Ernst And Young U.S. Llp vs Assistant Commissioner Of Income Tax on 11 December, 2024

Author: Yashwant Varma

Bench: Yashwant Varma, Dharmesh Sharma

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* IN THE HIGH COURT OF DELHI AT NEW DELHI
+ W.P.(C) 7578/2023
ERNST AND YOUNG U.S. LLP .....Petitione
Through: Mr. Kamal Sawhney, Mr. Nikhil Agarwal & Mr. Nisha Vashistha, Advs.
versus

ASSISTANT COMMISSIONER OF INCOME TAX .....Respondent
Through: Mr. Sunil Agarwal, SSC with Mr. Shivansh B. Pandya, Mr. Viplav Acharya, Ms. Priya Sarkar, JSCs & Mr. Utkarsh Tiwwari, Adv.
CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE DHARMESH SHARMA
ORDER

% 11.12.2024

1. The writ petitioner impugns the reassessment action initiated by the respondent in purported exercise of powers conferred by Section 148 of the Income Tax Act, 1961 1. The proceedings pertain to Assessment Year2 2019-20 and commenced with the issuance of a Show Cause Notice3 referable to Section 148A(b) on 30 March 2023. That SCN laid the following allegations:

> "Notice under section 148 of the Income-tax Act, 1961 Sir/ Madam/ M/s
>
> 1. I have the following information in your case or in the case of the person in respect of which you are assessable under the Income tax Act, 1961(here in after referred to as "the Act") for Act AY SCN This is a digitally signed order.
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> The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 18/12/2024 at 21:16:44 Assessment Year 2019-20 • Information in accordance with the risk management strategy formulated in this regard Suggesting that income chargeable to tax has escaped assessment within the meaning of section

147 of the Act. Order under sub- section (d) of section 148A of the Act has been passed in such case vide DIN ITBA/COM/F/17/2023-24/1052417972(1) dated 28.04.2023 and annexed herewith for reference,

2. I, therefore, propose to assess or reassess such income or recompute the loss or the Depreciation allowance or any other, allowance or deduction for the Assessment Year 2019-20 and I, hereby, require you to furnish, within 30 days from service of this notice, a return in the prescribed form of the Assessment Year 2019-20.

xxxx

Show cause notice u/s 148A(b) of IT Act, in case of ERNST & YOUNG US LLP for AY 2019-20

1. This case has been picked up by the Risk management Strategy of Insight for Non-Filing of Income Tax Return for the subject year, despite information available with the department of income in the year. On perusal of the AIR information and Form 15CA/CB available with the systems, it is observed that the assessee during the FY 2018-19 has entered into the following transactions:-

Person Details PAN 0000000000 DOB/Incorporation Name ERSNT & YOUNG US LLP Address -

State		Place Outside India	Pincode
Email			Mobile
Jurisdictional PCIT		PR. COMMISSIONER OF INCOM	

Information Details

Information FY	Information Source Type	Information Source Description	Information Type	Information Description

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35,535,295 CA/CB Outward has received Remittances remittances from S R Batliboi & Associates LLP Verification Details Nature of Others Priority Rating High Priority Verification Verification Result Actionable Result Result Result Income Remarks AY Type Description Value Represented by 2019-20 TDS The Applicant has 35.535.295 Others Default received remittances from S R Batliboi & Associates LLP Documents Document Document Remarks Document Note Size (DB) Type Description Others S R Batliboi & Associates 715453 LLP.pdf Upload Details Upload ID 1000157020 Uploaded On 20-01-2023 VSN 1 Reference --

Uploaded By Sanjay Kumar Mishra, Ward INT TAX 3(1)(2) DELHI However on perusal of the records of the assessee it is seen that the assessee has not filed its return of income for the AY 2019-20. Hence in the absence of the same of source of the funds and the tax liability on the income to the tune of Rs. 3,55,35,295/- could not be ascertained.

