



Newsflash:
Supreme Court rules that Identifying a Company's Residential status should be based on the Company's De Facto Control and Management

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1. Background and Facts of the case

- 1.1 Determining a person's residence status involves a mix of facts and law. While Indian corporations are always deemed to be residents of India, companies that incorporate or register outside India will have their residential status determined by the location of control and management.
- 1.2 Recently, Hon'ble Supreme Court of India in the case of ***Mansarovar Commercial Pvt Ltd vs Commissioner of Income-tax, Delhi (Civil Appeal No. 5769 of 2022)***, has ruled that a company's residential status is based on the company's de-facto control and management. Control and management means not merely theoretical control and power, i.e., not de jure control and power, but de facto control and power actually exercised in the course of the conduct and management of the affairs of the entity. The domicile or the registration of the company is not at all relevant and the determinate test is where the sole right to management and control of the company lies.
- 1.3 The facts of this case involve companies / assessee carrying on the business of commercial agents in agricultural products and incorporated under the Registration of Companies (Sikkim) Act, 1961. Before the Income-tax Act, 1961 ('the Act') was made applicable to the State of Sikkim from the previous year relevant to the Assessment Year commencing from 1 April 1990 by a notification issued by the Central Government, the income tax was to be charged and collected under the Sikkim State Income Tax Manual, 1948. The assessee filed an income tax return in terms of the Sikkim Manual for the assessment years 1987-88, 1988-89, and 1989-90.
- 1.4 During financial year ('FY') 1989-90, a search was conducted at the premises of the assessee's auditors Rattan Gupta & co. who was involved in the business of providing professional services. During the search, books of accounts, cheque books, signed blank cheques, vouchers, and other income papers of the assessee were discovered at the consultant's premises, and the auditors' statement was also recorded.
- 1.5 Based on the significant evidence, records, or other material obtained during the search, the income-tax authorities contended that the assessee was a resident of India because the assessee's management and control were based at the auditors' location in Delhi, India.

2. Issues involved

The main issue before the Hon'ble Supreme Court is whether the assessee was a resident of India within the meaning of section 6(3)(ii) of the Act.

3. Contention of the assessee

- 3.1 The main contention of the assessee was that the Act was made applicable to the State of Sikkim from 1 April 1990 and was not applicable for the assessment years 1987-88, 1988-89 and 1989-90.
- 3.2 Assessee had paid tax under Sikkim Manual, 1948 and accordingly, discharged their income tax liability. It has been further contended that same income cannot be taxed again just by applying 'head and brain' rule in the absence of expressed provision under the Act.
- 3.3 Assessee filed income tax returns before the appropriate authority as per Sikkim Manual, 1948 and a demand was raised by the said authority, which was paid by the assessee. Appropriate Income Tax Authority under the Sikkim Manual, 1948 accepted the income tax returns filed by the assessee and raised demand based on such returns establish the bona fides of the assessee.
- 3.4 It was further submitted that ACIT, Delhi (i.e., AO) had no jurisdiction to assess the income of the assessee and thus, AO has exceeded his jurisdiction for issuing notices under section 148 of the Act on the assumption that the assessee were carrying on business in India, on the basis of availability of books of accounts of the assessee at the premises of auditors of the assessee. They submitted that since the registered office of the assessee were in Sikkim, thus, jurisdiction lies with the income-tax authority of the state of Sikkim;
- 3.5 It was also contended that auditors of the assessee were engaged in providing accounting and auditing services to several corporates and individuals and could have never been the "head and brain" behind the business of the assessee. Books of accounts, ledgers etc. were handed over to Mr. Rattan Gupta for providing professional accounting services as he was a practising Chartered Accountant.
- 3.6 Business operations were carried out from Sikkim by a local Director, and auditors had nothing to do with the business operations of the assessee.

4. Findings of the tax authorities

- 4.1 The books of account, cheque books, signed blank cheque, vouchers, blank printed letters pads and rubber stamps, and other documents related to the assessee were found at the

premise of the auditors of the assessee. The statutory books, registers and the shareholders were all located in Delhi.

- 4.2 No evidence was ever produced for having conducted board meetings in Sikkim. There were no employees, and no expenses were incurred at Sikkim.
- 4.3 When it came to earning commission from various agents, the genuineness of the addresses given at Sikkim could not be proved. In this regard, notices under section 131 of the Act were issued to such persons, however, no response had been received. Further, from the memorandum and articles of association, it was clear that the agents were kith and kin of the directors.
- 4.4 Mr. Rattan Gupta in his statement dated 15 March 1990 had confirmed that as part of reconciliation, the persons contacted were Dalmia Resorts International Private Limited and Gujarat Heavy Chemicals Limited and other entities.

