HIGH COURT OF BOMBAY

Vodafone India Services (P.) Ltd.

v.

Union of India

MOHIT S. SHAH, CJ.
AND M.S. SANKLECHA, J.
WRIT PETITION NO. 1877 OF 2013
NOVEMBER 29, 2013

Harish Salve, Ms. Anuradha Dutt, Ms. Fereshte Sethna, Ms. Gayatri Goswami, Tushar Jarwal, Ram Kakkar, Chirag Dave, Aagam Doshi, Shantanu Singh, Antik Senapati, Adhiraj Malhotra, Ms. Aarti Basantani *for the Petitioner*. **Mohan Parasaran, B. M. Chaterjee, Girish Dave** and **Tejveer Singh** *for the Respondent*.

JUDGMENT

Mohit S. Shah, CJ. - At the request of learned counsel for both the sides, the writ petition was taken up for final disposal.

2. By this petition under Article 226 of the Constitution of India, the petitioner challenges:-

(*a*) the order dated 28 January 2013 of the Transfer Pricing Officer (TPO) passed in terms of Section 92CA of the Income Tax Act,1961 ("the Act"); and

(*b*) the Draft Assessment Order dated 22 March 2013 passed by Assessing Officer(AO) in terms of Section 143(3) read with Section 144-C (1) of the Act in consequence of order dated 28 January 2013 of the TPO.

3. Learned counsel for the petitioner has raised the following questions for consideration by this Court:

(1) Whether the existence of a potentially taxable income or an expenditure (capital or revenue) that impacts computation of taxable income is a *sine qua non* for the invocation of jurisdiction under Chapter X ?

(2) Whether Chapter X confers the jurisdiction to

(*a*) treat a transaction on the capital account as a revenue transaction,

(*b*) treat a single transaction of issue of shares as two transactions - *viz.* as that of issue of shares and of grant of a financial accommodation (equal to the difference in value of the arm's length price as determined and the issue price of shares), and to bring to tax a notional amount as interest foregone on this notional amount of financial accommodation?

(3) Whether the provisions of Chapter X confer the power and jurisdiction upon the department to treat the arm's length price determined in an earlier year as a sum actually

received (or receivable) in the later year, and determine the arm's length price of transactions in the later year on that basis?

4. The petition relates to Assessment Year 2009-10.

5. Brief facts leading to this petition are as under:-

(*a*) The petitioner is a wholly owned subsidiary of a Mauritian Entity namely Vodafone Tele-Services (India) Holdings Ltd ("the Holding Company.");

(*b*) On 21 August 2008, the petitioner issued 2,89,224 equity shares of a face value of Rs.10/- each at the premium of Rs.8591/- per share aggregating to a total consideration of Rs.246.38 Crores to its holding company. The petitioner received an amount of Rs.86.93 Crores on 21 August 2008 and the balance amount of Rs.159.46 Crores on 5 November 2008 from its holding company;

(*c*) As the issue of the equity shares by the petitioner was to a non-resident entity, the same was done in compliance with the provisions of Foreign Exchange Management Act, 1999. The Fair Market Value of the said equity shares was determined in accordance with the methodology prescribed under the Capital Issues (Control) Act, 1947;

(*d*) On 30 September 2009, the petitioner filed its return of income for Assessment Year 2009-10 with the respondent-revenue. Along with its return of income, the petitioner also filed Form 3 CEB dated 28 September 2009 by an accountant in accordance with Section 92-E. In the said Form, the transaction of issuance of equity shares by the petitioner to its holding company (undisputedly an Associated Enterprise) was declared as an International Transaction and also the Arm's Length Price ("ALP") of the shares so issued, was also determined. However, a note was appended by the accountant to its Form 3 CEB report making it clear that the transaction of issue of equity shares did not affect the income of the petitioner and was being reported only as a matter of abundant caution. The note read as under:-

"Note 1:-

"The company has issued 289224 equity shares of Rs.10/- each fully paid at a premium of Rs.8500 per share aggregating to total consideration of Rs.2,46,38,99,016. As per Section 92(1) of the Income Tax Act, 1961 any income arising shall be computed having regard to the arm's length price. This transaction of issue of equity shares does not affect income of the Company. However, out of abundant caution, the same is reported here."

(*e*) On 30 August 2010, the Assessing Officer issued a notice under Section 143(2) to the petitioner for the purposes of carrying out scrutiny assessment;

(*f*) On 11 July 2011, the Assessing Officer after obtaining the previous approval of the Commissioner of Income Tax referred all the transactions reported in Form 3 CEB dated 28 September 2009 by the petitioner to the TPO in accordance with Section 92CA(1) . This reference to the TPO was for determining the ALP of the reported International Transactions;

(*g*) On 14 December 2012, the TPO issued a show cause notice to the petitioner. In the above notice, in so far as relevant to these proceedings , the petitioner was, *inter alia*, called upon to show cause why:

(*i*) the issue price (including the premium) of the equity shares to its holding company as declared by the petitioner should be accepted for the purposes of computing ALP under the Act;

(*ii*) the ALP of the shares issued by the petitioner to its holding company be not determined on the basis of its Net Asset Value (in short "NAV"), after taking into account the transfer pricing adjustment for the Assessment Years 2007-08 and 2008-09 which would result in the NAV being enhanced from Rs.12,341.80 millions to Rs.75,564.28 millions. This would result in the ALP per share being enhanced leading to a price adjustment of Rs.2034.95 crores to arrive at the ALP of the equity shares;

(*iii*) the above short fall of Rs.2034.15 crores should not be treated as amount due from the holding company to the petitioner; and

(*iv*) the above shortfall of Rs.2034.95 crores from the holding company should not be considered as deemed loan by the petitioner and the interest at the rate of 13.50% should not be charged thereon.

(*h*) The petitioner filed its replies on 24 December 2012, 7 January 2013 and 22 January 2013 to the show cause notice issued by the TPO. The petitioner in all its replies contended that Chapter X i.e. Transfer Pricing provisions do not apply to the issue of equity shares. Therefore, it was contended that the notice was completely without jurisdiction and its replies should not be construed as submitting to jurisdiction under Chapter X . Without prejudice, the petitioner contested the show cause notice on merits pointing out that Transfer Pricing provisions do not apply to the issuance of the equity shares. Besides reliance was placed upon the concept of real income and no jurisdiction to tax hypothetical income by re-charactering the same as deemed loan;

(*i*) On 28 January 2013, the TPO passed the impugned order holding that the transaction of issuance of equity shares by the petitioner to its holding company is an international transaction covered under Chapter X . In particular, it records the following findings:

(*i*) The issue of equity shares is an International Transaction governed by Chapter X as is evident from Form 3 CEB dated 28 September 2009 filed by the petitioner. The valuation of equity shares was arrived at by application of Comparable Uncontrolled Price method by the petitioners.

(*ii*) The issue whether any Income has arisen and/or affected by the International Transaction for purposes of Chapter X would be determined by the Assessing Officer. The jurisdiction exercised by him is only to determine the ALP of International Transactions and not compute the income arising out of such International Transactions;

(*iii*) The transaction was an International Transaction as is evident from the *Explanation* (i)(c) and (e) to Section 92-B , which provides that capital financing and re-structuring of business would be included within the meaning of International Transactions;

(*iv*) The issue of shares by the petitioner to its holding company at lower premium then what is due, results in the petitioner subsidizing the price payable by the holding company. This deficit would be a loan extended by the petitioner to its holding company and such loan would have bearing on the profit of the assessee in terms of interest;

(*v*) The ALP of the issue of equity shares by the petitioner to its holding company as determined by the Accountant under Section 92E was rejected on the ground that methodology of valuation adopted is not suitable to derive the ALP;

(*vi*) The Transfer Pricing adjustment for the Assessment Years 2007-08 and 2008-09 have to be taken into account to determine the fair value of the Petitioner's business;

(*vii*) Finally, the TPO determined the ALP of equity shares issued by the petitioner to its holding company as under:-

"7.5 Determination of Arm's Length Price:

Thus, based on the above discussion, the ALP of equity shares of the company as on 31-03-2008 is computed as below:-

Description	*Amount (Rs. Million)*	*Number/ Amount (Rs.)*	*Remarks*
Net-worth of the assessee company based on audited balance sheet as on 31-03-2008	12341.8		As per the audited balance sheet of the assessee as on 31-03-2008
Add: Off-Balance sheet items (for TP adjustment made in the earlier years, ALP valuation of sale of call centre business and ALP of assignment of call options)			
i Shortfall (net of taxes) in charging for provision of IT enabled services for FY 2006-07	331.53		As per information available in the order of the TPO for the FY 2007-08
ii. Shortfall in charging for sale of call centre business during FY 2007-08	13443.92		As per the order of the TPO for the FY 2008-09, as modified by the directions given by DRP-I, Mumbai.
iii. Shortfall in charging for	61788.83		As per the order of the TPO

assignment of call options during FY 2007-08.		for the AY 2008-09
Less: Provision for tax on shortfall in charging for sale of call centre during FY 2007-08 @ 22.66%	3046.39	As discussed above
Less: Provision for tax on assignment of call option during FY 2007-08 @ 33.99%	21002.02	As discussed above
Total Net Asset Present Value	51515.87	

No. of Equity Shares as on 31-03-2008	9,57,992
ALP Value of each equity Share as on 31-03-2008	53,77,500

Computation of ALP

Description	*Number/Amoun (Rs.)*
ALP Value of each equity shares as on 31-03-2008(a)	53,775
Value of equity shares as per the assessee (b)	8,519
Deficit amount per share (c) = (a)-(b)	45,256
No. of equity shares issued (d)	2,89,224
Price charged by the assessee (e)	246,38,99,016
Arm's Length Price (f) = (a) x (d)	1555,30,20,600
Total shortfall from ALP (g) = (f)-(e)	1308,91,21,344

As can be seen from above, the price charged by the assessee in these international transactions falls beyond the +-5% range. Thus, the above shortfall of Rs.1308,91,21,344/- is treated as transfer pricing adjustment for the price charged by the assessee in these international transactions in the nature of issue of equity shares."

