

Bombay High Court

Uti Mutual Fund vs Income Tax Officer -19(3)(2 on 6 March, 2013

Bench: Dr. D.Y. Chandrachud, A.A. Sayed

PNP

1/14

WPL523-6.3

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION (LODG.) NO.523 OF 2013

UTI Mutual Fund,
Through its Trustees UTI Trustee
Company Pvt. Ltd., Mumbai

..Petitioner.

versus

Income Tax Officer -19(3)(2),

Mumbai and others

..Respondents.

Mr. S.E. Dastoor, Senior Advocate with Mr. Madhur Agarwal and Mr. Atul K. Jasani for the Petitioner.

Mr. P.C. Chhotaray with Ms. Padma Divakar for the Respondents.

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CORAM : DR.D.Y.CHANDRACHUD, AND
A.A. SAYED, JJ.

6 March 2013.

ORAL JUDGMENT (PER DR.D.Y.CHANDRACHUD, J.) :

1. Rule, by consent returnable forthwith. With the consent of counsel and at their request, the petition is taken up for hearing and final disposal.

2. The Petitioner has sought to challenge principally an order that was passed by the Income Tax Officer - 19(3)(2), the First Respondent, on 25 February 2013 calling upon the Petitioner to pay an outstanding demand under the provisions of Section 177(3) of the Income Tax Act 1961 to the extent of the share of investment by the Petitioner in a securitization trust, called the Indian Corporate Loan Securitization Trust 2008 Series 24. For Assessment Year 2010-11 an assessment was completed under Section 143(3) in respect of the trust resulting in a net demand of Rs.1.57 Crores. During the pendency of these proceedings an application by the trust to the CIT-19 for holding the demand in abeyance under Section 220(6) has been rejected.

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3. The Petitioner is registered as a mutual fund with the Securities and Exchange Board of India (SEBI) and has contributed to the funds of nine trusts :

1. Indian Corporate Loan Securitization Trust 2008 - Series 24,
2. Indian Corporate Loan Securitization Trust 2008 - Series 22,
3. Indian Corporate Loan Securitization Trust 2008 - Series 27,
4. Indian Corporate Loan Securitization Trust 2008 - Series 28,
5. Indian Corporate Loan Securitization Trust 2008 - Series 38,
6. Indian Corporate Loan Securitization Trust 2008 - Series 40,
7. Indian Corporate Loan Securitization Trust 2008 - Series LVI,
8. Indian Corporate Loan Securitization Trust 2008 - Series LX and
9. Indian Commercial Loan Trust Series VIII 2008;

4. The trust issued Pass Through Certificates (PTCs) to which the Petitioner has contributed. The Petitioner is a beneficiary of the trusts. Regulation 43 of the SEBI (Mutual Funds) Regulations 1996 categorizes the investments which mutual funds such as the Petitioner are permitted to make. Among them are securitized debt instruments, which are either asset backed or mortgage backed securities. The Reserve Bank issued guidelines on 2 February 2006 on securitization of standard assets. The guidelines stipulate that banks and other financial institutions can securitize debts by assigning the debts to a bankruptcy-

remote Special Purpose Vehicle (SPV) for immediate cash payment. The cash flow from the underlying pool of assets is used to service the securities issued by the SPV. Securitization under the guidelines follows a two stage process which is as follows :

"In the first stage there is sale of single asset or pooling and sale of pool PNP 3/14 WPL523-6.3 of assets to a 'bankruptcy remote' special purpose vehicle (SPV) in return for an immediate cash payment and in the second stage repackaging and selling the security interests representing claims on incoming cash flows from the asset or pool of assets to third party investors by issuance of tradable debt securities."

5. The first trust was declared by IL & FS Trust Company Limited for the securitization of loans of Rs.80 Crores granted to Tata Capital Limited by Yes Bank. The first trust issued PTCs in two series, A1 and A2 which were subscribed to by the Petitioner. The beneficial interest of the Petitioner in the trust is proportionate to the PTCs subscribed. The Petitioner subscribes to the PTCs issued by the trust from separate funds of specified schemes and interest income earned is credited to the scheme from which the PTC investment is made by the Petitioner. Yes Bank Limited has assigned the loans due to it from Tata Capital Limited to the trust. The other trusts are stated to be similar to the trust declared by IL & FS Company Limited.

