

AUTHORITY FOR ADVANCE RULING-A CRITICAL ANALYSIS

By Swechha Malik³⁸⁸

Authority for Advance Ruling

A scheme of Advance Ruling was incorporated in Chapter XIX-B of the Income-tax Act in respect of assessment of income-tax liability of the transaction undertaken or proposed to be undertaken, in the case of non-residents and also specified categories of residents. For this purpose, an Authority was constituted under the Act called as the Authority for Advance Rulings ('AAR'), presided over by a retired Supreme Court judge.

AAR was constituted in order to help the applicant(s) ascertain their tax liability, and avoid the time-consuming and expensive process of litigation through obtaining a binding ruling from the AAR. Broadly speaking, the concept of advance ruling implies a written confirmation from a tax authority, in advance, regarding the tax implications of a proposed transaction. **This concept, based on the canon of certainty, is intended to overcome the obvious disadvantage of an uncertain tax position so that the taxpayer is forewarned about the tax ramifications of the action he proposes to undertake.³⁸⁹ Thus, the primary object of an advance ruling is to enable a taxpayer to know his tax liability in advance so that he can make a sound decision whether or not to go ahead with the transaction he has planned to undertake.³⁹⁰**

Who may file the application? Section 245N (B) of the Income-tax Act lays down various categories of applicants³⁹¹:

- i. Any non-resident person whether individual, company, firm, association of persons or other body corporate can make an application for seeking an advance ruling in regard to his/its tax liability.
- ii. A resident who has undertaken or proposes to undertake a transaction with a non-resident may seek a ruling for determination on any question of law or fact in relation to such transaction involving the tax liability of the non -resident.
- iii. A resident falling within notified categories may seek determination or decision by the Authority in respect of an issue relating to computation of total income which is pending

³⁸⁸ LLM Student(Taxation),O.P Jindal Global University

³⁸⁹ Pranav Sharma & Dipen Sabharwal, *System of Advance Rulings in India*, [2000]108 TAXMAN 105 (ART).

³⁹⁰ *Id*

³⁹¹ Section 245N (B) of Income-Tax Act,1961

before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact relating to such computation of total income.

Recently, resident applicant can make an application to the AAR in order to determine their tax liability arising out of one or more transaction valuing Rs.100 crore or more in total which has been undertaken or is proposed to be undertaken by such applicant.³⁹²

Procedure for filing application-The applicant may seek advance ruling by making an application to the Authority in the prescribed form i.e. Form No. 34C, 34D or 34E, as the case may be in the manner indicated therein and following the procedure as prescribed in AAR (Procedure) Rules, 1996. The application including the documents annexed thereto shall be signed in the manner indicated in the prescribed form and a fee is 10,000Rs.

Withdrawal of application-An applicant can withdraw an application within 30 days from the date of the application.

Procedure of advance ruling under Section 245 R of the Income Tax Act, 1961:

- The Authority on receipt of application will send a copy to the Commissioner concerned and, wherever considered necessary, also call upon the Commissioner to furnish relevant records. Such records will be returned to the Commissioner as soon as possible. The Authority may either allow or reject an application.
- *When the application can be rejected*-In the following three cases, an application of Non-Resident may be rejected³⁹³ :
 - i. The Authority shall not allow an application from a non-resident where the question of law or fact raised is already pending in the case of an applicant, either before any income-tax authority, the Appellate Tribunal or any Court.
 - ii. Applications will also not be allowed where the transaction, in relation to which the question is raised, is designed for the avoidance of Income-tax.
 - iii. Applications will not be allowed where the question raised relates to the determination of the fair market value of any property.
- **Application for Advance Ruling should be allowed even after filing of return of income**

³⁹² CBDT Notification No. 73/2014, dated 28-11-2014

³⁹³ Section 245 R of Income Tax Act,1961

The Authority for Advance Ruling does not allow the application if the question raised in it is already pending before any income-tax authority as provided in proviso to section 245R(2). Now, the question arises when the case would be deemed to be pending before an income-tax authority: (a) on filing of return of income; or (b) on issue of notice under Section 143(2) for scrutiny assessment?

