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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Dated of decision : 11.12.2012

\+ ITA 908/2011

\+ ITA 909/2011

DIRECTOR OF INCOME TAX ..... Appellant

Through: Mr. Rohit Madan, Sr. Standing Counsel.

versus

MC DONALDS CORPORATION ..... Respondent

Through: Mr. G. C. Shrivastava with Mr. Robin David, Mr. Chitranshul Sinha and Mr. Febin Mathew, Advocates.

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V. EASWAR

S. RAVINDRA BHAT, J: (OPEN COURT)

In these appeals the Revenue impugns a common order of the Income Tax Appellate Tribunal ('Tribunal', for short) dated 18.02.2011 made in ITA No.4433 & 4434/Del/2010. The common question of law framed is as follows: -

> "*Whether the Income Tax Appellate Tribunal was right in holding that jurisdictional pre-condition for issuance of notice under Section 147/ 148 of the Income Tax Act, 1961 are not satisfied in the present case and, accordingly, the re-assessment proceedings are bad in law?*"

2. The assessee entered into a master licensing agreement ("MLA") on 01.01.1996 with McDonalds India Private Limited ("MIPL"). In terms of that arrangement the MIPL was granted non-exclusive right to use the McDonald's system at agreed locations in India. The terms also required MIPL to pay the assessee initial franchise fee of USD 45000 upon the opening of each restaurant and royalty on recorded monthly sales of each restaurant during the period. For the relevant assessment years i.e. 2000-01 and 2001-02, scrutiny assessments were completed after the relevant documents and materials were considered. On

13.11.2003 notice was issued under Section 148 proposing to reopen the proceedings under Section 148. The assessee filed its return and assessment was completed. On that occasion the assessing officer accepted the assessee's submissions that the rate of taxation applicable was 15% as originally held and assessed the royalty receipts of ₹2,61,33,570/- and ₹3,95,03,200/- in respect of the relevant assessment years.

3. After completion of re-assessment proceedings, again in respect of the same assessment years i.e. 2000-01 and 2001-02 the Assessing Officer sought to initiate proceedings afresh on the second notice under Section 147 issued on 26.03.2007. The reasons recorded on that occasion – which has led to the present proceedings would reveal that the Assessing Officer had in mind the same very royalty income received by the assessee. In the reasons to be recorded while reopening the assessment the Assessing Officer stated that: -

> "*Therefore, it is clear that MIPL is working as fully dependent agent of McDonald Corporation USA and parent company is directly doing business through the permanent establishment (MPIL) in India.*
>
> *Article 12(6) read with article 7 of Double Taxation Avoidance Agreement between Government of India and USA provides that where an assessee is earning income in the nature of Royalty or Fees for Technical Services through a permanent establishment situated in the other state, such income is taxable as business income in accordance with the domestic provisions of the state of source.*
>
> *As per article 5(1) and 5(2) of Double Taxation Avoidance Agreement "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on and it includes 'a place of management'.*
>
> *Therefore, in such case section 44D of I.T. Act, 1961, should be applied. Under section 44D read with section 115A of the Income Tax Act, Royalty or Technical Fee received by a foreign company from Government or Indian concern under an agreement made before 31st May, 1997 is to be taxed at the* ***rate of thirty percent****.*

Hence, royalty income received by McDonald Corporation from India should have been charged at the rate of thirty percent instead of fifteen percent.

Considering the above I have reasons to believe that thorough application of mind that income 'chargeable to tax has escaped assessment."

4. The assessee filed its return in response to the notice on 20.04.2007 and the reassessment proceedings were completed on 28.05.2007. This time the income was held to be taxable in terms of section 115A read with section 44D @ 30%. The assessee being aggrieved appealed to the CIT (Appeals) who was of the opinion that since the basic facts relevant for the royalty income had been disclosed by the MLA and all the other materials, the inference sought to be drawn could hardly be characterised as "reasons to believe". On these grounds the CIT (Appeals) accepted the assessee's contention and set-aside the re-assessments. The Revenue thereafter unsuccessfully appealed to the Tribunal. The Tribunal after hearing the grounds and the contentions, dismissed the appeals recording as below: -

"*10. We have hard both the parties and gone through the material available on record. From the facts stated above, there is no dispute that the material on the basis of which 2nd reassessment proceedings were initiated was available on record and was considered by the A.O. while making assessment u/s 147/ 143(3) on 7.3.2005. There is also no dispute about the fact that 2nd reassessment proceeding had been initiated on the same material. The A.O. in the reasons recorded has not recorded satisfaction that there was a failure on the part of the assessee to disclose fully and truly all the material facts necessary for his assessment. In the absence of such reasons, the assessment-framed falling under the proviso to Section 147 have to be declared bad in law. In the instant case, original assessment was made u/s 147/ 143(3) on 7.3.2005 and assessment could be reopened under main provisions of Section 147 within the period of 4 years from the end of the Assessment Year in which the income was first assessable. For the Assessment Year 2000-01, the assessment could have been reopened under the main provisions of Section 147 by 31.03.2005*

and for the Assessment Year 2001-02 by 31.03.2006. However, assessment can be reopened under the proviso to Section 147 beyond the period of 4 years if there was failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment. In the case before us, all the facts and the MLA which has been relied upon by the A.O. for reopening of assessments 2nd time was available at the time when original reassessment was made. Therefore, in the absence of any specific recording that there was failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment, the assessments made on 26.12.2007 are bad in law. The assessment made cannot be upheld as there is a change of opinion in 2nd assessment proceedings when material, which formed the basis for 2nd reassessment was available at the time of original reassessment and was duly considered by the A.O. while arriving at certain conclusion. Therefore, in our considered opinion, Ld. CIT(A) has rightly cancelled the assessments. Accordingly, we do not find any infirmity in the orders passed by the Ld. CIT(A) cancelling the assessment for both the years."