6. During the financial year relevant to Assessment Year 2010-11 the trusts received interest from the borrower on account of the loans assigned to the trusts. This was distributed to the beneficiaries including the Petitioner which has been reflected as income in the Profit & Loss Account of the Petitioner. The trusts filed returns of income for Assessment Year 2010-11. On 31 October 2012 the First Respondent passed orders of assessment under Section 143(3) in respect of the trusts, to treat the trusts as Associations Of Persons (AOP) and held the interest income to be income earned under the head "income from business and profession". According to the Assessing Officer, the trusts were a smokescreen whose entity should be disregarded since the trust is an AOP having members in the form of mutual funds. The Assessing Officer inter alia held that even if the assessee were to be regarded as a trust, the assessment PNP 4/14 WPL523-6.3 would be under Section 161(1A) as the trusts are engaged in business and would be chargeable at the maximum marginal rate of tax. The trusts have filed appeals before the CIT(A) which are pending.

7. On 17 January 2013 the trusts filed applications under Section 220(6) for holding recovery in abeyance. The First Respondent on 20 February 2013 rejected the applications for stay of demand. On 21 February 2013 applications were stated to be filed before the CIT-19 for stay of the recovery of the demand.

The CIT-19 by an order dated 5 March 2013 has declined to hold the demand in abeyance, thereby rejecting the applications filed by the trusts.

8. The First Respondent has issued a notice dated 25 February 2013 to the Petitioner stating that (i) The assessment of the trusts was completed under Section 143(3); (ii) The trusts failed to make payment; and (iii) The Assessing Officer was informed that the trust is not in existence as on date and therefore no recovery can be made. By his communication the Assessing Officer has called upon the Petitioner in its capacity as a contributor and beneficiary of the trusts to pay the outstanding demand to the extent of its share of the investment in the trusts under the provisions of Section 177(3) of the Income Tax Act of 1961. Before the Court it is not in dispute that no order of assessment has been passed against the Petitioner since the income of the Petitioner is exempt

under the provisions of Section 10(23D). The demand as against the trust is sought to be enforced in the hands of the Petitioner on the ground that it is a contributory and beneficiary and to the extent of its share of investment in the trust.

9. A similar issue pertaining to Assessment Year 2009-10 and relating to the PNP 5/14 WPL523-6.3 Petitioner came up for consideration before this Court. On 14 March 2012 the Division Bench of this Court rendered judgment in UTI Mutual Fund v. Income Tax Officer¹. In that case the issue was whether the Revenue should be permitted to take coercive steps under Section 226(3) in the form of a garnishee notice which had been issued to the bankers of the Petitioner. At that stage the Court, while clarifying that it was not called upon to adjudicate upon the merits of the rival contentions and was dealing only with the issue of whether the demand could be enforced in the hands of the Petitioner pending the disposal of the appeal before the CIT (A) held as follows :

"From the record before the Court however it now emerges as an admitted position that the demand against the Trust is sought to be enforced against the petitioner on the basis of the provisions of Section 177(3). The Petitioner has not been independently assessed and the issue which falls for determination is whether the petitioner has made out a substantial prima facie case to seek protection against coercive proceedings at this stage pending an appeal filed by the Trust against the assessment made in respect of the Trust. Sub-section (3) of Section 177 provides that where a business which has been carried on by an association of persons has been discontinued, every person who was at the time of such discontinuance or dissolution a member of the association of persons, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act, so far as may be, shall apply to any such assessment or imposition of penalty, or other sum. Prima facie, the submission of the petitioner that the Trust itself cannot be regarded as being an association of persons finds support from a judgment of a Division Bench of this Court in CIT v.

Marsons Beneficiary Trust [1991] 188 ITR 224/[1990] 52 Taxman 454 (Bom.). The Division Bench of this Court in that case held that the beneficiaries of a trust cannot be construed as having set up the trust nor had they authorised the trustees to carry on business. The beneficiaries who are named in the trust as recipients of the income of the trust cannot be considered as an association of persons. Therefore, ruled the Division Bench, the trustees also cannot take on the character of an association of persons. The judgment of the Division Bench was followed subsequently by another Division Bench of this Court in L.R. Patel Family Trust v. ITO [2003] 262 ITR 520/ 129 Taxman 720 (Bom.). We are indicating the nature of the controversy making it expressly clear that we are not rendering any conclusive determination of the Court on the merits of the issue which will arise in the appeal which has been filed by the trust and which, the Court is informed, is pending before the Commissioner (Appeals). The second submission which has been urged on behalf of the petitioner, based on the provisions of Section 61, is equally a matter which 1 (2012) 345 ITR 71 (Bom) PNP 6/14 WPL523-6.3 would require careful consideration at the appellate stage. As we have noted earlier, the submission of the petitioner is that under Section 61, all income arising to a person by virtue of a revocable transfer of assets is chargeable to income tax as the income of the transferor. Under