The Supreme Court in the case of *Sin Oceanic Shipping ASA Norway v. AAR* [2014] 41 taxmann.com 444 (SC) affirmed the ratio laid down in the *Mitsubishi Corporation, Japan, In re* [2013] 40 taxmann.com 335 (AAR - New Delhi) that question raised in application for Advance Ruling will be considered as pending for adjudication before Income-tax Authorities, only when issues are shown in return and notice under Section 143(2) is issued.³⁹⁴ **Thus, application for Advance Ruling is to be admitted which is filed after filing of return but prior to issue of notice under section 143(2).** So, the AAR has set in stone its view on the contentious issue as to whether the filing of a tax return would in itself preclude an advance ruling application from being admissible. **The Authority for Advance Rulings in the case of *In Re: Mitsubishi Corporation*³⁹⁵, has held that the mere filing of a tax return does not create grounds for the rejection of an advance ruling application under proviso (i) to Section 245R of the Income Tax Act, 1961.³⁹⁶**

- **Pronouncement of advance ruling**-Where an application is allowed, the Authority shall pronounce its advance ruling on the question specified in the application. The applicant can, on request, appear either in person or can be represented through a duly authorized representative. A time limit of 6 months is provided for the pronouncement of advance ruling after the receipt of the application by authority.³⁹⁷ A copy of the advance ruling pronounced by the Authority (duly signed by the Members and certified), shall be sent to the applicant and the Commissioners soon as may be, after such pronouncement.
- **Certainty to tax payers in India (Section 245 S):** The advance ruling shall be binding only on the applicant who has sought it and in respect of the specific transaction in relation to which such advance ruling was sought.³⁹⁸ It will also be binding on the Commissioner and the income-tax authorities subordinate to the Commissioner.³⁹⁹ The ruling provides will remain in force unless there is change in law or in fact on the basis of which the advance ruling was

³⁹⁴ Pre-Budget-Key Expectations from the Budget 2015-16,[2015]54 taxmann.com 416 (Article)

³⁹⁵ [2013] 40 taxmann.com 335 (AAR - New Delhi)

³⁹⁶ NDA, *Mere Filing of Return does not bar admission of Advance Ruling Application*, Tax Hotline (December 13, 2013).

³⁹⁷ *Supra note 4*

³⁹⁸ Section 245 S of Income Tax Act,1961

³⁹⁹ *Id*

pronounced. So, Section 245 S was introduced to provide certainty of decision to the specified categories of tax payers.

Recent Controversy in Columbia Sports Wear case

Supreme Court in the case of *Columbia Sportswear Company vs. Director of Income Tax, Bangalore*⁴⁰⁰ has held that–

- i. An AAR is a tribunal within the meaning of the expression in Articles 136 and 227 of the Indian Constitution;
- ii. **Section 245S of the Act does not bar the jurisdiction of the Supreme Court under Article 136 or the jurisdiction of the High Court under Articles 226 and 227 of the Indian Constitution to entertain a challenge to the advance ruling of the AAR;**
- iii. To hold that an advance ruling of an AAR should not be permitted to be challenged before the High Court under Articles 226 and 227 of the Indian Constitution would be to negate the basic structure of the Constitution;
- iv. It does not encourage an aggrieved party to appeal directly to the Supreme Court against the order of the tribunal exercising judicial functions unless it appears to the court that a question of great importance arises.
- v. The power of the Supreme Court to entertain a SLP under Article 136 of the Indian Constitution is discretionary in nature and hence, **even if good grounds are made out in the SLP for challenge to an advance ruling given by an AAR, the apex court may still refuse to grant special leave** on the ground that the challenge to the advance ruling of the AAR can also be made to the High Court under Article 226 and/or Article 227 of the Indian Constitution.⁴⁰¹

So, the apex court through its decision in the Case has clarified that the ruling of an AAR can be challenged before a High Court by filing a writ petition under Articles 226/227 of the Constitution.⁴⁰² Further, that an SLP challenging a ruling of an AAR will be considered for admission in the Supreme Court only if it involves a question of principle of great importance or a similar question is already pending before the Supreme Court.⁴⁰³ The apex Court has made

