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3rd National Moot court Competition, 2014

March 28-30, 2014

IN THE HIGH COURT OF JUDICATURE
AT NEW DELHI
(Ordinary Original Civil
Jurisdiction)

IN APPEAL NO. _____ OF 2014

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 by the Income-tax
Appellate Tribunal, for the
assessment year 2008-09.

Mr. Rahul Sharma) … Appellant
Versus
Director of Income Tax) … Respondent

AND

Mrs. Vandana Mittal) … Appellant
Versus
Director of Income Tax) … Respondent

AND

M/s Henshaw & Purvis) … Appellant
Versus
Director of Income Tax) … Respondent

MEMORANDUM OF APPEAL

The Appellants prefer this appeal before the Hon'ble Delhi High Court against the order passed by the Income Tax Appellate Tribunal (herein after ITAT)

STATEMENT OF FACTS

1. Mark Henshaw was born in the county of Yorkshire in 1869. In 1908, he established a partnership known as Henshaw & Purvis, with Helen Purvis, a childhood friend and an expert in the then-nascent business of international finance. During their lifetime, Henshaw & Purvis was known as an astute, if conservative, lender. But its business suffered greatly after Mr. Henshaw and Ms. Purvis passed away, in 1948 and 1941 respectively. In 1969, when Henshaw & Purvis had become virtually worthless, Rahul Sharma, a gifted Indian entrepreneur who had emigrated to England in the early 60s, decided that there was a great potential in the firm, and was admitted as a partner (on injecting £500,000 as capital contribution) by the then-partners, who were descendants of Mr. Henshaw and Ms. Purvis. As is common practice, Henshaw & Purvis was registered with HMRC as a partnership firm although, of course, it is not a distinct legal entity under English partnership law.
2. Within a decade, Henshaw & Purvis's business began to pick up and the firm, by the mid-1980s, established itself as the leading private lender in England. Mr. Sharma felt that the time was ripe to take advantage of opportunities offered by developing economies and decided to expand Henshaw & Purvis' global reach. As a

first step, the descendants of the original partners were persuaded to retire in 1989, and replaced by three relatively young entrepreneurs handpicked by Mr. Sharma—Mr. Richard Downer, a resident of the UK, Mrs. Vandana Mittal, a resident of the USA, and Mr. Edward Key, a resident of the UK. Each of them paid £10 million as capital contribution. Mr. Sharma was himself no longer a UK resident; he had become a resident of France in 1982. Although all the descendants of the original partners had left, the firm decided to retain its name in order to take advantage of the goodwill attached to it. The partnership agreement provided that any partner could freely transfer his share to any outsider, without the consent of the other partners, and that the outsider would thereupon be admitted as a full partner entitled to all the rights available to a partner under the partnership agreement. Mr. Sharma also introduced a professional management structure for the firm by recruiting highly experienced finance professionals from across the world, to whom day-to-day management was entrusted and whose advice the partners ordinarily followed.

3. The firm chose to commence its international operations in India and Australia, not least because of the personal connections of some of its partners. Of these, India was by far the more important project for the firm. Mrs. Mittal and Mr. Sharma had many contacts in that country, and the market was there for the taking since there were few international finance companies lending to Indians. Henshaw & Purvis decided not to establish a branch or a subsidiary company in India because it did not wish to subject itself to Indian regulators or Indian law. As far as it was concerned, compliance with Indian law was a matter for the borrower; a loan would proceed only if the borrower was able to satisfy Henshaw & Purvis that it was permitted under Indian law to borrow from a foreign entity. But by no

means did this stop the firm from penetrating the Indian market; an advertising blitz coupled with attractive terms. (Low interest rates, low margin, low security) soon generated a large volume of business. By 1995, its global turnover was £600 million of which its Indian operations accounted for 40%. India grew, and England receded, in importance as the new millennium approached, principally because of regulatory setbacks private lenders faced in England. Its Australian operations generated a mere 2 percent of global turnover and it did not appear likely that this would change for the better. As a consequence, the firm became even more reliant on India. Indeed, by 2005, its Indian operations generated 65% of the global turnover of £900 million.

4. Although Henshaw & Purvis did not have a branch in India, firm officials had to make frequent visits because of the rapid growth of its Indian business. Senior employees, such as the Finance Director, Marketing Manager and Privilege Sector Director (all of whom had a contract *of* service with the firm), regularly travelled to New Delhi, Mumbai, Bangalore and other cities to meet potential borrowers, members of the Indian Government and India Inc, execute concluded deals and promote the firm. They always spent considerably more than 90 days in India in any twelve month period (typically in excess of four months), but did not use an office or branch in any Indian city. Business meetings were conducted in hotels and none of the employees had a residence in India or the use of premises: they always stayed in hotels.

5. With its rapid growth in the late 1990s and the early part of the 21st century, Henshaw & Purvis soon began to interest some of the largest finance companies in the world, particularly because its acquisition would offer a relatively easy entry into the Indian market. Although some of the other partners were happy to

continue, Mr. Sharma, who was by then nearly 70 years old, was keen to sell so that he could retire. Ultimately, a deal was struck in February 2008 with Victoria Finance Ltd ["VFL"], a leading finance company in Australia. Mrs. Mittal was also inclined to sell, so that she could focus on her other business and personal interests in the USA. Accordingly, Mr. Sharma and Mrs. Mittal, who were entitled to 80 percent of the profits of the firm between them, transferred their share to VFL for sums of £4 billion and £1 billion respectively. Mr. Downer and Mr. Key continued as partners with VFL under the same partnership agreement.