Section 63(a)(i) a transfer is deemed to be revocable if it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor. The submission of the petitioner is that if at all, an assessment could have only been made in the hands of the petitioner as the transferor of a revocable trust, in which event the income would be exempt under Section 10(23D). Whether the submission should be accepted is again a matter which would have to be determined in the course of the appellate proceedings arising from the order of assessment. The petitioner has intervened before the appellate authority. In our view, the Revenue has made an unfortunate and hasty attempt to make a recovery of the demand which has been imposed on the trust pursuant to the order of assessment, against the petitioner without enabling the petitioner to take reasonable recourse to the remedies available in law."

10. Consequently, this Court held that the Petitioner had a serious issue to urge as regards the legitimacy of the demand which had been raised upon it by a notice dated 29 February 2012 including in regard to the applicability of Section 177(3) on which the demand had been founded. The Petitioner having intervened in the appeal by the trust before the CIT (A), this Court directed that pending the disposal of the appeal and for a period of six weeks thereafter the Revenue shall not take any coercive steps against the Petitioner for enforcing the demand. During the course of the judgment, this Court has enunciated guidelines consistent with the earlier Division Bench judgments of this Court in KEC International Ltd. v. B.R. Balakrihanan 2 and in Coca Cola India P. Ltd.

v. Addl. CIT³. Instead of following the judgment of the jurisdictional High Court, the Revenue has once again issued notices to the Petitioner under Section 177(3) for A.Y.2010-11. The appeals of the trust for the earlier year continue to remain pending.

11. Counsel appearing on behalf of the Revenue, however, submits that the 2 (2001) 251 ITR 158 (Bom).

3 (2006) 285 ITR 419 (Bom).

PNP 7/14 WPL523-6.3 judgment which was delivered by this Court on 14 March 2012 is distinguishable since the Assessing Officer has in the course of the assessment of the trust carefully evaluated the provisions of law. Learned counsel submitted that :-

(i) The explanatory memorandum to the Finance Bill, 2013 indicates that with effect from 1 June 2013, it is proposed to amend Section 10 and to insert Chapter XII EA for providing a special tax regime to govern trusts formed for the purpose of undertaking securitization activities.

Consequently, for the period prior thereto to which this proceeding relates the income would be exigible to tax;

(ii) If the income represents an income of an association of persons in law, it is well settled that the AOP alone has to be taxed and the members of the AOP cannot be

taxed individually on the income of the AOP;

(iii) Alternately, under Section 161(1A), where the income of a representative assessee consists of and includes profits and gains of business, tax is liable to be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate. Sub-section (1A) overrides Section 161(1) and therefore in any event, the fact that the income of the Petitioner is exempt under Section 10(23D) would be of no consequence.

12. At this stage it is necessary for the Court to indicate that we are not called upon to adjudicate finally upon the merits of the rival contentions. All that the Court has to consider is whether the Petitioner has, prima facie, a serious triable case to urge on the basis of which a stay can be sought on the enforcement of PNP 8/14 WPL523-6.3 the notice dated 25 February 2013 pending disposal of the appeals by the CIT (A); these appeals being preferred by the trusts who have been assessed under Section 143(3). Now at the outset it is necessary to note that the foundation of the notice dated 25 February 2013 is Section 177(3). Section 177(1) provides that where any business or profession carried on by an association of persons has been discontinued or where an association of persons is dissolved, the Assessing Officer shall make an assessment of the total income of the association of persons as if no such discontinuance or dissolution had taken place. Under sub-section (3) every person who was at the time of such discontinuance or dissolution a member of the association of persons shall be jointly and severally liable for the amount of tax, penalty or other sum payable.