As per the RMS details, the assesee has carried out above mentioned transactions, and thereby has exceeded the maximum amount which is not chargeable to tax. However assessee has not filed the return of income for the FY 2018-19 relevant to AY 2019-

20. In absence of the return of income filed by assessee, the transaction remains unexplained and the assessee has failed to comply with the statutory provisions of the Income Tax Act, therefore, I have reason to believe that income has escaped assessment in the case of the assessee.

3. You are therefore required to show cause why the amount of Rs.3,55,35,295/- shall not be treated as escaped assessment and This is a digitally signed order.

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4. You are required to justify your claim with the relevant bank statement/documentary evidence. You are required to submit the details on or before 10.04.2023.

AKSHAY ANAND CIRCLE INT TAX 1(2)(2)"

2. As is evident from a reading thereof, the reassessment was triggered by the case of the petitioner being picked up by the Risk Management Strategy tool pertaining to assessees who had not filed Income Tax Returns 4. The Assessing Officer5 alleged that the remittances received by the petitioner from S. R. Batliboi & Associates LLP 6 and which constituted a 'Foreign Outwards Remittance' had not been disclosed.

3. The SCN issued under Section 148A(b) proceeds on the premise that the assessee had not filed its ITR for AY 2019-20 and hence, in the absence thereof, the source of funds and tax liability of those receipts not being ascertainable. It thus proceeded to observe that since no ITR had been filed, the transaction remained "unexplained". It was on the aforesaid basis that the AO came to form the opinion that income had escaped assessment.

4. Pursuant to the issuance of the SCN, the petitioner furnished a detailed reply and whereafter a final order referable to Section 148A(d) came to be passed and in which the AO came to affirm its original opinion of income otherwise assessable under the Act, having escaped assessment.

5. For the purposes of appreciating the challenge which stands ITRs AO SRB This is a digitally signed order.

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"3. Please give detailed background of the company and its activities and sources of revenue with particular reference to business model and activities carried out in India during the year under consideration. Give a detailed note regarding nature of your business activities and furnish details in respect of the works undertaken/executed in India alongwith total receipts/income derived from in India during the year.

xxxx xxxx xxxx

9. Please give details along with bifurcation into different streams in respect of all the streams of revenues accruing/ arising/ receipt either directly or indirectly through/from India.

10. Please furnish copies of all contracts and agreements (clearly explaining the "scope of work") operative during the year in respect of your activities in India. Copy of agreement/Contracts entered into with Indian customers/clients or any other party in India from whom any payment is received during the year or has accrued or arisen during the year may also be provided.

xxxx xxxx xxxx

> 12. Copy of all orders u/s 197 obtained from the assessing officers relevant to the assessment year in question, if any."

6. Responding to that notice, the petitioner submitted a detailed reply on 25 September 2021. Along with the reply that was submitted, the petitioner while responding to the specific queries noticed above, also provided details of its Indian clients along with particulars of invoices and the foreign remittances received by it. This also becomes This is a digitally signed order.

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> "As mentioned above, the assessee is a limited liability partnership (firm of individuals) engaged in rendition of professional services. As assessee has opted to be taxed as per the provisions of India-US tax treaty, the provisions pertaining to accrual or deemed accrual under the domestic tax law are not applicable and the information is provided herein under to the extent relevant and relatable to the income taxable as per the provision of Article 15 of the India-US tax treaty as further elaborated below.
>
> It is submitted that considering the assessee is a partnership firm rendering professional services, its income will not be governed by Article 12 of FTS in light of specific exclusion in Article 12(5) of the Treaty.
>
> Given the above, the taxability of various receipts of the assessee are governed by the provisions of Article 15 "Independent Personal Services" which provides as under:
>
> 1. Income derived by a person who is an individual or firm of individuals (other than a company) who is a resident of a Contracting State from the performance in the other Contracting State of professional services or other independent activities of a similar character shall be taxable only in the first-mentioned State except in the following circumstances when such income may also be taxed in the other Contracting State :
>
> (a) if such person has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other State; or
>
> (b) if the person's stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 90 days in the relevant taxable year."