6. This transaction attracted a great deal of interest in the international media and it soon came to the notice of the Indian tax authorities. Eventually, the Office of the Director of Income Tax (International Taxation), New Delhi (herein after DIT), issued a notice dated 29.01.2009 to Mr. Sharma and Mrs. Mittal asking them to show cause why tax should not be levied on the capital gain arising out of the sale of their share in the firm. The same office also issued a notice dated 24.02.2009 to Henshaw & Purvis asking it to show cause why its profits for FY 2007-2008 (AY 2008-2009) should not be taxed in India. As on 31.03.2008, Henshaw & Purvis' assets were worth £2 billion. Debt owed to the firm by borrowers was the single largest asset in the balance sheet (£1.7 billion) and most debtors (representing about £1.4 billion of the £1.7 billion) were Indian residents. Net profit for FY 2007-2008 was £80 million.

7. Mr. Sharma and Mrs. Mittal denied their liability to pay any capital gains tax, and Henshaw & Purvis likewise denied its liability to pay tax on its business profits. These explanations were rejected by the Assessing Officer, who proceeded to pass an assessment order and issue notices of demand. A writ petition challenging the jurisdiction of the DIT (in both cases) was dismissed by the Delhi High Court in

2011 on the ground that the taxpayers had an alternative remedy. In January 2012, the Supreme Court dismissed Special Leave Petitions challenging those orders. Appeals filed by the taxpayers before the CIT (A) were also dismissed. In the ITAT, counsel for Mr. Sharma and Mrs. Mittal argued that: (a) their share in the partnership was not a capital asset; alternatively, it was not situated in India; (b) in any event, the capital gain, if any, was exempt under the provisions of the respective Double Taxation Avoidance Agreements (DTAA). Counsel for Henshaw & Purvis likewise argued that: (a) the profits of the firm did not accrue or arise in India, nor did Section 9 of the Income Tax Act, 1961 (herein after 1961 Act) , deem them to have accrued or arisen in India; (b) in any event, the profits of the firm were exempt under the provisions of the India-UK DTAA.

8. In *Sharma v. DIT* and *Mittal v. DIT*, the ITAT held that: (a) a share in a foreign partnership is a capital asset under Section 2(14) of the 1961 Act; (b) this capital asset is situate in India by virtue of Explanation 5 to Section 9 of the 1961 Act; (c) although Mr. Sharma and Mrs. Mittal are 'residents' under Article 4 of the India-France and India-USA DTAA respectively, both treaties permit India to impose capital gains tax on this transaction. In *Henshaw & Purvis v. DIT*, the ITAT held that: (a) Henshaw & Purvis is a 'firm' under Section 2(23) of the 1961 Act and is alternatively an association of persons; (b) the income earned by Henshaw & Purvis from its lending activities accrued in India under Section 5 of the 1961 Act; (c) in any event, such income was deemed to have accrued or arisen in India under Section 9; (d) as Henshaw & Purvis is a 'fiscally transparent' entity in its country of registration, it is not a resident under Article 4 of the India-UK DTAA and therefore not entitled to invoke that treaty, and individual partners are not entitled to invoke their respective treaties since they are not taxed in India as individuals; and

(e) even if Henshaw & Purvis is a resident under Article 4 of the UK DTAA, its Indian profits are taxable under Article 7 read with Article 5(2)(k) of that treaty. Accordingly, both taxpayer appeals were dismissed.

9. The taxpayers filed appeals before the Delhi High Court under Section 260A of the 1961 Act. By its order dated 27.08.2013, the High Court admitted the appeals and framed the following substantial questions of law:

Sharma v. DIT and Mittal v. DIT

(1) Is Mr. Sharma and Mrs. Mittal's share in Henshaw & Purvis a 'capital asset' under Section 2(14) of the 1961 Act?

(2) If so, was that capital asset situated in India either under the general law of situs, or by virtue of Explanation 5 to Section 9 of the 1961 Act?

(3) If so, is the capital gain arising from the transfer of that share to VFL taxable under Section 45?

(4) Is the transaction nevertheless immune from Indian taxation by virtue of the India-France or the India-USA DTAA or both?

Henshaw & Purvis v. DIT

(1) Is Henshaw & Purvis a 'firm' under Section 2(23) of the 1961 Act? If not, is it an association of persons or any other entity under the 1961 Act?

(2) Did the business profits, or any part thereof, earned by Henshaw & Purvis during FY 2007-2008 accrue or arise in India?

(3) If not, are such profits nevertheless deemed under Section 9 to have accrued or arisen in India?

(4) If the answer to (2) or (3) above is in the affirmative, is Henshaw & Purvis a resident under Article 4 of the India-UK DTAA? If not, are individual partners entitled to invoke the respective treaties with respect to their share of the

partnership income for FY 2007-2008?

(5) If so, is the business profit earned by Henshaw & Purvis taxable in India under Articles 5 and 7 of the UK DTAA or, as the case may be, under Articles 5 and 7 of the DTAA applicable to the individual partner in question?

10. For convenience, and at the joint request of both counsel, the High Court has tagged these appeals and will dispose of them by a common judgment. In view of the important and unsettled questions of law to which these appeals give rise, the High Court has directed the Registry to list them for final hearing in March 2014.