As the previous judgment of this Court in UTI Mutual Fund (supra) notes there are two Division Bench judgments in CIT v. Marsons Beneficiary Trust 4 and L.R. Patel Family Trust v. ITO 5 in which it has been held that a beneficiary of a trust cannot be construed as having set up the trust or having authorized the trustees to carry on the business. As the Court noted in the previous judgment, the law laid down by the Division Bench, prima facie, indicates that the beneficiaries who are named in the trust as recipients of the income of the trust cannot be considered as an association of persons. If that be the position, prima facie, the question as to whether Section 177(3) would apply to the Petitioner raises a serious issue for consideration.

13. The next point to consider is the alternative hypothesis under which, under Section 160(1)(iv) a representative assessee is defined to mean, in respect of the income which a trustee appointed under a trust declared by a duly 4 (1991) 188 ITR 224 (Bom).

5 (2003) 262 ITR 520 (Bom).

PNP 9/14 WPL523-6.3 executed instrument in writing receives or is entitled to receive on behalf or for the benefit of any person, such trustee. Section 161(1) provides that every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of the beneficiary and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative

capacity only and the tax shall be levied upon and recovered from him "in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him". The contention of the Petitioner is that under Section 161(1) tax is to be levied on the representative assessee in the like manner and to the same extent as would be leviable upon the person represented by him and since the income of the Petitioner is exempt under Section 10(23D), no tax can be levied or recovered under Section 161(1).

The contention of the Revenue, however, is that sub section (1A) of Section 161 has a non obstante provision under which, where any income in respect of which a person mentioned in Section 160(1)(iv) is liable as a representative assessee consists of or includes profits and gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate. The issue which would fall for determination is as to whether Section 161(1A) lays down only the rate of tax without affecting the basic principle underlying Section 161(1) viz. that tax would be levied upon and recovered from the representative assessee in the like manner and to the same extent as would be leviable upon the person represented by him or whether the non-obstante provision would over ride sub Section 1 in its entirety. We have adverted to the nature of the controversy in the present case in order to elucidate PNP 10/14 WPL523-6.3 that the questions on which there is a controversy, which is still to be resolved, involves serious triable issues. The contention of the Petitioner, prima facie, cannot be rejected out of hand particularly having regard to the fact that the earlier judgment of this Court for Assessment Year 2009-10 also took the same position. Moreover, the issue as to whether the income in question is business income is a matter which would have to be determined. Finally, on this aspect of the matter, it may be necessary also to note the submission of the Petitioner with reference to the provisions of Section 61 which stipulate that all income arising to any person by virtue of a revocable transfer of assets shall be chargeable to income.

income tax as the income of the transferor and shall be included in his total Section 63(a)(i) stipulates when a transfer shall be deemed to be revocable and the contention of the Petitioner is that in the case of a revocable transfer of assets, the income as in the present case would be income in the hands of the transferor which is exempt under Section 10(23D).

14. In assessing as to whether a stay of demand should be granted to the Petitioner for the year in question, it would also be necessary to take note of the fact that the Finance Bill, 2013 has proposed to set up a new dispensation in the form of Chapter XII EA with a view to providing a special tax regime to facilitate the securitization process. The explanatory memorandum accompanying the Finance Bill has adverted to the rationale for the proposed amendment as follows :

"Taxation of Securitisation Trusts Section 161 of the Income-tax Act provides that in case of a trust if its income consists of or includes profits and gains of business then income of such trust shall be taxed at the maximum marginal rate in the hands of trust.

The special purpose entities set up in the form of trust to undertake securitisation activities were facing problem due to lack of special PNP 11/14 WPL523-6.3 dispensation in respect of taxation

under the Income-tax Act. The taxation at the level of trust due to existing provisions was considered to be restrictive particularly where the investors in the trust are persons which are exempt from taxation under the provisions of the Income-tax Act like Mutual Funds.

In order to facilitate the securitisation process, it is proposed to provide a special taxation regime in respect of taxation of income of securitisation entities, set up as a trust, from the activity of securitisation. It is proposed to amend section 10 and also insert a new Chapter XII-EA for providing a special tax regime. The salient features of the special regime are :-

(i) In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either SEBI or RBI, the income from the activity of securitisation of such trusts will be exempt from taxation.

(ii) The securitisation trust will be liable to pay additional income-tax on income distributed to its investors on the line of distribution tax levied in the case of mutual funds. The additional income-tax shall be levied @ 25% in case of distribution being made to investors who are individual and HUF and @ 30% in other cases. No additional income tax shall be payable if the income distributed by the securitisation trust is received by a person who is exempt from tax under the Act.