Per the above provision, income derived by a USA partnership from performance of professional services in India can be taxed in USA only unless:

(a) such USA partnership has a fixed base regularly available to such partnership for performing the activities; or

(b) if personnel of EY US stay in India for a period(s) of 90 days in the relevant taxable year.

Thus, the income from services performed in India for clients based in India will be taxed in India provided the non-resident has fixed base or personnel of EY US stay in India exceeds 90 days for This is a digitally signed order.

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1. Receipts from clients based in India for services performed in and from "USA" for such clients The assessee has received USD 80,97,926 (i.e. INR 55,41,41,076) from its clients based in India for the rendering professional services, based on agreed agreements/ statement of works. A detailed party wise breakup of the said amount along with sample copy of invoices are enclosed as Annexure I and Annexure II respectively.

Such amounts have been earned by the assessee with respect to professional services performed outside India. The assessee does not have any office in India and these services are not performed in India, thus, the said receipt are taxable in USA only and hence, have not been offered to tax in India in light of the provisions of Article 15 of the India-USA tax treaty."

7. From a perusal of the response which was submitted, it is evident that the petitioner claimed the benefit of Article 15 of the India-United States Double Taxation Avoidance Agreement 7 and which exempts Independent Personal Services 8 from taxation, except in cases where the foreign entity has a fixed base regularly available in the other Contracting State or if that entity stays in the other Contracting State for a period or periods amounting to or exceeding in the aggregate 90 days in the relevant taxable year.

8. The assessment for AY 2019-20 ultimately came to be finalized in terms of Section 143(3) of the Act. The stand of the petitioner insofar as remittances received from Indian clients and the same liable DTAA IPS This is a digitally signed order.

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passing the final order dated 27 July 2022. This is apparent from a reading of the following extracts of that order:

> "2. The assessee is LLP incorporated under the laws of US and is engaged in providing services in the field of assurance, tax, transaction and business advisory services etc. to its clients across globe including India. The assessee is eligible to treaty benefits as per the India-USA tax treaty.
>
> 3. A notice u/s 142(1) of the Act was issued on 08 July 2021 to assessee seeking details of various receipts offered/ not offered to tax in return filed for the subject year. In response to the said notice, the assessee has filed its submission in two parts vide letters dated 30 July 2021 and 25 September 2021."

9. As would be evident from a reading of the final assessment as framed, the AO ultimately held against the petitioner only in respect of 'secondment of employees'. These facts, however, clearly do not appear to have been either noticed or taken into consideration while issuing the SCN under Section 148A(b).

10. It is thus evident and apparent that the very premise which constituted the foundation for the formation of an opinion under Section 148 was inherently flawed and factually incorrect. The formation of opinion was clearly tainted beyond measure since not only were the remittances from SRB duly disclosed, the petitioner had also asserted that the said remittances were not liable to be taxed under the Act since they would constitute IPS and be regulated by Article 15 of the DTAA. This stand also came to be accepted by the AO while finalizing the assessment in terms of Section 143(3).

11. It is in the aforesaid backdrop that Mr. Sawhney, learned counsel appearing for the writ petitioner contends that the impugned This is a digitally signed order.

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12. We had in Banyan Real Estate Fund Mauritius vs. CIT9 dealt with an identical situation and where too the reassessment action was premised on the fact that the petitioner therein was a non-filer. Upon noticing that the said assumption itself was factually incorrect, we had in Banyan Real Estate held as follows:

> "22. Having noticed the rival contentions which were addressed, we find that the notice under Section 148A(b) of the Act undoubtedly suffers from certain fundamental factual errors. As was pointed out by the writ petitioner, and which fact has been tacitly admitted by the respondents, the SCN had proceeded on the premise that the petitioner had not filed its Return of Income for AY 2016-2017. Once this was established to be factually incorrect, the respondent while passing the order under Section 148A(d) sought to overcome this mistake by observing that although a Return