(*viii*) The short fall in the value of shares issued by the petitioner to its holding company was treated as a deemed loan by the petitioner to its holding company. This deemed loan was sought to be charged with interest at 13.5% per annum. Consequently, the TPO arrived at the following transfer pricing adjustment as under:-

" 9.2.4 Computation of Arm's Length Price:

Amount of Deemed Loan	Rs. 1308,91,21,344/-
Period	6 months

Arm's Length Interest Rate	13.50% p.a.
Arm's Length Price @ 13.97% p.a.	Rs.88,35,15,691/-

9.2.5 Price Received vis-A-vis the Arm's Length Price:

The price charged by the assessee at Rs. Nil in the form of interest chargeable on the debts delayed from its Associated Enterprise is compared to the Arm's Length Price or interest as under:

Arm's Length Interest	Rs.88,35,15,691/-
Interest received	Rs. Nil
Shortfall being adjustment u/s 92 CA	Rs.88,35,15,691/-

The above amount of Rs.88,35,15,691/- is treated as an adjustment u/s 92CA for the price chargeable as interest on the deemed loan to its AE for the F. Y. 2008-09.

10 Summary of TP adjustments

The transfer pricing adjustments made in this order is summarized as below:-

Sr. No.	*Nature of International transactions*	*Adjustment Amount (Rs.)*
1.	Shortfall in price of shares issued to AE	1308,91,21,344
2.	Interest on deemed loan	88,35,15,691
	TOTAL	1397,26,37,035

Thus the above total amount of Rs.1397,26,37,035/- is treated as transfer pricing adjustment for the FY 2008-09, relevant for the AY 2009-10."

(*j*) Consequent to the order dated 28 January 2013 of the TPO, the Assessing Officer on 4 February 2013 issued notice to the petitioner. The above notice under Section 142 (1) *inter alia* called upon the petitioner to show cause as to why adjustment aggregating to Rs.1397.26 Crores as proposed by TPO should not be made to the total income of the petitioner;

(*k*) On 12 February 2013 and 19 March 2013, the petitioner responded to the show cause notice dated 4 February 2013. The petitioner submitted that the order of the TPO is without jurisdiction as the transfer pricing provisions do not apply to a transaction of issuing equity shares to its holding company. Besides, the transaction of issuing shares cannot be governed by Chapter X as no income arises and /or affected by it. Further, there is no occasion to re-characterize a *bona fide* transaction of issue of shares as deemed loan under the Act. Thus, it was submitted that the proceeding seeking to apply Chapter X to issue of shares to its holding company is bad in law;

(*l*) On 22 March 2013, the Assessing Officer passed the impugned Draft Assessment Order under Section 143 read with Section 144-C(1). The Assessing Officer did not deal with the petitioner's principal contention that Chapter X would not be applicable as the issuance of equity shares to its holding company does not give rise to any income. This

was not dealt with by the Assessing Officer on the ground that in terms of Section 92-CA(4) , the Assessing Officer has to compute the total income in conformity with the ALP determined by the TPO. In view of the above, the Assessing Officer added the entire amount of Rs.1397.26 Crores determined by the TPO to the petitioner's income;

(*m*) On 24 April 2013, the present petition was filed on 26 April 2013, the petitioner filed objections to the draft Assessment Order dated 22 March 2013 before the Dispute Resolution Panel ("DRP") under Section 144-C . However, the petitioner raised objections before the DRP only with regard to the valuation/ quantification issue and not with regard to issue of jurisdiction viz: the issue of equity shares by the petitioner to its holding company does not affect income and is thus outside the ambit of Chapter X . This was for the reason that the issue of jurisdiction was the subject matter of challenge in this petition before the Court.

6. Affidavit in reply dated 23 September 2013 came to be filed by respondent No.3-Dy.Commissioner of Income Tax, (Assessing Officer) for and on behalf of respondents, wherein , inter alia, the deponent has raised the preliminary objection that the writ petition is not maintainable as it is at the stage of draft assessment order and the petitioner has an effective alternate remedy before the DRP, which remedy the petitioner has already resorted to. Affidavit also deals with the petitioner's contentions on merits, which will be referred to hereinafter.

The petitioner has filed affidavit-in-rejoinder dated 10 October 2013 dealing with the preliminary objection on maintainability and on merits. The Assessing Officer has filed sur-rejoinder dated 15 October 2013.

7. Learned counsel for the petitioner submitted that -

(A) On correct interpretation of the provisions of Chapter X of the Act including section 92, the following two conditions precedent must be satisfied before invocation or application of Chapter X:-

(*i*) There must be an international transaction, and

(*ii*) (*a*) income must arise from such international transaction, or

(*b*) there must exist any expense or interest arising from such international transaction, which can impact computation of total income.

Upon fulfilment of such conditions precedent and upon application of Chapter X , the only consequence that follows is that the computation of income (expense or interest) shall be computed having regard to ALP.

(B) Chapter X relating to avoidance of tax does not purport to create any new or additional head of income over and above those provided in section 14 . If a receipt does not fall under any of the heads of income specified in section 14, the revenue cannot by invoking Chapter X create an additional head of income for the purposes of charging of income tax and computation of total income.

(C) The legislative intent that for invocation of Chapter X , income must arise from the

international transaction in question (or the expense or interest capable of impacting computation of taxable income must arise) is supported by intrinsic evidence in the provisions of Chapter X as under:-

(*i*) Title of the chapter is special provisions relating to avoidance of tax meaning thereby avoidance of tax on taxable income;

(*ii*) Marginal note to section 92 is "computation of income from international transaction having regard to arm's length price". That means section 92 is only a machinery provision and not a charging section.

(*iii*) All that sub-section (1) of section 92 provides is that income arising from an international transaction shall be computed having regard to ALP and, therefore, the explanation clarifies that the allowance for any expenditure or interest arising from such transaction shall also be determined as having regard to arm's length price. Expense or interest can possibly impact computation of taxable income and, therefore, it is taken within the sweep of Chapter X .

(*iv*) Sub-section (3) of section 92 again provides that the provisions of section 92 shall not apply in a case where computation of income under section 92 has the effect of reducing the income chargeable to tax computed on the basis of entries made in the books of account. The emphasis again is on computation of income for the purposes of tax.

(*v*) Sub-section (3) of section 92C confers power on the Assessing Officer to compute ALP. It also provides that this can be done "during the course of any proceeding for the assessment of income".

(*vi*) Even where the Assessing Officer himself does not determine the ALP but makes a reference to the Transfer Pricing Officer (TPO) under section 92CA and the TPO passes an order determining the arm's length price, sub-section (4) provides that the Assessing Officer is to apply the said order "to compute the income of the assessee" in conformity with the arm's length price so determined by TPO.

(D) "Income" is defined by section 2(24) as including –

(*i*) profits and gains,

(*vi*) any capital gains chargeable under section 45 and

w.e.f. 1-11-2013 (*xvi*) any consideration received for issue of shares as exceeds the fair market value of the shares referred to in clause (viib) of sub-section (2) of section 56.

Section 56(2) (viib) reads as under:-Income from other sources.

56 (1) Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14,

items A to E.

(2) In particular and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources" namely:-

"** ** **"

(*viib*) Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares. (emphasis supplied)

Nowhere in the Act any shortfall in share premium is treated as income. If a case does not fall under section 56(2)(viib) , even share premium in excess of fair market value of shares is not treated as income.

It is therefore vehemently submitted by the learned counsel for the petitioner that the question of determining the arm's length price by invoking the provisions of Chapter X can arise only for the purpose of assessing the income as defined by the Act.