(iii) Consequent to the levy of distribution tax, the distributed income received by the investor will be exempt from tax.

(iv) The securitisation trust will be liable to pay interest at the rate of one percent. for every month or part of the month on the amount of additional income-tax not paid within the specified time.

(v) The person responsible for payment of income or the securitisation trust will be deemed to be an assessee in default in respect of amount of tax payable by him or it in case the additional income-tax is not paid to the credit of Central Government.

This amendment will take effect from 1st June, 2013."

15. The Revenue urged before the Court that the proposed amendment which is to take effect from 1 June 2013, would in fact indicate that Parliament took heed of the problems which were faced by special purpose entities formed for undertaking securitization activity and sought to bring about a change in the law.

Hence, it was urged that this would indicate that for the previous Assessment Years, the income would be subject to tax.

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16. The effect of the proposed amendment once the Finance Bill is enacted into legislation in respect of periods prior to the date of the enforcement of the amendment is something which will fall for serious consideration. Prima facie, at this stage, the setting up of a special purpose vehicle in the

form of a trust for carrying out securitization activities cannot be regarded as a smokescreen.

Mutual Funds such as the Petitioner are governed by the regulatory provisions of the Mutual Fund Regulations made by SEBI. As we have noted earlier, the guidelines issued by the Reserve Bank of India on the securitization of assets in fact contemplate the setting up of special purpose vehicles as an intrinsic element of the securitization process.

17. The Appeals for Assessment Year 2009-10 are pending; the Court being informed that the Appeals are in the course of being heard. In this view of the matter, and for the reasons which we have indicated already in the earlier judgment of this Court in UTI Mutual Funds (supra) and for the reasons indicated in this judgment, we are of the view that a prima facie case raising serious triable issues has been made out for stay of the enforcement of the demand in the hands of the Petitioner in pursuance of the impugned notices dated 25 February 2013.

18. Counsel appearing on behalf of the Revenue has sought to rely upon an order of the Karnataka High Court in ITA 31 of 2013 dated 4 February 2013 taking the view that in a revenue matter an interim order should be passed only in the case of genuine financial hardship and not otherwise. With respect, the order of the Karnataka High Court cannot be read to mean that consideration of whether an assessee has made out a strong prima facie case for stay of PNP 13/14 WPL523-6.3 enforcement of a demand is irrelevant. Nor is the law to the effect that the absent a case of financial hardship, no stay on the recovery of a demand can be granted even though a strong prima facie case is made out. In considering whether a stay of demand should be granted, the Court is duty bound to consider not merely the issue of financial hardship if any, but also whether a strong prima facie raising a serious triable issue has been raised which would warrant a dispensation of deposit. That is a settled position in the jurisprudence of our revenue legislation. In CEAT Limited v. Union of India⁶, the Division Bench of this Court has held as follows :

"If the party has made out a strong prima facie case, that by itself would be a strong ground in the matter of exercise of discretion as calling on the party to deposit the amount which prima facie is not liable to deposit or which demand has no legs to stand upon, by itself would result in undue hardship of the party is called upon to deposit the amount."

Where a strong prima facie case has been made out calling upon the Petitioner to deposit, would itself occasion undue hardship. Where the issue has raised a strong prima facie case which requires serious consideration as in the present case, a requirement of predeposit would itself be a matter of hardship. Finally, we express our serious disapproval of the manner in which the Revenue has sought to brush aside a binding decision of this Court in the case of the assessee on the issue of a stay on enforcement for the previous year. The rule of law has an abiding value in our legal regime. No public authority, including the Revenue, can ignore the principle of precedent. Certainty in tax administration is of cardinal importance and its absence undermines public confidence.

19. For these reasons, we direct that pending the disposal of the appeals which have been filed by the trusts for Assessment Year 2010-11 and for a 6 2010 (250) E.L.T. 200 (Bom).

PNP 14/14 WPL523-6.3 period of six weeks thereafter, no coercive steps shall be taken against the assessee for the recovery of the demand in pursuance of the impugned notices dated 25 February 2013.

20. Before concluding, we clarify that the observations in the present judgment are confined only to the disposal of the application for stay of the recovery of the demand against the Petitioner and shall not prejudice the rights and contentions of the assessees, the Petitioner and the Revenue in the pending appeals.

The Petition is accordingly disposed of.

There shall be no order as to costs.

(Dr. D.Y.Chandrachud, J.) (A.A. Sayed, J.)