⁴⁰⁰ *Columbia Sports Wear Company vs Director of Income Tax Bangalore*, Special Leave Petition No. 31543 of 2011

⁴⁰¹ Law Senate, *Special Leave Petitions in Indian Judicial System*,7 (2012).Available at <http://www.lawsenate.com/publications/articles/special-leave-petition-slp.pdf>

⁴⁰² PWC News Alert, *Special Leave Petition not permitted directly before the Supreme Court against the ruling of Authority for Advance Rulings* 4(August 7,2012).Available at <https://www.pwc.in/services/tax/news alert/2012/pdf/pwc news alert 7 august 2012 columbia sportswear company.pdf>

⁴⁰³ *Sirpur Paper Mills Ltd. vs Commissioner of Wealth Tax, Hyderabad* ,AIR 1970 SC 1520

an order that a Division Bench (bench consisting of two judges) of the High Court would directly hear the petitions and decide it as expeditiously as possible.⁴⁰⁴

This decision appears to have defeated one of the primary reasons for the establishment of the AAR in the very first place (i.e. the certainty of its decision) by reducing the AAR to the level of the Income

Tax Appellate Tribunals.⁴⁰⁵ This may therefore lead to more protracted litigation.⁴⁰⁶

Given that the Courts are already burdened with a large number of cases, one would need to wait and see how the matters pertaining to AAR are taken up, and extent of time is taken for decision in these cases at the High Court level. Given the dynamic nature of business and international trade, especially in cases where businesses are looking at fresh investment, if the overall time period for obtaining **Certainty** is significant for AAR applicants, it may dilute the whole purpose for which this body has been framed.⁴⁰⁷ One would need to wait and see how things would move on this front.

This decision also raises some apprehensions on the part of taxpayers that this decision would take away the element of certainty arising from a favorable ruling particularly in cases where a ruling is sought on a proposed transaction.⁴⁰⁸ So, now the investors have to obtain justice in form of appeal in two stages first at the High Court and then at the Supreme Court which will involve significant time and expense and will be a blow to the confidence of foreign investors.⁴⁰⁹ So, continuing the existing practice of approaching HC and SC, this order does not create any new rule but definitely limits the approachability of the applicants to the SC.⁴¹⁰

One of the primary objective behind the establishment of the AAR was attaining finality and certainty in tax matters and this feature becomes illusory if the rulings of AAR are routinely

⁴⁰⁴ KPMG Flash News, *The Supreme Court held that an appeal against the AAR ruling should be filed with the jurisdictional High Court And it should be decided expeditiously.* (August 10, 2012). Available at <http://www.kpmg.com/IN/en/services/Tax/FlashNews/Columbia-Sportswear-Company.pdf>

⁴⁰⁵ ALMT Legal News Flash, *Supreme Court- Challenging AAR Rules,1* (August, 2012). Available at <http://almtlegal.com/articles-pdf/ALMT%20News%20Flash%20-%20Two%20Recent%20Rulings.pdf>

⁴⁰⁶ *Id*

⁴⁰⁷ Arinjay Kumar Jain, *The wait for Expedious Advance Ruling might just get a little longer,* [2012] 26 taxmann.com 178 (Article)

⁴⁰⁸ BMR Edge, *AAR is a tribunal and appeal against its decisions can be entertained by High Courts*, Vol.7 Issue 8.3 (August 7, 2012).