(E) While section 2(24) gives an inclusive definition of "income", section 7 provides which income shall be deemed to be received in the previous year in question and section 9 provides which income shall be deemed to accrue or arise in India. None of those provisions provide for any fiction of treating the receipt of share premium as deemed or notional income. Similarly, no provision even in Chapter X provides that a receipt, even if otherwise not covered by the definition of "income" computed having regard to ALP, will be treated as notional income or deemed income.

Section 92(1) only provides for computation of income arising from an international transaction having regard to the ALP and does not provide that the amount computed as having been received in terms of the ALP shall be treated as deemed income or notional income.

(F) The suggestion made by the Department in the Counter affidavit, that the definition of International Transaction by itself creates a legal fiction by which the ALP of an International Transaction is deemed to be income runs counter to the legislative material placed before this Court by them. It is submitted that the assessments in the present case are a mockery of the legislative intent.

(*a*) The Notes on Clauses refers to Section 92 as a new section to "provide that any income arising from an International Transaction shall be computed having regard to arms length price....", and the meanings of associated enterprise and International Transaction "..... with reference to which the income is to be computed under the new section."

(*b*) The Memorandum Explaining the Finance Bill 2001 refers to "MEASURES TO CURB TAX AVOIDANCE" and "New Legislation to curb tax avoidance

by abuse of transfer pricing." It points out that "the profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices.... leading to erosion of tax revenue...". The provisions were inserted ".... With a view to provide a statutory framework which can lead in computation of reasonable fair and equitable profits and tax in India in the case of such multinational enterprises..."

(*c*) The circular issued by the CBDT also echoes the same sentiment- it states "... with a view to provide a detailed statutory frame work which can lead to the computation of reasonable, fair and equitable profits and tax in India....".

(G) As per settled legal position Income tax is a tax on real income. Income tax cannot be levied on hypothetical income. If income does not result at all, there cannot be a tax. It is submitted that the share premium, which is not taxable, cannot be taxed on the ground that the assessee ought to have received higher share premium and, therefore, the difference should be treated as notional income.

(H) The assessee required from its holding company funds to the tune of about Rs.246 crores for its operations in India. On the basis of the fair market value of equity shares calculated in accordance with the formula under the Capital Shares (Control) Act, 1947, the assessee issued 2,89,224 equity shares of Rs.10/- each at a premium of Rs.8,519/- per share aggregating to total consideration of Rs.246.38 crores to its Holding company which is undisputedly an Associated Enterprise. The petitioner received the said amounts in August/ November 2008. At the relevant time sub-clause (xvi) was not yet inserted in Sec.2(24) - which, in certain cases, treats share premium in excess of fair market value of shares as income w.e.f. 1 April 2013. Hence the petitioner could have as well received Rs.246.38 crores from its holding company by simply issuing only share or 100 shares.

(I) The AO and the TPO have determined the ALP of each share at Rs.53,775/- and on that basis they have treated the differential amount of Rs.45,256/- (Rs.53,775 - Rs.8,519) as the shortfall in the share premium. Since the number of equity shares issued by the petitioner was 2,89,224, the transfer pricing adjustment of Rs.1308.91 crores has been made. This alleged shortfall has been treated as loan from the petitioner to the Associated Enterprise or a receivable from the Associated Enterprise or financial facility extended by the petitioner to the Associated Enterprise or a call in arrears that should have been paid by the Associated Enterprise on the date of issue of shares.

(J) The AO and the TPO both have still gone further and an interest at the rate of 13.5% for 6 months has been computed on the deemed loan interest quantified at Rs.88.35 crores and thus the total transfer pricing adjustment of Rs.1397.26 crores is made.

(K) The transfer pricing provisions have thus been used by the TPO and the AO to treat the alleged shortfall in the amount of share premium as income. It is vehemently submitted by Mr.Harish Salve that the TPO and the AO have turned the entire tax jurisprudence on its head by passing the impugned orders.

(L) The issue of equity shares at a premium by the petitioner to its holding company is

itself a process of creation of shares and thus would not be covered as a transfer as held by the Apex Court in *Khoday Distilleries Ltd.* v. *CIT* 2009(1) SCC 256. In the above case, the Supreme Court held as under:-

"There is a vital difference between "creation" and "transfer" of shares ……There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation, whereas the second case is that of transfer of chose-in-action."

Consequently, the issue of shares at a premium being *sue generis* would not attract the provisions of Section 2(47) and 45 dealing with transfer of capital assets and capital gains.

(M) Section 4 is the charging section and Section 5 which defines the scope of total income to include income received and deemed to be received or accrued. It is submitted that in this case, no income has accrued or has been received or deemed to be received by the petitioner on the issue of equity shares to its holding company and therefore, cannot be subjected to tax. In support of the above submission, reliance was placed upon the decision of this Court in *Cadell Weaving Mills Company Limited* v. *CIT* 116 Taxman 77. In the above case the issue was whether an amount received in consideration for surrendering statutory tenancy could be considered as an amount liable to tax under section 56 i.e. income from other sources. This Court inter alia held as follows:-

"It is true that Section 2(24) defines would "income". That the definition is an inclusive definition. However, it is well settled that capital receipts do not come within the ambit except to the extent of any capital receipt being expressly sought to be covered by the act of the Parliament as in the case of Section 2(24) (vi) ."

The Court held that where capital gain is not chargeable for any reason under Section 45 then any amount/income/gain cannot be brought to tax by applying the general understanding of income in the inclusive definition provided under Section 2(24) . In the present case also it was submitted that the issue of shares was on capital account and the same is not taxable under the head Capital Gains, therefore, cannot be brought to tax as income under any other head unless it is specifically defined in the Act. The aforesaid decision of the Bombay High Court was upheld by the Apex Court in 273 ITR page 1.

(N) One more issue which arises in this case and which cannot be contended before the authorities is: if the revenue's contention is accepted (the amount received as share premium on issuance of equity shares was received in terms of the ALP determined by the department, then no amount received by the petitioner would be subjected to tax. However, if there is any short fall/difference on the amount determined as ALP and amount received by the petitioner then the petitioner would have to pay tax on the differential amount), such construction would lead to imposition of penalty and would not only be arbitrary and violative of Article 14 but also violative of Article 19(1) (g) of the Constitution. In support of the aforesaid proposal reliance was placed upon the decision of the Apex Court in the matter of *K.P.Varghese* v. *ITO* 1981 (4) SCC 173.

In view of the above, it is submitted by Mr.Salve that this Court should exercise its extra ordinary writ jurisdiction and entertain the petition as the alternative remedy is not an efficacious remedy.

(O) The TPO while determining the ALP of the issue of equity shares by the petitioner to its holding company has treated the ALP determined in respect of transactions in earlier Assessment Years 2007-08 and 2008-09 as the sums actually received/receivable. This is not permissible as the ALP transaction for the earlier period only results in a tax being paid on proper value of the international transaction on the basis of ALP so determined for that transaction in that year. It does not have any carry forward effect.

8. Mr. Salve has also assailed the impugned order on the ground of breach of principles of natural justice:

(*a*) The impugned orders of the TPO and the draft assessment order of the Assessing Officer are in breach of principles of natural justice in as much as the fundamental issue going to the root of the matter raised by the petitioner viz: the international transaction in question does not give rise to and/or affect any income has not been considered and/or dealt with either by the TPO or by the Assessing Officer and yet Chapter X has been applied. The TPO does not consider the issue of income on the ground that in terms of Section 92CA his mandate is only to determine the ALP of the transaction whereas the Assessing Officer has not dealt with the issue in the Draft Assessment Order on the ground that in terms of Section 92CA (4) , he is bound by the ALP as determined by the TPO;

(*b*) Before the Assessing Officer refers a transaction to the TPO for determination of the ALP under Section 92CA , it is incumbent upon the Assessing Officer to hear the petitioner before coming to the conclusion that it is necessary and expedient to refer the transaction to the TPO for computation of ALP. This not having been done, the entire reference to TPO is bad.

(*c*) Further while referring the matter to the TPO, the Assessing Officer is also required to consider whether there is any income arising from international transactions so as to make provisions of Chapter X applicable as otherwise, at no point of time, the question whether or not, any income arises from international transactions is subject to any examination by the authorities.

(*d*) The constitution of the DRP is such that one of its members is Director of Income Tax (Transfer Pricing). In terms of Instruction No. 3/2003 dated 20 May 2003 a person of equal rank to the Director of Income Tax (Transfer Pricing) who is equal to a member of the DRP is required to approve the order of the TPO. In view of the above, it is submitted that the Writ Petition be entertained and be disposed of on merits.

