



Government Law College, Mumbai

10th Nani Palkhivala National

Tax Moot Court Competition 2013

3rd – 5th October, 2013

In association with



**ITAT Bar Association
Mumbai**



**All India Federation of
Tax Practitioners**

IN THE HIGH COURT OF JUDICATURE
AT BOMBAY
(Ordinary Original Civil Jurisdiction)
IN APPEAL NO. ____ OF 2013

IN THE MATTER OF:

The Income-tax Act, 1961

And

IN THE MATTER OF:

Section 260A of the Income-tax Act,
1961

And

IN THE MATTER OF:

Order dated 20th July, 2013 by the
Income-tax Appellate Tribunal,
Mumbai, for the assessment year-2008-
09.

M/s GORAKALA Co. Pvt. Ltd.) ... Appellant

Versus

Commissioner of Income-tax) ... Respondent

MEMORANDUM OF APPEAL

The Appellant prefers this Appeal against the order dated 20th July, 2013 passed by the Income-tax Appellate Tribunal (hereinafter referred to as “**the Tribunal**”) for the assessment year 2008-09.

I. Statement of facts:

1. The Appellant is a company registered under the Companies Act and is engaged in the business of manufacturing and trading of readymade garments. The Appellant is a wholly owned subsidiary of KalaChasma Corporation (herein after referred to as “**KalaChasma**”), a company incorporated and registered in the United Kingdom. KalaChasma is holding 10,00,00,000 shares of the Appellant which were subscribed by them at the face value of Rs. 10 each.

2. On 1st May, 2007, KalaChasma Corporation further subscribed to 10,00,00,000/- shares of Appellant at its face value of Rs. 10 each. The value of the shares of the Appellant before subscription by KalaChasma was Rs. 15 per shares on the basis of valuation as per the net asset method (i.e. Assets – Liabilities of the Appellant) and Rs. 1000 per share of the basis of the DCF method (Discounted Cash Flow method i.e. the present value of the expected future earning of the Appellant.)

3. The Appellant filed its return of income for the relevant Assessment Year 2008-09 on 30th September, 2009 declaring a total income of Rs. 15,22,74,167/-. The Appellant had also paid an amount of Rs.

10,00,00,000/- as royalty to KalaChasma and the same was reflected as international transaction in Form 3CEB filed by the Appellant.

4. During the course of the assessment, the Assessing Officer (“**AO**”) made a reference to the Transfer Pricing Officer (“**TPO**”) of the transactions referred in Form 3CEB for computation of arm’s length price of the international transaction as per section 92CA of the Income-tax Act, 1961 (“**the Act**”). The reference by the AO states that the reference is made on the basis of Instruction No. 3 dated 20th May, 2003, as per which any transactions in excess of Rs. 5 Crores is required to be referred to the TPO. The Respondent has also given its approval merely relying on the said instruction.

5. The TPO vide its order dated 1st January, 2010, under section 92CA(3) of the Act, accepted that the payment of royalty by the Appellant was at arm’s length price. The TPO, however, held that the subscription of shares of the Appellant by KalaChasma is an international transaction under section 92B of the Act and, hence, arm’s length price is required to be determined on the said transaction. The TPO held that arm’s length price of the shares subscribed by KalaChasma is to be computed on the basis of the DCF method. The TPO, therefore, made an addition of Rs. 99,00,00,00,000/- holding that the Appellant ought to have received the aforesaid additional amount on the issue of shares. The TPO further held that as the Appellant ought to have received the aforesaid amount from KalaChasma, the same is to be treated as a loan given by the Appellant to KalaChasma on which the Appellant should to have earned interest @

12% PA. Therefore, the TPO made a further addition of notional interest of Rs. 9,90,00,00,000/-.

6. The AO passed the assessment order on 2nd January, 2010, in conformity with the TPO's order.
7. Being aggrieved by the said assessment Order, the Appellant filed an Appeal before the CIT(A).
8. The CIT(A) allowed the appeal of the Appellant holding that the reference under section 92CA(1) to the TPO by the AO was invalid as the AO had not come to the conclusion that it was necessary or expedient to make a reference to the TPO. Further, Respondent has not given a valid approval as the approval is without application of mind. The CIT(A) further held that the subscription of shares of the Appellant by KalaChasme is not an international transaction under section 92B of the Act. Therefore, the CIT(A) deleted the additions made by the AO.
9. Being aggrieved by the said order, the Respondent filed Appeals before the Tribunal.
10. The Tribunal allowed the appeal of the Respondent holding as under:
 - a. The reference to the TPO on the basis of the instruction of the board is a valid reference. Further, the TPO is only a substitute to the AO, therefore, it is not necessary for the AO to come to the conclusion that it is necessary or expedient to make a reference. The approval by the CIT is also a valid approval.

- b. The transaction of subscription of shares of the Appellant by KalaChasma is an international transaction under section 92B of the Act. The Tribunal also relied on the Explanation to section 92B inserted with effect from A.Y. 2002-03 and held that the transaction of subscription of shares by KalaChasma would be covered under clause (i)(c) of the Explanation to section 92B of the Act. The Tribunal rejected the argument of the Appellant that as the Appellant is wholly owned by KalaChasme, the number of shares issued by the Appellant does not make any difference and therefore, there can be no adjustment to the arm's length price.
- c. The Tribunal rejected the argument of the Appellant that for valuation of shares no method has been prescribed under section 92C of the Act. The Tribunal held that the DCF is the correct method for valuation of shares for the purpose of computation of arm's length price. The Tribunal rejected the argument of the Appellant that net asset method should be applied as the same is contemplated to be the method of valuation of shares under the Act.
- d. The Tribunal also confirmed the addition of notional interest on the ground that the addition of notional interest is as per the provisions of the Act.

II. Substantial questions of law:

The Appellant submits that the following substantial questions of law arise from the Order of the Tribunal dated 20th July, 2013:-

- (i)** Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the reference made by the AO to the TPO is a valid reference under section 92CA(1) of the Act?
- (ii)** Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the transaction of subscription of shares is an international transaction?
- (iii)** Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the TPO has followed a method prescribed under section 92C of the Act and without prejudice, whether the DCF is the most appropriate method for the valuation of the shares?
- (iv)** Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the TPO was right in making the addition of notional interest by treating the addition on the subscription of the shares as deemed loan by the Appellant to KalaChasme?

III. The Appellant says that the Appeal is filed within the time prescribed.

IV. The Appellant states that the Appellant is assessed to tax at Mumbai. Thus, this Hon'ble Court has jurisdiction to try, entertain and dispose of the present appeal.

V. The Appellant says that the Appellant has paid the court fees of Rs. 10,000/-.

VI. The Appellant prays that:

- a. This Hon'ble Court may be pleased to admit the present appeal and after considering the aforesaid substantial questions of law to allow the appeal;
- b. This Hon'ble Court may be pleased to set aside the impugned order and direct the Tribunal to decide the appeal afresh after hearing both parties.
- c. For costs of and incidental to this appeal; and
- d. This Hon'ble Court may be pleased to grant such further and other relief as it may deem fit.

Note: The Appeal has been admitted on all the questions and has been fixed for final hearing.