He further confirmed that Mr. Rajiv Jain became a director in 3 assessees on his instructions and he had also made directors in all the 5 assessees and named a few of them. It was conceded that though these persons were directors, but no work was performed by these persons except signing of papers;

- 4.5 Former auditor of the assessee in his statement confirmed that he was responsible for the day-to-day affairs of assessees from Delhi till March, 1988. Afterwards, Rattan Gupta took over the position as the only director and the other directors were his nominees, and Mr. Rattan Gupta functioned and operated only from Delhi and no office expenses had been incurred in Sikkim during the period under consideration;
- 4.6 This was done till 31 March 1989 and the moment the Act was extended in 1990 the whole apparatus erased, and no commission was shown by any of the companies.
- 4.7 AO concluded that each of the assessees were intentionally trying to take advantage of the prevailing laws at Sikkim by routing money through Sikkim and ploughing back in India.
- 4.8 AO rejected the objections raised by the assessees as to the jurisdiction that AO has no jurisdiction to assess the income of the assessees. AO made additions to the income of the assessees for the aforesaid three AYs in question.
- 4.9 The findings of the AO were confirmed by the CIT(A).

5. Observations of the Income Tax Appellate Tribunal ('ITAT')

- 5.1 ITAT has neither challenged nor found findings of the AO and CIT(A) erroneous. The entire discussion by the ITAT has only been an analysis on control and management of the affairs of the assessees without questioning the findings of the AO and the CIT(A).

- 5.2 ITAT concluded that since assesseees had been registered in Sikkim, jurisdiction to tax these assesseees will be with the state of Sikkim only.
- 5.3 While reversing the finding of the AO on whether the commission was not earned in Gangtok, Sikkim though the AO found that the notices were sent to those who had allegedly paid the commission to the assesseees and the summons issued under Section 131 of the Act had not been complied with, the ITAT gave a finding that the AO did not proceed further and thus, since no adverse material has been brought on record by the AO, the AO could not have proceeded to draw adverse inference as the burden was heavily on the revenue.

6. Observations of the HC

High Court concluded that the **control and management of affairs was wholly in India** for the following reasons;

- Mr. Rattan Gupta was not only doing audit work but determining who should be the directors of the said assesseees.
- The rubber seals, letter heads, blank signed cheques and other records were all found in the office of Rattan Gupta. The factual determination by the AO remains undisputed and this supports that the control and management was in Delhi.
- The statement of Rattan Gupta suggesting that H.L. Verma or Uma Shankar Sitani were actually handling the affairs of the 5 entities could not be made good by offering either of them for examination.
- Once documents were seized and statements were recorded from various persons, the burden gets shifted to the assesseees to produce some evidence to counter the picture and, the court found that its extremely unusual that the seals and the signed blank cheques would be lying with the Chartered Accountant.
- HC held that the revenue is right as there can be no presumption in law that control and management is at the registered office.

7. Findings & Order of the Hon'ble SC

- 7.1 Relying upon the findings of the AO, CIT(A) and HC, the Hon'ble SC held that Mr. Rattan Gupta did not only render professional service but was also having control and management of the assesseees during the period under consideration.
- 7.2 The Hon'ble SC has also relied upon the below-mentioned judgements wherein it has been held that control and management lies where the 'head & brain' is situated i.e., it is irrelevant where the business is done and income is earned, what is relevant is the place from where the affairs were controlled and managed:

- **V.V.R.N.M. Subbayya Chettiar v. CIT, Madras [1951] 19 ITR 168 (SC);**
- **Erin Estate, Galah, Ceylon v. CIT [1958] 34 ITR 1 (SC);**
- **Narottam and Pereira Ltd. v. CIT [1953] 23 ITR 454 (BOM.);**
- **CIT v. Bank of China [1985] 23 Taxman 46 (Calcutta);**
- **CIT v. Nandlal Gandlal [1960] 40 ITR 1 (SC).**

7.3 The Hon'ble SC held that HC has not committed any error in reversing the findings of the ITAT. It is further held that the Hon'ble SC agreed with the findings of the AO, CIT(A) and HC on all the issues such as:

- Control and management of the affairs of the assessee lies with Mr. Rattan Gupta;
- Jurisdiction to tax the assessee lies with the ACIT, New Delhi;
- Provisions of the Act shall be applicable to the assessee for the period under consideration;
- Assessee did not prove that income was earned by them by way of commission in the Sikkim.

7.4 With regard to the commission income earned by the assessee on account of sale of cardamom in Sikkim, the Hon'ble SC held that once the AO issued summons to those who had paid the commission to the assessee and the summons were not complied with, the burden to prove the assertion that the assessee earned the commission income within Sikkim lies with the assessee themselves.

Therefore, in absence of any material on record that the commission was earned only in Sikkim, the assessee cannot be permitted to say that they were liable to pay the tax under the Sikkim Manual, 1948 and not under the Act. It appears that the assessee with mala fide intention and to evade the payment of tax under the Act.

8. Our Comments

- 8.1 It is a settled position that control and management of affairs is the key factor to determine the residential status of the fictitious/ artificial person. Vide this judgement, it has further been clarified by the Hon'ble SC that place of doing a business is less important than the place of taking decisions to control and manage the business.
- 8.2 Company may not only conduct its affairs from one fixed place but also from other different places, thus, country/ state of incorporation does not play an important role in defining the residential status of the company as it may conduct its business in different country/ state while decisions are being taken at the other place. Thus, it is necessary to keep in mind the place of doing a business and place of taking decisions to control and manage the business while determining the residential status.
- 8.3 It is important to note that the criteria of control and management has been replaced with place of effective management vide Finance Act 2016.

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