9. Mr. Salve further submitted that the petition should be entertained and the petitioner should not be relegated to avail of alternate remedy as the challenge in the petition was to the very jurisdiction of the respondent-authority to tax issue of shares at premium by the petitioner to its holding company. In support of the above, the following submissions were made:-

(*a*) From the very beginning, the petitioner has protested and challenged the jurisdiction of the authorities in applying Chapter X in respect of the issue of shares, inter alia, on the ground that it does not give any rise to any income. This is evident from Form 3 CEB dated 28 September 2009 filed by the petitioner along with its return of income and the replies filed by the petitioner to the show cause notice dated 14 December 2012 issued by the TPO;

(*b*) The decision of this Court in W. P. No. 488 of 2012 rendered on 6 September 2013 (for convenience Vodafone II case), wherein this court refused to entertain a writ petition challenging proceeding under Chapter X for the Assessment Year 2008-09, is inapplicable to the present facts. This is for the reason that unlike in the above case, the petitioner had in these proceedings challenged the jurisdiction of the TPO and the Assessing Officer right from the beginning of the proceeding. Besides in this case, there are no disputed questions of fact as found in Vodafone II case;

(*c*) Though after the filing of this petition on 24 April 2013, the petitioner has on 26 April 2013 filed objections against draft assessment order before the DRP, these objections were filed only with regard to quantification/valuation issue and not with regard to the jurisdiction of the authorities to apply Chapter X to the issue of shares to its holding company. Thus petitioners are not availing of two remedies at the same time;

(*d*) In any event, the objections filed by the petitioner to the draft Assessment Order before the DRP is not an efficacious alternative remedy. This is for the reason that in terms of Section 144C (5) read with Section 144C(8) , the DRP has no jurisdiction to set aside any proposed variation in the draft assessment order, even if is satisfied that the same is without jurisdiction.

(*e*) The impugned orders are in the nature of penalty in violation of petitioner's fundamental rights as submitted in ground (N) on merits. Hence, the petitioner should not be relegated to a departmental authority like DRP.

(*f*) It was also submitted that in the affidavit in reply, the respondent-revenue have set out the reasons why according to them income arises on the international transaction being the issue of shares at a premium is covered by Chapter X . In these circumstances, the contentions of the parties be considered on merits and the matter be decided by this Court finally without relegating the petitioner to either the Assessing Officer or the DRP.

10. On the other hand, Mr. Mohan Parasran, learned Solicitor General, in support of the impugned orders passed by the TPO and the Assessing Officer, submitted that this petition be dismissed at the threshold as an efficacious alternative remedy is provided under the Act, the issues raised herein can more appropriately be dealt with by the authorities under the Act. In support, the following submissions were made:-

(*a*) The Act provides a complete and self contained machinery for obtaining relief against improper action by the authorities. In this case, the petitioner has already resorted to the alternative remedy by preferring its objections before the DRP. In the above circumstances, the petitioners be directed to proceed with their objections before the

DRP and not be allowed to avail of parallel remedies;

(*b*) This Court in almost similar circumstances in Vodafone II case by its order rendered on 6 September 2013 relating to Assessment Year 2008-09 in respect of the same petitioner refused to exercise its writ jurisdiction. In the aforesaid decision, it has been held that the draft assessment order based on the order of the TPO could be challenged before the DRP on all grounds in its entirety including the issue of jurisdiction. Therefore, whether or not any income arises consequent to the international transaction of issue of shares at a premium to its holding company attracting the provisions of Chapter X is also amenable to challenge before the DRP;

(*c*) The petition itself involves mixed questions of facts and law. The issue of transfer pricing involves valuation which is the result of facts based analysis which could be best done by the authorities under the Act. It was submitted that for this very reason, the respondents are not arguing on the merits, save and except to point out that once an International Transaction exists then the ALP has to be determined by the TPO; and

11. The learned Solicitor General further submitted that the Assessing Officer is under no obligation to give any hearing to an assessee before it makes a reference to the TPO under Section 92CA(1) . All that the Assessing Officer has to do is to reach a *prima facie* satisfaction that there is an international transaction and that the ALP of the same is to be determined by the TPO after obtaining the previous approval of the Commissioner. There is no need for a hearing as it is only a prima facie opinion of the Assessing Officer. Further, in any view of the matter, the TPO in terms of Section 92CA(2) serves a notice on the assessee and entertains the objections of the assessee while determining the ALP of the international transaction. Therefore, the principles of natural justice are satisfied and the assessee has an opportunity to present its case before the TPO to whom the case is referred to by the Assessing Officer. In these circumstances, there is no justification for the assessee to have one hearing before the transaction is referred to the TPO and another hearing on the same issue after it is referred to the TPO.

12. On merits of the issue, the learned Solicitor General in his reply after canvassing the submissions on the questions of alternate remedy and obligation, if any, of the AO or TPO to give any hearing to assessee simply declined to make any submission on merits of the aspect on the ground that since merits would be considered by the DRP, he would not make any submission on merits of the controversy at the hearing of this writ petition.

13. Subsequently, one week after conclusion of the arguments including rejoinder, learned counsel for the respondents submitted written submissions on behalf of the revenue dealing with merits of the controversy and attempting to rebut the petitioner's contentions on merits. As indicated earlier, in the affidavit-in-reply dated 23 September 2013 also the revenue had dealt with merits of the controversy.

14. When the learned counsel for the petitioner submitted in rejoinder that the learned counsel for the revenue had shied away from the merits of the case because the revenue has no case on merits, in the subsequent written submission submitted on behalf of the revenue reliance is placed upon the decision of the Supreme Court in *Tin Plate Co. of India Ltd.* v. *State of Bihar*(1998) 8 SCC 272. The Supreme Court observed in that case that when the High Court dismisses a writ petition on the ground that the petitioner has an alternate remedy available to him, the High Court should not make observations touching upon the merits of the case.

True it is, that while disposing of a writ petition on the ground of alternate remedy, the Court should not express any opinion on merits of the controversy between parties. That, however, does not absolve the respondent-authority from its duty to Court to indicate a prima facie, probable or atleast a plausible defence when the Court calls upon the respondent-authority to disclose its defence in a nutshell, after the petitioner makes out a strong prima facie case for invoking the jurisdiction of the High Court on the ground that the respondent-authority has ex facie acted without jurisdiction. Otherwise, even in case of grossly arbitrary action or proceeding initiated without any jurisdiction whatsoever, the authority raising plea of alternate remedy, may remain silent on merits of the matter and expect the High Court to dismiss the writ petition on the ground of alternate remedy, requiring the petitioner to go through the labyrinth of appeals and revisions, hoping to tire the petitioner out in terms of time, energy and costs before he can approach the writ court again for adjudication of merits of the dispute. Authorities shall keep this caution in mind for future.

15. Now we will make a brief reference to the reply on merits in the affidavit-in-reply, wherein the respondents had taken the following stand:

> "... I state that the Revenue contends that the nature of receipt, whether 'capital or revenue', has no bearing on the issue of accrual of income for the purposes of Chapter X."
>
> "...The transaction of issue of shares by the petitioner to its AE does have a bearing on the assets of the petitioner company and hence is as per the mandate of law, within the jurisdiction of the TPO for determining the arm's length price...."
>
> ".... the computation part of transfer pricing regulation does not put a pre condition of tax implication before examining ALP of an international transaction " (para 15)
>
> "....The Act nowhere states that only revenue items would be taken as income ".
>
> "....the determination or variation in the ALP of an International Transaction as determined by the AO/TPO under Chapter X, would be part of 'notional income' including the total income of an assessee." (para 20).
>
> "For the purposes of Chapter X, the difference in ALP of an international transaction has to be treated as income, for which no express statutory fiction is required, as contended by the petitioner." (para 40.2(J))

16. On merits of the issue the revenue made the following submissions :—

(*a*) The issue of equity shares at a premium by the petitioner to its holding company is an international transaction in terms of section 92B . This was recognized even by the petitioner who along with its return filed the requisite statutory Form 3CEB, declaring the issue of shares to its holding company as an international transaction. In terms of section 92B of the Act, all transactions between Associated Enterprises which have bearing on profit, income or loss or assets would be considered to be an international transaction. Therefore, the issue of equity shares would be regarded as international transaction as it would have bearing on the assets of the petitioner. Moreover, section 92B includes within the meaning of international transactions also capital financing and business re-structuring as provided in *Explanation* (1) (c) and (1) (e) to Section 92B. It

was submitted that whether or not, the issue of shares has a bearing on the assets and income of the petitioner and the extent of the assets and income would be decided by the authorities, assessing the petitioner to tax. In view of the above circumstances, no submission on merits of the transactions were being made by the revenue at the bar;

(*b*) Issue of share capital by a subsidiary to its holding company is normally liable to capital gains. This is evident from the fact that Section 47 provides for transactions not to be regarded as transfers for the purpose of capital gain. Attention was particularly drawn to Section 47(vi)(d) which clearly provides that issue of shares in certain situation is regarded as transfer and may give rise to capital gains under Section 45. Therefore, though this is not a case of demerger, the same is being relied upon so as to emphasize that conceptually an issue of share capital could be regarded as transfer giving rise to capital gains. Therefore, the difference between the ALP and the declared value would give rise to income.

17. The petitioner as well as the respondents have relied upon various decisions in support of their above submissions. We shall deal with the relevant case law cited by the counsel, where necessary, while considering their submissions.