> of Income had been submitted, it had not been subjected to assessment as contemplated under Sections 143(3), 147 or 144 of the Act. It while passing the order disposing of the objections taken by the writ petitioner, also observed that the income relating to the transactions in question had not been offered to tax. It is on the aforesaid basis alone that the AO proceeded to observe that income earned in the concerned AY appeared to have escaped assessment.
>
> 23. We at the outset note that the aforesaid reasoning as adopted is rendered wholly unsustainable since undisputedly prior to the petitioner submitting its reply to the SCN, the AO was not only totally oblivious of a return having been submitted, it had not even examined the same in order to form an opinion that income liable to tax had escaped assessment. The original show cause notice was neither reflective of nor based on a due evaluation of the return as submitted. Regard must also be had to the fact that undisputedly the financial transactions which were spoken of were duly disclosed in the return which had been submitted for AY 2016-2017. Merely because the petitioner had taken the position that the income was not taxable under the Act, would not constitute a basis for the respondent forming the opinion that income had escaped assessment. The question of income being voluntarily offered to taxation would ultimately depend upon an assessee conceding to its exigibility to 2024 SCC OnLine Del 5312 This is a digitally signed order.
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> The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 18/12/2024 at 21:16:45 tax. In order to sustain a proposed reopening, it was incumbent upon the respondent to have formed an opinion that the financial transaction was in fact liable to be taxed under the Act and thus, resulting in income having escaped assessment. However, and as is manifest from a reading of the original SCN, no such allegation stood levelled against the petitioner."

13. As was found by us in Banyan Real Estate, the AO was wholly oblivious of the stand taken by the writ petitioner during the course of the original assessment proceedings and where it had relied upon Article 15 of the DTAA. Before us, it is only in the course of the framing of the final order under Section 148A(d) and for the first time that the AO now seeks to question the eligibility of the petitioner to claim benefits under that covenant and to characterise the remittances as IPS. This was thus a position identical to what had obtained in Banyan Real Estate and led us to come to the irresistible conclusion that the reassessment proceedings were rendered unsustainable.

14. While dealing with the formation of opinion originally and the ultimate order that may come to be passed under Section 148A(d) of the Act, we had in Banyan Real Estate additionally observed as follows:

> "28. Before concluding, and in our considered opinion, the impugned action is liable to be faulted since it clearly suffers from the following foundational illegality. As was rightly contended by Mr. Singh, the reasons which weigh upon an Assessing Officer

proposing to reopen an assessment and form the bedrock of a notice under Section 148A(b) of the Act alone are germane for the purposes of evaluating the validity of that action. It is those set of reasons and which form the basis for the Assessing Officer forming an opinion that income liable to tax has escaped assessment alone which would merit examination and evaluation. A decision to reopen or reassess cannot be based or sought to be justified either on additional reasons or those which may be supplied subsequently while disposing of objections preferred by an assessee. The statutory scheme of reassessment neither sanctions vacillation nor can a decision to trigger reassessment be sustained based upon an attempted This is a digitally signed order.

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29. These fundamental precepts assume added significance when viewed in light of the right to object which stands statutorily conferred upon an assessee. If the ultimate decision to justify initiation of reassessment be based on entirely new or previously undisclosed material or reasoning, it would clearly result in deprivation of a right to effectively object to the proposed action. It is these aspects which constrain us to come to the conclusion that the impugned action is rendered wholly unsustainable.

30. The aforenoted imperatives were duly highlighted by us in our recent decision in ATS Infrastructure Limited v. Assistant Commissioner of Income Tax Circle 1(1) Delhi and where we had an occasion to deal with a similar challenge. While ruling on these aspects, we in ATS Infrastructure Limited had observed as follows:--

"6. Our Court in Commissioner of Income Tax-II v. Living Media India Ltd. had pertinently observed that additional reasons cannot be provided or recorded by the Assessing Officer4 subsequent to the issuance of a notice under Section 148 of the Act. We deem it apposite to quote the following passage from that decision:--

"13. With regard to the additional reasons which were recorded subsequent to the issuance of notice under section 148 of the said Act, we have already observed that this could not have been done by the Assessing Officer. The validity of the proceedings initiated upon a notice under section 148 of the said Act would have to be judged from the stand point of the reasons which existed at the point of time when the section 148 notice was issued. The additional reasons cannot be provided or recorded subsequent to the issuance of notice under section 148. It is, of course, open to the Assessing Officer, if some other information comes within his knowledge to

> issue another notice under section 148 for different reasons. But that is not the case here. On the basis of the very same notice issued under section 148, the Assessing Officer has recorded additional reasons subsequent to the issuance of notice and this is impermissible in law."