Available at <http://www.bmr advisors.com/upload/documents/BMR%20Edge%2081344347548.pdf>

⁴⁰⁹ Neeraj Dubey, *New Dimension to the AAR*, Tax Affairs Bulletin Issue XX (September 2012). Available at <http://psalegal.com/upload/publication/assocFile/TaxAffairsBulletin-IssueXX.pdf>

⁴¹⁰ *Id*

challenged before the High Courts and Supreme Court.⁴¹¹ Furthermore, of late, i.e. over the last 2-3 years, the AAR has been taking up to 2 years to pronounce a ruling. This is much more than the statutorily prescribed timeline of 6 months.⁴¹² Additional benches will not only help in clearing pending applications but also help in expeditious disposal of new applications besides reducing the cost of obtaining advance rulings for the applicants.⁴¹³ So, *in my opinion*, additional benches of AAR should be created in order to provide advance ruling to the applicant within time-limit of 6 months. This becomes even more crucial because now AAR is extended to the Indian resident taxpayers as well (beyond a certain threshold), who can now approach the AAR for obtaining advance rulings in their tax matters.

It can be argued that this decision provides clarity on which Court should be approached if a person is aggrieved by the order of AAR. After this decision, AAR is not providing certainty to tax payers in India. *In my opinion*, the decisions of AAR should not be appealable because if a decision is appealable, then it shrouds in the cloak of ambiguity until and unless the final decision is given by the Supreme Court because the decision of AAR can always be changed by the Supreme Court. This gives rise to uncertainty and the foreign investors will not be able to decide with certainty as to what will be their tax liability in respect of a particular transaction. This will discourage the foreign investors from investing in India as uncertain financial equilibrium is detrimental to the interests of business enterprise. Further; the AAR has to pronounce the judgment timely and expeditiously in time frame of 6 months. So, the objective of establishing AAR is to provide certainty in regard to tax liability of a transaction to certain persons especially Non –Resident Investors in a timely manner. The delay which will take place by way of appeals in High Court and Supreme Court will not only lead to uncertainty but also will lead to opportunity cost of not investing in suitable projects at a proper time. For instance, the funds may remain idle till the decision is rendered leading to the loss of interest on money which can be earned if invested earlier. Also, certain good projects will be missed by foreign investors since they are available only for a specified time.

Further, inclusion of resident taxpayers in the ambit of AAR, is also a welcome move. So, now Indian taxpayers can approach the AAR to get a ruling to determine their own tax liability

⁴¹¹ Sanjay Sanghvi, Partner Khaitan &Co, *Should Government relook at AAR Mechanism? Is having more benches a solution?* Available at < <http://www.taxsutra.com/experts/column?sid=232>>

⁴¹² Id

⁴¹³ Id

to a transaction that they undertake or propose to undertake if the value of transaction is 100 crore or more. Tax lawyers say this is a positive step towards achieving a non-adversarial tax regime as promised by the new government.⁴¹⁴ It is expected to bring about clarity at the time the transactions or projects are proposed to be undertaken, making the tax outcome more certain and minimizing the possibility of a tax dispute arising at a later stage, thereby saving resources in terms of time, cost and efforts in defending or litigating a dispute.

In my opinion, the threshold limit of transaction value of ₹100 crore is very high for Indian residents. Currently, there is no threshold limit on Non-residents for filing and obtaining the benefit of AAR Ruling. The Central Board of Direct Taxes (CBDT) without any public debate notified that only those residents' transactions that may have a tax liability of INR 100 crore or more are eligible to use this facility of advance ruling – a similar monetary threshold does not exist for non-residents' transactions.⁴¹⁵ So, I think either the threshold limit of 100 crore in order to seek advance ruling for residents be lowered down or completely removed.

Another suggestion is that criteria for appointing Chairman of AAR should be expertise or advanced knowledge of tax is must. Wrong appointments in AAR may lead to delay in pronouncement of AAR Ruling. Presently, AAR rulings are even taking time for 2 years. So, there is a need to check this tendency of delay in pronouncement of AAR Ruling and this can be done by appointing experts in taxation and also by having additional benches for AAR Ruling.

⁴¹⁴ Dev Chatterjee, *Taxpayers can approach AAR for tax liabilities on deals above Rs 100 crore*, Available at http://www.business-standard.com/article/economy-policy/taxpayers-can-approach-aar-for-tax-liabilities-on-deals-above-rs-100-cr-114120800470_1.html

⁴¹⁵ Surya Prakash B.S., *A 100 crore Advance Ruling question*, Available at <http://www.taxsutra.com/experts/column?sid=329>