18. The first issue which arises for our consideration is whether this petition as contended by the petitioner should be entertained in exercise of our writ jurisdiction under Article 226 of the Constitution of India or dismissed at the very threshold on the ground of alternative remedy as submitted by revenue.

19. The respondent-revenue has placed strong reliance upon the decision of this Court rendered in Vodafone II case filed by this petitioner relating to the Assessment years 2008-09. In the above case, the petitioner had challenged the jurisdiction of the TPO in taking *suo motu* notice of International Transactions and determining its ALP. It is the contention of the revenue that on a similar fact situation, this Court directed the petitioner to avail of the alternate remedy available under the Act. The Court held that the DRP and the ITAT are entitled to set right any defect in the order of the TPO as reflected in the draft Assessment Order including the question of lack of jurisdiction of the TPO. In view of the above, it was submitted by the revenue that this Court should not exercise its extraordinary jurisdiction and follow its decision rendered in Vodafone II case.

20. It is not possible to accept the contention of the revenue that the situation in Vodafone-II case was similar to the present case (which may, for the sake of convenience, be referred to as Vodafone-III case).

(*a*) In Vodafone-II, TPO had *suo motu* exercised his jurisdiction to determine the arm's length price in respect of two unreported international transactions, being

(*i*) the transaction relating to sale of call centre business by the petitioner to Associated Enterprise, and

(*ii*) the assignment of call options under the new framework agreement dated 5 July 2007.

The petitioner had contended before the TPO that the transactions did not constitute

international transactions. The Division Bench held that there were several issues of fact and law on material aspects which were required to be considered by the authorities under the Act and, therefore, it was not a fit case to invoke Article 226 of the Constitution of India (para 195/page 195).

(*b*) In para 145, the Division Bench dealt with the contentions thus:

"The petitioner's case is this. The petitioner and HWP (India) are Indian companies. The call centre business was therefore, transferred by the petitioner, an Indian company, to HWP (India), another Indian company. Section 92B requires at least one of the parties to be a non-resident. As both the parties to the transaction were Indian companies, section 92B did not apply. There was no agreement between HWP (India) and the associated enterprise of the petitioner viz. VIH BV. The findings to the contrary are perverse and without jurisdiction."

(*c*) The Division Bench held that the relevant question was whether call centre business was sold before or after the sale of the CGP share. Determination of that question was necessary to decide whether the transaction of sale of call centre business was an international transaction because after the sale of CGP share the authorities would be entitled to consider the petitioner as being in the Vodafone group. (para 187/page 189).

(*d*) The Division Bench also noted that the completion date under the Share Purchase Agreement admittedly was 8 May 2007. The BTA was also dated 8 May 2007. The answer to the question whether the sale and purchase of the share preceded the sale of the call centre business or vice versa or whether they were simultaneous requires a consideration of facts, circumstances and factors, including the conduct of parties. (para 170/pages 178-179)

(*e*) Another question, which was agitated before the Division Bench, was whether MOU purported to have been signed on 25 April 2007 was ante-dated or not. The Division Bench held that this was a question of fact which must be decided by the authorities/Tribunal under the Act. (paras 172-173/pages 180-181)

(*f*) The Division Bench further held that even assuming that MOU was not ante-dated and was executed prior to the Share Purchase Agreement, the petitioner did not have an open and shut case. The terms and conditions of the MOU require serious consideration - whether the MOU constituted an agreement at all or whether it was only an agreement to enter into an agreement which is not enforceable in law. (paras 174/pages 181)

(*g*) The Division Bench held that the following were questions of fact:

"151. …. The question would be whether the parties, including HWP (India) intended that HWP (India) would be bound by the terms of the SPA relating to the sale of the call centre business.

158. The next question is in relation to Mr. Salve's third contention - whether the relevant transaction i.e. the BTA/sale of the call centre business was in relation to the SPA and/or the terms thereof were determined by the SPA.

164. The fourth question is whether the SPA was prior in point of time to the BTA / the sale of the call centre business.

The Division Bench thereafter referred to the contention of the respondents and then held that the contention was not wholly inarguable or improbable. (para 146/pages 164-165)

(*h*) The Division Bench gave a specific finding that TPO had jurisdiction to determine the arm's length price of the two unreported and unreferred transactions. (para 131/ page 140)

(*i*) The Division Bench held that in the case before it, there was no warrant for exercise of writ jurisdiction because the petitioner had not only an equally but a more efficacious remedy by filing the objections before DRP and that DRP would be entitled to go into all aspects of the matter, factual and legal, whereas in a writ petition a Court may decline interference where there are disputed questions of fact. (Para 107/page 119)

21. It must be pointed out that while relegating the petitioner to the alternate remedy in Vodafone II case, this Court had also entered a caveat that the existence of alternate remedy by itself will not bar the Court from exercising its extra ordinary jurisdiction if the facts of the case so warrant. Moreover, we find that the Court while refusing to entertain the petition had on facts found that the petitioner had not challenged/objected to the jurisdiction of the TPO at any time prior to filing the petition and on the contrary, the petitioner had actively participated in the proceedings before the TPO without raising any objections as to its jurisdiction.

As against the above, in the present proceedings, the petitioner has from the very out set, been objecting to the jurisdiction of the authorities to apply Chapter X on issue of shares at a premium by it to its holding company. This is evident from the Form 3CEB dated 28 September 2013 filed by the petitioner, wherein it was specifically stated by its accountant that the International Transaction of issuing shares at a premium to its holding company is not covered by Chapter X as the issue of shares does not give rise to or affect any income. Further, even while replying to the show cause notice dated 14 December 2012 issued by the TPO, the petitioner had in its replies dated 24 December 2012, 7 January 2013 and 22 January 2013 protested to the jurisdiction of the TPO to apply Chapter X to issue of equity shares, inter alia, on the ground that it does not give rise to any income.

Thus, the fact situation in the present case is fundamentally different from the fact situation in Vodafone II case where the petitioner had submitted to the jurisdiction of the revenue-authorities and had not challenged and/or protested to the same till such time the TPO had passed an order.

22. Further, the revenue has also placed reliance upon the decision of this Court in *Hindalco Industries Ltd.* v. *Addl. CIT* [2012] 211 Taxman 315 wherein also this Court refused to entertain a petition under Article 226 of the Constitution on the ground of alternative remedy. However, this was for the reason that in the above case also the petitioner had willingly participated in the proceedings before the TPO and only after the TPO had rendered a finding on 31 October 2011 with regard to the ALP, that the petitioner moved the petition. It its petition, Hindalco had also challenged the validity of the reference made by the Assessing Officer to the TPO on 9 October 2009 as well as approval of the Commissioner of Income Tax on 30 September 2009 for making the reference to TPO. However the above challenge in Court was made after delay of two years.

It was in the above circumstances that the Court refused to entertain the petition holding that a comprehensive remedy was available to the petitioner under the Act to challenge the order of the TPO.

23. In view of the above, none of the two decisions being relied upon by the revenue are applicable to the present facts so as to warrant dismissal of the petition at the very out set. Therefore, we would have to independently examine the issue on the facts arising herein whether the petition should be entertained or the petitioner be directed to pursue its remedies under the Act.

24. The contention of the petitioner is that filing of objections with the DRP from the draft assessment order is not an efficacious alternative remedy for the reason that in view of Section 144C(8), the DRP while passing order under Section 144C(5) cannot set aside any variations in the draft assessment order or remand the matter to Assessing Officer for further enquiry. Section 144C(8) reads as under:-

> " The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order." (emphasis supplied)

Learned counsel for the petitioner further referred to powers of the Commissioner (Appeals) conferred by Section 251(1)(a) in the following terms:—

> 251(1) In disposing of an appeal the Commissioner (Appeals) shall have the following powers—
>
> (*a*) in an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.

Thus the contention of the petitioner is that primary issue raised by it (viz: Chapter X is not applicable in view of the fact that no income arises and /or is affected) could never result in the draft assessment order being set aside by the DRP even if it is convinced of the petitioner's case. According to the petitioner the only jurisdiction the DRP has is with regard to quantification/valuation and therefore, this Court should exercise its writ jurisdiction.

25. On the above issue, the revenue has submitted in their written submissions as under:—

> "The petitioner is not correct in contending that the powers conferred in sub-section (5) of Section 144C to the DRP are curtailed by its sub-section (8), particularly when fetters are put on the DRP that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order. In this context, it is submitted that a purposive construction should be given to this sub-section by harmoniously reading the entire scheme of section 144C, including sub-sections (6), (7), (12) and sub-section (13). It is further submitted that fetter to set aside and issue of directions is limited to further enquiry by the AO which can be read with sub-section (13) so that the completion of assessment is expedited within available limited time of nine (9) months."