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7. It becomes pertinent to observe that the validity of the proceedings initiated upon a notice under Section 148 of the Act would have to be adjudged from the stand point of the reasons which formed the basis for the formation of opinion with respect to escapement of income. That opinion cannot be one of changing hues or sought to be shored upon fresh reasoning or a felt need to make further enquiries or undertake an exercise of verification. Ultimately, the Court would be primarily concerned with whether the reasons which formed the bedrock for formation of the requisite opinion are tenable and sufficient to warrant invocation of Section 148 of the Act.

8. We in this regard find the following pertinent observations which appear in a decision of the Bombay High Court in Indivest Pe. Ltd. v. Additional Director of Income-tax.

> "11. Reading the reasons of the Assessing Officer, it is evident that there is absolutely no tangible material on the basis of which the assessment for the assessment year 2006-2007 could have been reopened. Upon the return of income being filed by the assessee both in the electronic form and subsequently in the conventional mode, the assessee received an intimation under section 143(1). The Assessing Officer would have been legitimately entitled to issue a notice under section 143(2) within the statutory period. That period has expired. We must clarify that the non-issuance of a notice under section 143(2) does not preclude the Assessing Officer from reopening the assessment under section 147. For that matter, as has been held by the Supreme Court in Asst. CIT v. Rajesh Jhaveri Stock Brokers P. Ltd., (2007) 291 ITR 500 (SC), the failure of the Assessing Officer to take steps under section 143(3) will not render the Assessing Officer powerless to initiate reassessment proceedings even when an intimation under section 143(1) has been issued. But it is also a settled principle of law that when the Assessing Officer issues a notice under section 148, at that stage the only question is whether there was relevant material on which a reasonable person could have formed a requisite belief (Rajesh Jhaveri (supra). At that stage, an established fact of the escapement of income does not have to be proved, since it is not necessary that the This is a digitally signed order.
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> The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 18/12/2024 at 21:16:45 Assessing Officer should have finally ascertained that income has escaped assessment. The nature of the jurisdiction of the Assessing

Officer which was dealt with by the judgment of the two learned judges of the Supreme Court in Rajesh Jhaveri's case was revisited in a decision of three learned judges in CIT v. Kelvinator of India Ltd., (2010) 320 ITR 561 (SC). The Supreme Court has held that though after April 1, 1989, a wider power has been conferred upon the Assessing Officer to reopen an assessment, the power cannot be exercised on the basis of a mere change of opinion nor is it in the nature of a review. The Supreme Court has laid down the test of whether there is tangible material on the basis of which the Assessing Officer has come to the conclusion that there is an escapement of income. The Supreme Court held thus (page 564):

"However, one needs to give a schematic interpretation to the words 'reason to believe' failing which, we are afraid, section 147 would give arbitrary powers to the Assessing Officer to reopen assessments on the basis of 'mere change of opinion', which cannot be per se reason to reopen. We must also keep in mind the conceptual difference between power to review and power to reassess. The Assessing Officer has no power to review; he has the power to reassess. But reassessment has to be based on fulfilment of certain precondition and if the concept of 'change of opinion' is removed, as contended on behalf of the Department, then, in the garb of reopening the assessment, review would take place. One must treat the concept of 'change of opinion' as an in- built test to check abuse of power by the Assessing Officer. Hence, after April 1, 1989, the Assessing Officer has power to reopen, provided there is 'tangible material' to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. Our view gets support from the changes made to section 147 of the Act, as quoted hereinabove. Under the Direct Tax Laws (Amendment) Act, 1987, Parliament not only deleted the words 'reason to believe' but also inserted the word 'opinion' in section 147 of This is a digitally signed order.

