Mutual Agreement Procedure clause in the treaty cannot oust Parliament's jurisdiction to enact a law and the Executive to issue a notification in exercise of the powers conferred by such a law. Further, the HC held that the clause does not deal with the failure of one of the contracting parties to honour its commitment under the Treaty.
- With regard to challenge to the notification being ultra vires to section 94A(1) of the Act, the HC held that the provision of section 94A(1) of the Act empowers the Central Government to specify by notification in the official gazette, any country or territory outside India, as a notified jurisdictional area, in relation to transactions entered into by any assessee. The HC confirmed that this exercise may be done, by the Central Government, having regard to the lack of effective exchange of information with such a country or territory outside India. The HC also held that they cannot read the words "other than those covered by section 90(1)" in section 94A(1) of the Act without express mention.
- The HC also rejected petitioners argument that use of the words "any payment " in the Government's Press Release runs contrary to the expressions "any sum", "income" and "amount" used in section 94A(5) of the Act stating that if spoken from the point of view of the recipient of an amount, the word "payment" would be normally be used. The HC held that press release is not a legal document, but a note intended for the benefit of the

common man. Therefore, the words and expressions used therein cannot be tested on the strength of Law Lexicons.

- Thus, the HC, dismissed the writ petitions and upheld the validity of section 94A(1) of the Act, and related notification and press release.

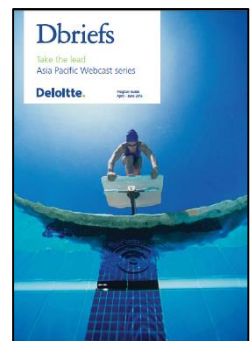
## Comments

While there have been tax cases earlier which have held that the Parliament cannot amend the Treaty provisions unilaterally, the Madras HC in this case has held that Parliament has the supreme power to make laws even in relation to matters which are covered by a Treaty. The HC has also appreciated that provisions like section 94A of the Act are “need of the hour” and a good answer to “tax havens” not co-operating in exchanging information and who do not follow the obligations entrusted by tax treaties.

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