26. This very submission was made by the Petitioner before another Division Bench of this Court in Vodafone II case and was negatived by decision dated 6 September 2013 (supra) wherein it recorded the submission and observed, inter alia, as under:-

> " 82. Mr. Salve submitted that the DRP is entitled under Section 144C only to "confirm, reduce or enhance" the variation proposed in the draft order. These words according to him, relate and are germane only to quantification of the arms length price. The DRP is therefore not entitled to consider whether or not the transaction are international transactions. We are unable to agree.
>
> 83 to 86 ** ** **"
>
> 87. …… Nor does it limit the consideration by the DRP to the nature of the report relating to draft assessment order.
>
> Sub-section (6) and especially clauses (a) and (b) thereof illustrate the DRP would also be entitled to consider whether or not the TPO was entitled to exercise jurisdiction.
>
> 88. This view is not repugnant to the words "confirm reduce or enhance" in section 144C(8). The suggestion that these three words refer only to the valuation or quantification of the arm's length price is unfounded. A reduction or an enhancement indeed relate to the valuation or quantification. The word 'confirm', however, is much wider. The DRP's power to confirm would include the power not to confirm. It would include the power to annul the variations or any of them. The doubt if any, is set to rest by the use of the words "may confirm". Once the entire draft order is before the DRP for confirmation, it is axiomatic that it would have the power to consider the entire draft assessment order, including the question as to whether the unreported transactions are international transactions or not or even whether what the TPO considered was a transaction at all.
>
> The Division Bench of the Gujarat High Court in Veer Gems (supra) also held that the issue whether there was an international transaction or not can also be examined by the DRP.
>
> 89 to 93 ** ** **"
>
> 94. In the result, the petitioner has, in fact, more than one alternate remedy although not to the extent contended by the Advocate General. In view of our findings, the petitioner's remedy against the order of the TPO is not before the AO. The AO must make the assessment in conformity with the TPO's order. The AO is not entitled to either question the TPO's order in any respect or to make the assessment contrary thereto. However, the assessee is entitled to challenge not merely the determination of the arm's length price, but also the TPO's conclusion that a particular transaction is an international transaction before the DRP. Alternatively, the assessee can wait till the final assessment order is passed without raising any objections upon the receipt of the report from the TPO and challenge the same before the CIT(Appeals). The petitioner, therefore, has an alternate remedy of challenging all aspects of such a matter either before the DRP or before the CIT(Appeals). The alternate remedy is, therefore, clearly there. In fact, from the order of the DRP or the CIT, the petitioner is entitled to file a further appeal before the ITAT. These appellate authorities are entitled to go into all questions of law and of fact. It is not suggested that

either the CIT or the ITAT cannot consider the question as to whether a transaction is an international transaction or not."

27. Thus the contention of the petitioner that the filing of objections to the DRP from the draft assessment order is not an efficacious remedy on the ground that issues other then quantification/valuation could not be raised stands negatived by the judgment dated 6 September 2013 of this Court in Vodafone II case. We are informed at the Bar that the said decision has been accepted by the petitioner as it has not been challenged before the Apex Court. The learned Solicitor General also submitted that the DRP has jurisdiction to consider all issues including the question whether a transfer is an international transaction and the question whether income has arisen or has been affected by the international transaction.

28. Thus it would be open to DRP to consider all issues, including the jurisdictional issue of no income arising and/or affected by the International Transaction. This the DRP can do by issuing final directions under section 144C(5) to the Assessing officer or before issuing final directions, by issuing directions under section 144C(7) to the assessing officer to make a further enquiry and report.

29. Therefore, we have now to consider the issue whether in the face of availability of an efficacious alternative remedy, this Court should exercise its writ jurisdiction. It was contended by the revenue that the petition should not be entertained as the petitioner has already availed of the alternative remedy by filing its objections with the DRP on 26 April 2013. Normally, a writ petition would not be entertained if the petitioner has availed of an alternative remedy on the ground that it is not permissible for a party to pursue two parallel proceedings at the same time. This would be particularly so when the alternative remedy provided under the Act provides for the petitioner obtaining the relief sought in the petition. However, in this case, we find that the petitioner has only filed its objections with regard to valuation/ quantification of the ALP and not with regard to jurisdiction. In its objections to the DRP, the petitioner has specifically noted as under:-

" Accordingly, since the issues involved in the present case relate to jurisdiction of the AO/TPO and the applicability of transfer pricing provisions, the remedy before the DRP is not efficacious. The Assessee has, therefore, filed a Writ Petition before the Bombay High Court assailing the jurisdictional issues arising out of the TP Order and the draft assessment order. The Assessee, by way of the present objections, is only assailing valuation/quantification issues involved in the present transaction before the DRP. "

The petitioner has reserved its rights to file objections with regard to jurisdiction in case the Court does not interfere with the petition. Therefore, the petitioner could now file objections with regard to jurisdiction before the DRP.

30. However, as of date, the petitioner has not challenged the issue of jurisdiction before the DRP. It is well settled that where an alternative remedy is available, normally a writ will not be issued, but this is a self imposed restriction i.e. restraint and not a case of the Court not having jurisdiction to entertain a petition. Declining to exercise writ jurisdiction due to availability of an alternative remedy is a rule of discretion and in an appropriate case, the Court would exercise its writ jurisdiction notwithstanding availability of an alternative remedy or mould the reliefs appropriately even while relegating the petitioner to the alternate remedy.

31. In this case, the petitioner seeks the exercise of writ jurisdiction by us on the following three grounds:—

(*a*) The entire proceedings to tax issue of shares under Chapter X is without jurisdiction as the sine qua non to exercise jurisdiction is: Income arising and/or being affected from or potentially arising and/or being affected from an International Transaction. This issue has not been examined either by the Assessing Officer or by the TPO at any time; Section 92(1) reads as under:-

Computation of income from international transaction having regard to arm's length price.

92(1) Any income arising from the international transaction shall be computed having regard to the arm's length price.

Explanation:—For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price. (emphasis supplied)

(*b*) The proceedings are in breach of natural justice in as much as no hearing was given to the petitioners by the Assessing Officer before making a reference to the TPO under Section 92CA(1) , which reads as under:—

Reference to Transfer Pricing Officer.

92CA (1) Where any person, being the assessee, has entered into an international transaction (or specified domestic transaction) in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction (or specified domestic transaction) under section 92C to the Transfer Pricing Officer. (emphasis supplied)

(*c*) The Constitution of the DRP as constituted consists of one Director of Income Tax (Transfer Pricing). In terms of Instruction No.3/2003 dated 20 May 2003, a person of equal rank i.e. Directorate of Income Tax (Transfer Pricing) has to approve the speaking order passed by TPO. Therefore, the appeal provided from the draft assessment order is illusory being an appeal from Ceaser to Ceaser's wife.

We shall now examine each of the above contentions.

32. It is clear that in view of Section 92(1) , there must be income arising and/or affected or potentially arising and/or affected by an International Transaction for the purpose of application of Chapter X . This would appear to be in the nature of jurisdictional requirement and the Assessing officer must be satisfied that there is an income or a potential of an income arising and/or being affected on determination of an ALP before he proceeds further in determining the ALP or referring the issue to the TPO to determine the ALP. In this case, we find that the petitioner has from the very beginning been challenging the jurisdiction to apply Chapter X on the ground that no income arises and/or is affected or potentially arises and/or is affected on account of issue of its shares to its holding company. The Assessing officer does not deal with this objection/issue before referring the matter to the TPO. The TPO does not deal with the

above objection on the ground that in terms of Section 92CA, his mandate is only to compute the ALP in relation to the International Transaction. The TPO in the impugned order dated 28 January 2012 meets the petitioner's objection by stating that the same would be dealt with by the Assessing Officer. However, when the same objection was raised before the Assessing Officer post the order of the TPO, the Assessing Officer does not consider the same in the impugned draft assessment order dated 22 March 2013 on the ground that in view of Section 92 CA (4) , the Assessing Officer is obliged to pass an order in conformity with the ALP determined by the TPO. This jurisdictional issue has to be dealt with either by the TPO or the Assessing Officer when specifically raised by the petitioner/assessee.

33. Normally when an accountant reports an international transaction under Section 92E there may be no dispute that there is an income arising and/or being affected or a potential of an income arising and/or being affected by an international transaction on determination of ALP. However when an assessee challenges the above premise, then the issue must be decided. Such an issue must be dealt with at the very threshold that is before determination of ALP. This is so because in case it is held that in the International Transaction there is no income or potential of any income arising and/or being affected on determination of an ALP, the entire exercise of determining the ALP would become academic. In terms of Section 92CA(4) , the Assessing Officer is bound to pass an order in conformity with the ALP determined by the TPO as held by another Division Bench of this Court in the judgment dated 6 September 2013 in Vodafone II case. However where the Assessing officer is himself determining the ALP in terms of Section 94C(3) then in accordance with Section 94C(4) he would compute the income, having regard to the ALP. In such cases where the Assessing officer decides the ALP himself, it is open to him to consider the issue of income arising and/or being affected or not before commencing the proceedings under Chapter X or at the stage of passing an assessment order.