5. Learned counsel for the appellant/ revenue relied upon the decision of the Supreme Court in *ACIT v. Rajesh Jhaveri Stock Brokers Pvt. Ltd.*, (2007) 291 ITR 500 (SC) and the judgment in *Honda Siel Power Products Ltd. v. DCIT*, W.P. (C) No.9036/2007 decided on 14.02.2011. It was argued that the expression "reason to believe" cannot be read as implying that Assessing Officer should have finally ascertained the fact by legal evidence or conclusion and that the final outcome of the proceedings is not relevant so long as basic facts are before the assessing officer to infer that some income exists which had escaped assessment. The observations of this Court in *Honda Siel Power Products Ltd. (supra)* particularly were highlighted as under: -

"*10. Thus, the petitioner has accepted and admitted that he had not given details with regard to proportionate expenses relatable to tax free or exempt income, which were claimed as a deduction under the cumulative head "expenditure". It is pleaded and stated that the petitioner was not required to disclose the said fact as when they had filed the return, Section 14A was not in the statute book. Sequitor, there was no omission and failure on the part of the assessee-petitioner to make full and true disclosure. The term "failure" on the part of the assessee is not restricted only to the*

> *income-tax return and the columns of the income-tax return or the tax audit report. This is the first stage. The said expression "failure to fully and truly disclose material facts" also relate to the stage of the assessment proceedings, the second stage. There can be omission and failure on the part of the assessee to disclose fully and truly material facts during the course of the assessment proceedings. This can happen when the assessee does not disclose or furnish to the Assessing Officer complete and correct information and details it is required and under an obligation to disclose. Burden is on the assessee to make full and true disclosure.*"

6. This Court is of the opinion that the assessment record reveals that the MLA had been placed on the record of the assessing officer in the very first instance when the assessment was completed under section 143(3). Thereafter the reassessment proceedings were initiated in November, 2003 and completed in March, 2005; for those proceedings too what drove the Revenue to issue notice and reopen the proceedings was the master licensing agreement and the nature of 'royalty income'. The assessing officer in that instance consciously after going through the material concluded that the rate of taxation was 15% in the reassessment proceedings. The scope was the same as in the original proceeding and in the first reassessment proceedings i.e. the taxability of the royalty income under section 44D. Having regard to these, this Court is of the opinion that the declaration of law by the Supreme Court in *Calcutta Discount Co. v. ITO*, (1961) 41 ITR 191 applies; squarely to the facts in this case it was held by the Supreme Court that the duty of the assessee to make full disclosure extends to primary facts. Once that is done, it is the Assessing Officer's duty to draw the conclusion and inference flowing from the disclosure so made. This aspect was highlighted in the following terms: -

> "*Does the duty, however, extend beyond the full and truthful disclosure of all primary facts? In our opinion, the answer to this question must be in the negative. Once all the primary facts are before the assessing authority, he requires no further assistance by way of disclosure. It is for him to decide what inferences of facts can be reasonably drawn and what legal*

inferences have ultimately to be drawn. It is not for somebody else – far less the assessee – to tell the assessing authority what inferences, whether of facts or law, should be drawn. Indeed, when it is remembered that people often differ as regards what inferences should be drawn from given facts, it will be meaningless to demand that the assessee must disclose what inferences – whether of facts or law – he would draw from the primary facts.

If from primary facts more inferences than one could be drawn, it would not be possible to say that the assessee should have drawn any particular inference and communicated it to the assessing authority. How could an assessee be charged with failure to communicate an inference, which he might or might not have drawn?

It may be pointed out that the Explanation to the sub-section has nothing to do with "inferences" and deals only with the question whether primary material facts not disclosed could still be said to be constructively disclosed on the ground that with due diligence the Income-tax Officer could have discovered them from the facts actually disclosed. The Explanation has not the effect of enlarging the section, by casting a duty on the assessee to disclose "inferences" – to draw the proper inferences being the duty imposed on the Income-tax Officer.

We have, therefore, come to the conclusion that while the duty of the assessee is to disclose fully and truly all primary relevant facts, it does not extend beyond this."

7. Having regard to the previous discussion this Court is of the opinion that the conclusions drawn by the CIT (Appeals) and ITAT cannot be faulted in law. The substantial question of law is answered in favour of the assessee and against the Revenue in both the cases and consequently the appeals are dismissed.

S. RAVINDRA BHAT, J

R.V.EASWAR, J

DECEMBER 11, 2012
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