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12. If the test of whether there exists any tangible material were to be applied in the present case, it would be evident that the Assessing Officer has not acted within his jurisdiction in purporting to reopen the assessment in exercising the powers conferred by section 148. There was a disclosure clearly by the assessee that it is a body corporate incorporated in Singapore, the principal business of which is to invest in Indian securities; that the assessee is a tax resident of Singapore and that the profits which the assessee realised from its transactions in securities constituted its profits from business. The assessee stated that it had no permanent establishment in India as defined in article 5 of the DTAA and that based on the provisions of article 7

the profits of Rs. 131.70 crores from transactions in Indian securities were not liable to tax in India. The only basis on which the assessment is sought to be reopened is on the assumption that the provisions of section 115AD would stand attracted. That is on the assumption that the assessee is an FIL Though the attention of the Assessing Officer was drawn to the fact that the assessee is not an FII and that the provisions of section 115AD would not be attracted, the Assessing Officer persisted in rejecting the objections to the reopening of the assessment. In the order disposing of the objections which were raised by the assessee, the succeeding Assessing Officer has clearly attempted to improve upon the reasons which were originally communicated to the assessee. The validity of the notice reopening the assessment under section 148 has to be determined on the basis of the reasons which are disclosed to the assessee. Those reasons constitute the foundation of the action initiated by the Assessing Officer of reopening the assessment. Those reasons cannot be supplemented or improved upon subsequently.

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xxxx xxxx xxxx

11. We also find merit in the submission of Mr. Kantoor who drew our attention to the First Proviso to Section 148 which reads as under:--

"148. Issue of notice where income has escaped assessment-Before making the assessment, reassessment or recomputation under Section 147, and subject to the provisions of Section 148A,-

> xxxx xxxx xxxx Provided that no notice under this section shall be issued unless there is information with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment in the case of the assessee for the relevant assessment year and the Assessing Officer has obtained prior approval of the specified authority to issue such notice."

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12. As is manifest from the above, the Proviso again ties the initiation of action to the existence of information which already exists or is in the possession of the AO and on the basis of which it comes to form the opinion that income liable to tax has escaped assessment. The provision thus fortifies our view that the foundational material alone would be relevant for the purposes of evaluating whether reassessment powers were justifiably invoked. Accordingly, and for all the aforesaid reasons we find ourselves unable to sustain the impugned reassessment action."

15. In Banyan Real Estate, we had ultimately quashed the reassessment action based on the following conclusions:

> "31. When tested on the aforesaid principles, it becomes manifest that the impugned action is rendered wholly untenable. While the original SCN had proceeded on the basis that the petitioner was a non-filer and the subject income constituting remittances made to a foreign entity, it was clearly established that a return had in fact been filed and duly acknowledged. The petitioner had not made any remittances to third parties. In fact it had earned revenue from the sale of shares which were claimed exempt from taxation by virtue of Article 13(4) of the DTAA. Once the aforesaid explanation was proffered, the AO then proceeded to hold that the petitioner was not entitled to treaty benefits, a charge which was not even laid in the original SCN or which could be said to have constituted the basis for the formation of opinion that reassessment was warranted. In fact the petitioner was not even made aware of the view which the AO was inclined to take in this regard. The AO then sought to salvage the reopening by requiring the petitioner to furnish further particulars with respect to the allotment of shares in terms of the Scheme of Arrangement. Suffice it to note that the original SCN not only failed to refer to this Scheme, a reading thereof leaves us with the definite impression that the AO was perhaps not even aware of those developments. We are thus constrained to hold that the impugned action when tested in light of the above and the legal principles which stand enunciated in respect of the authority to reassess cannot sustain."

16. In our considered opinion, the challenge here is clearly well grounded and is liable to succeed on reasoning identical to that which we had assigned in Banyan Real Estate.

17. We, accordingly, and for all the aforesaid reasons, quash the This is a digitally signed order.

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18. This order, however, shall be without prejudice to the right of the respondents to initiate such proceedings as may be otherwise permissible in law.

YASHWANT VARMA, J.

DHARMESH SHARMA, J.

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