34. However, in cases of transaction referred to the TPO, it would be for the Assessing Officer to first determine the issue of any income arising and/or being affected or potentially arising on determination of ALP before referring the transaction to the TPO, when specifically contended by the petitioner/Assessee. This is also indicated in Section 92CA(1) which requires an Assessing officer to refer an International Transaction for determination to the TPO only if he considers it "necessary or expedient" to refer the mater to the TPO. The exercise of finding out whether any income arises and/or is affected or potentially arises and/or is affected by the International Transaction would certainly be a factor to determine whether or not it is necessary or expedient to refer the matter to the TPO. In case no objection is raised by the assessee to the applicability of Chapter X then the prima facie view of the Assessing officer would be sufficient before referring the transaction to the TPO for determining the ALP. However where an objection is raised about the applicability of Chapter X by an assessee then the requirement for taking a decision after taking on board the objection becomes necessary. In the absence of it being considered at this stage, the same could only be considered by the DRP and as pointed out above, if considered at the very threshold by the Assessing Officer it could save an elaborate exercise of determining the ALP which may turn out to be entirely academic. It is for the above reason that grant of personal hearing before referring the matter to the TPO has to be read into Section 92CA(1) in cases where the very jurisdiction to tax under Chapter X is challenged by the assessee. Admittedly the aforesaid exercise of considering the objection of no income arising or potentially arising from the transaction has not been done in this case and finds no mention even in the draft assessment order.

35. The revenue has relief upon various decisions to contend that no personal hearing is necessary before referring the matter to the TPO. The relevant cases are as under:

(*a*) *Sony India (P) Ltd.* v. *CBDT* 2007(288) ITR 512;

(*b*) *Aztee Software & Technology Services Ltd.* v. *ACIT* 2007 (294)(AT) 32; and

(*c*) *Veer Gems* v. *ACIT* 2013(351) ITR 35.

36. So far as the decisions at (a) and (b) are concerned they were rendered in the context of Section 92CA(4) as existing prior to 2007. The pre-amended Section 92CA(4) provided that the Assessing officer will determine the income having regard to the ALP arrived at by the TPO. The earlier (unamended) Section 92CA(4) reads as under:-

> 92CA (4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C having regard to the arm's length price determined under sub-section (3) by the Transfer Pricing Officer. (emphasis supplied)

This was similar to the power which the Assessing officer still enjoys when he determines the ALP himself in terms of Section 92C(4) as pointed out above. Thus at that time the Assessing officer was not bound to complete the assessment in compliance with the ALP determination of the TPO and it was open to the Assessing officer to consider the question of jurisdiction at the time of passing the draft assessment order. However with effect from 2007, Section 92CA(4) has undergone a change and the Assessing officer is bound to pass an order in conformity with the ALP determined by the TPO. Amended Section 92CA(4) reads as under:-

> 92CA(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer.
>
> (emphasis supplied)

Therefore in the context of the pre-amendment law as then existing hearing on jurisdictional issues could take place after the order of the TPO which is not possible post amendment of 2007. In any case, the fact situation existing in this case of viz. a question of jurisdiction was not in issue in the above cases and therefore these two cases can have no application to the present case.

37. So far as the decision of the Gujarat High Court in Veer Gems case is concerned, it deals with the post amended section 92CA(4) and holds that no hearing need be given by the Assessing Officer before making a reference to the TPO even in respect of jurisdictional issue. This was based on the reasoning that the jurisdictional issue can be decided by the Assessing Officer while framing the assessment order at which time a hearing would be given. The Gujarat High Court held that under section 92CA(4) the Assessing officer is bound by the order of the TPO only to the extent of determination of the ALP and on all other issues arising under Chapter X , the Assessing Officer can independently decide all other questions while framing the assessment at which time a hearing would be afforded to the petitioner. However, the Division Bench of this Court in Vodafone II case (para 69) has disagreed with above view of the Gujarat High Court in *Veer Gems* (*supra*).The Division Bench of this Court has held that the Assessing

Officer cannot deviate from the order of the TPO on any issue including jurisdictional issue that the transaction is or is not an International Transaction. Further we note that in case the draft assessment order is objected to before the DRP then in that event in terms of Section 144C(13) the Assessing Officer is obliged to complete the assessment without granting a hearing to the assessee in accordance with the directions of the DRP. Thus to our mind the hearing has to be given by the Assessing officer before making a reference to the TPO. Thus on this aspect of the matter in view of the decision of a co-ordinate Bench of this Court, we do not accept the view of Gujarat High Court in *Veer Gems*(*supra*).

38. The petitioner seeks to read the requirement of personal hearing in all cases where the Assessing officer seeks to refer an international transaction to the TPO for determination of ALP. It is submitted that even if the hearing is not provided at the stage of reference to TPO under Section 92CA(1) , atleast hearing on the jurisdictional issue is required to be given by TPO when he issues notice to assessee under Section 92CA(2).

39. It was contended by learned counsel for the petitioner that in *Veer Gems* (*supra*) after referring to the assessee's reply to notice under Section 92CA (2) and after recording prima facie satisfaction that the provisions of Section 92A were attracted, in his notice dated 16 August 2011 the TPO directed the assessee to show cause why its transaction with the associated enterprise should not be subject to transfer price proceeding and profits of the assessee not appropriately modified. The TPO had ,thus, appreciated that application of transfer pricing provisions was going to cause serious civil consequences for the assessee in that case and ,therefore, principles of natural justice were required to be followed. The same should be done by the TPO in all cases.

40. In our view, once the AO gives hearing to the assessee before making a reference to TPO, the TPO would be bound by formation of opinion of AO that there was international transaction in the relevant year and that income arises or is affected by the international transaction and the TPO is bound to determine the ALP of the international transaction under consideration, since ultimately it is the duty and responsibility of AO to assess chargeable income of the assessee on the basis of the provisions . Hence, there would be sufficient compliance with the principles of natural justice, if AO gives an opportunity of hearing to the assessee. Normally when the assessee files his return along with a copy of the Accountant's report under Section 92E the applicability of Chapter X may be an admitted position. However we may add a caveat and that is: where the assessee objects to the jurisdiction under Chapter X being exercised then hearing is required to be given by the Assessing officer to the assessee to consider whether it is necessary and expedient to refer the matter to the TPO as otherwise this objection would never be considered, as pointed out above and as in fact has happened in this case. In such cases where the applicability of Chapter X to the facts of the assessee's case is objected to, a hearing should be given to consider the assessee's objection but not otherwise.

41. Thus, in the above circumstances, there is no bar in the Assessing officer deciding the jurisdictional issues about applicability of Chapter X when objected to by the assessee, after giving a personal hearing before referring the matter to the TPO.

42. The revenue also places reliance upon the decision of the Authority for Advance Ruling (AAR) in the matter of *Castleton Investments Ltd*. (2012) 348 ITR 537 to contend that ALP has to be first determined and the chargeability to tax would arise only at later stage. Hence it is submitted that there is no requirement to decide the issue whether income arises or not at the threshold.

43. We find that the facts of the above case are completely different and a decision rendered in the context of facts therein can have no application to the present case. In the above case, the issue was whether income arising from an international transaction was chargeable to tax or not in view of the Double Tax Avoidance Agreement ("DTAA") between India and Mauritius. It was contended by the applicant therein that even if income does arise out of the international transaction, the same would not be chargeable to tax in view of the DTAA. Thus it was contended that the exercise of determining the ALP need not be gone into. The AAR held that whether or nor there is liability to pay tax would not affect the operation of Chapter X . In the present case, the issue which arises is whether income arises or potentially arises from the international transaction. The liability to pay tax is an issue which arises after determining the income arising from the transaction. In the case of *Castleton* (*supra*), there was no dispute that income does arise from the international transaction. Thus Chapter X became applicable and the entire exercise as provided therein has to be carried out and thereafter the issue of chargeability to tax would arise. In fact in the case before us the petitioner's contention is that no income arises from the International transaction and Chapter X is not applicable. Therefore the above case of Castleton (supra) does not support the revenue.

44. The learned Solicitor General submitted that the action of AO in referring the international transaction to TPO is a mere administrative act, because as per CBDT Instruction No.3 dated 20 May 2003, AO is to exercise powers under Section 92C where the value of the transaction is upto Rs.5 crores (now revised to Rs.15 crores) and AO is required to refer the transaction to TPO where even the value of the international transaction exceeds Rs. 5 crores (now exceed Rs.15 crores). It is, therefore, submitted that in view of the above Circular, AO has no discretion in the matter and , therefore, AO hearing the assessee before making reference to TPO would be an empty formality and a futile exercise.

45. We are unable to accept the above submission of the revenue. CBDT Circular regarding distribution of files depending on value of transaction cannot detract from the obligation of AO to follow the principles of natural justice, which we have read into Section 92(A)(1), because once AO refers the transaction to TPO, AO will be bound to act in conformity with the order of TPO, as mandated by Section 92CA(4), in all respects including jurisdictional issue as held by this Court in Vodafone II case.

46. In view of the above discussion, We find no merit in the contentions of the revenue that no hearing is required to be given to the assessee in respect of jurisdictional issues. There has to be consideration of the petitioner's objection to the applicability of Chapter X . The same should atleast have found a place in the impugned draft assessment order. The failure on the part of the AO in not having examined the issue of income arising or not from an international transaction is an illegality.

47. However as no final assessment order has yet been passed by the Assessing officer and the issues are still at large before the DRP the same could be urged before the DRP. In the facts of the present case we are not inclined to set aside the draft assessment order of the AO or the order of the TPO and remand the matter to AO, because the AO has already filed an affidavit contesting the petition on merits and justifying the stand that the alleged shortfall in premium upon issue of shares is chargeable to income tax under Chapter X . Hence, instead of remanding the matter to the AO to examine this question, we are of the view that the merits of this question must be considered by DRP under Section 144C(5) read with Section 144C (8) . In a given case

if the DRP requires any further material, DRP may exercise its powers either under Section 144C(7) or (5) i.e. by directing the Assessing officer to make enquiry into this aspect of the matter and report or alternatively decide it itself and give final directions to the assessing officer. The process before the DRP is a continuation of the assessment proceedings as only thereafter would a final appealable assessment order be passed. Till date there is no appealable assessment order. The proceeding before the DRP is not an appeal proceeding but a correcting mechanism in the nature of a second look at the proposed assessment order by high functionaries of the revenue keeping in mind the interest of the assessee. It is a continuation of the Assessment proceedings till such time a final order of assessment which is appealable is passed by the Assessing Officer. This also finds support from Section 144C(6) which enables the DRP to collect evidence or cause any enquiry to be made before giving directions to the Assessing Officer under Section 144C(5) . The DRP procedure can only be initiated by an assessee objecting to the draft assessment order. This would enable correction in the proposed order(draft assessment order) before a final assessment order is passed. Therefore, we are of the view that in the present facts this issue could be agitated before and rectified by the DRP.

48. We now take up for consideration the ground based on the constitution of the DRP: one of the members is the Director of Income Tax (Transfer Pricing). In terms of CBDT Instruction No.3/2003 a Director of Income Tax(Transfer Pricing) is required to approve the order passed by the TPO on the ALP. Hence it is submitted that the hearing before the DRP would not be fair hearing as a person of equal rank has already approved the order of TPO.

49. This submission completely overlooks the fact that the proceedings before the DRP are not appeal proceeding but a proceeding to finalize the assessment on the basis of the draft assessment order. Besides, the DRP consists of three members and does not have the Director of Income Tax (Transfer Pricing) in particular who had approved the order of the TPO as a member. In these circumstances, we do not find any merit in this objection.

50. We have mentioned herein above that it is necessary for the Assessing Officer to decide the issue of objection to applicability of chapter X , if raised by the assessee, before referring the transaction to the TPO as it is a basic issue and would prevent loss of man hours on both sides in computing the ALP if it is finally concluded that Chapter X is not applicable. We are of the view that this exercise could also be done by the Assessing officer before he determines the ALP in exercise of his powers under Section 92C(3) . It was Mr. Nani Palkhiwala who in the concluding paragraph of his Preface to the eighth edition of his monumental work

> "The Law and Practice of Income Tax" observed:-
>
> "Every Government has a right to levy taxes. But no Government has the right, in the process of extracting tax, to cause misery and harassment to the taxpayer and the gnawing feeling that he is made the victim of palpable injustice"

The revenue would do well to keep the above stage advice in mind while dealing with the assessee. We are constrained to observe that in this case it would be natural for the petitioner to feel harassed as the Assessing Officer did not give any opportunity of hearing before making a reference to the TPO and none of the two authorities viz. the TPO and the Assessing Officer dealt with its preliminary objection. The TPO does not deal with the petitioner's objection about applicability of Chapter X , on the ground that it would be dealt with by the Assessing officer. Thereafter when the petitioner raises the same issue before the Assessing Officer he does not

deal with the same on the ground that he is bound to complete the assessment in terms of the ALP determined by the TPO. We hope the revenue will be more sensitive to the just demands of the assessee and not treat the assessee as an adversary who has to be taxed, no matter what.

51. Mr.Harish Salve, learned senior counsel for the petitioner has made a serious grievance that when the assessee is bringing in the country Foreign Direct Investment (FDI) by way of issue of share capital by an Indian subsidiary company to its foreign holding company, such capital receipts are sought to be taxed, even when the Income-tax Act does not contain any provision for such chargeability. Even with effect from 1 April 2013, it is only when the share issuing company falling under Section 56 receives share premium in excess of fair market value of such shares, that such excess premium would be chargeable to income-tax. The revenue's case in the present matter is that the share premium was less than the fair market value of the shares issued by the petitioner. Secondly, the petitioner has heavily relied upon the decision of the Supreme Court in *Khoday Distilleries Ltd.* v. *CIT* [2009] 1 SCC 256 (261) laying down that issue of shares to a subscriber is creation of shares, whereas purchase of shares from an existing shareholder is transfer of share. Hence, there is no question of taxing the difference between alleged fair market price of the shares issued by the petitioner to its holding company and the issue price as capital gains as contended by the revenue in its reply-affidavit.

52. The assessee is entitled to have its preliminary objection (against chargeability of the alleged short fall in share premium) dealt with. Not a single authority has so far dealt with this issue and even the learned counsel for the revenue did not address us even briefly on merits of this controversy to show a plausible prima facie defence (though the revenue sought to justify its stand in the affidavit-in-reply and in the written submissions after conclusion of the oral argument) Though the petitioner submitted that we decide the issue on merits, we have not done so for the present for all the reasons pointed out above. Therefore the submissions made on merits are not being considered by us and left open to be urged before the DRP for consideration by the DRP, but even proceeding on the basis that transaction in question is an international transaction since the preliminary objection raised by the petitioner raises a question of law and does not involve disputed questions of fact and having regard to how the petitioner's preliminary objection has so far not been dealt with by the Revenue, this appears to be a fit case to direct the DRP to decide the petitioner's objection regarding chargeability of alleged shortfall in share premium as a preliminary issue and further to observe that in case the decision of the DRP on the preliminary issue is adverse to the petitioner, it would be open to the petitioner-assessee to challenge the decision of the DRP on the preliminary issue in a writ petition, in case the petitioner makes out a case at that stage that the decision of the DRP on the preliminary issue is patently illegal, notwithstanding the availability of alternate remedy before the ITAT.

53. In the above circumstances, we dispose of the present petition with the following directions:-

(A) The petitioner shall within two weeks from today submit before the DRP its preliminary objections to Draft Assessment Order and the TPO's order by raising jurisdictional issues.

(B) The DRP shall decide the issue of jurisdiction before considering issue of valuation / quantification raised by the petitioner in its objections filed before the DRP, this of course subject to the additional grounds on jurisdiction being filed by the Petitioner within two weeks from today. The DRP shall decide the issue of jurisdiction as a

preliminary issue within two months from the date on which the petitioner files its objections on the question of jurisdiction.

(C) We make it clear that since the question of jurisdiction for applicability of Chapter X for the Assessment Year 2009-10 is raised independently of the challenge to the orders of the TPO and the AO for the Assessment Year 2008-09, the DRP shall decide the preliminary issue about applicability of Chapter X to the assessment for the Assessment Year 2009-10, without awaiting for decision on the dispute relating to the Assessment Year 2008-09.

(D) We further make it clear that in case the decision of the DRP on the above preliminary issue is adverse to the petitioner, it would be open to the petitioner to challenge the order of the DRP on the preliminary issue in a writ petition if a case is made out at that stage that the decision of the DRP is patently illegal, notwithstanding the availability of alternative remedy of filing an appeal before the Income Tax Appellate Tribunal.

54. The petition was filed on 24 April 2013. The objections with regard to computation in the draft assessment order were lodged before DRP on 26 April 2013. In view of the matter pending before this Court, the respondent-revenue had made a statement before us to maintain status-quo and not to proceed with the hearing before the DRP. This statement was made on 24 August 2013. Thereafter, on 29 October 2013 we have granted stay of the proceedings before the DRP. In view of the fact that this petition was filed, the DRP was not able to conduct proceedings in respect of the objections filed by the petitioner. The DRP in terms of Section 144C(12) has to give its directions within nine months from the end of the month in which the Draft Assessment Order is received by the assessee. The draft assessment order was passed on 22 March 2013. The period of nine months would thus commence from 1 April 2013 and expire on 31 December 2013. In view of the above, the period for the DRP to give its directions under Section 144C(5) shall exclude the period from 24 August 2013 (when the respondent-revenue made a statement to the Court that they would maintain status-quo) till the DRP decides the preliminary issue.

55. All the issues and contentions are left open, to be urged/ agitated before the DRP.

56. Writ Petition is disposed of with the above directions, with no order as to costs.