

# EY Tax Alert

**Bombay HC upholds DRP Proceedings be time barred if not completed within overall limitation period prescribed**

## Executive summary

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

The instant Alert summarizes a recent Bombay High Court (HC) ruling in a batch of writ petitions, with the lead case of Shelf Drilling Ron Tappmeyer Ltd.<sup>1</sup> (Taxpayer) where the issue before the HC pertained to time limit for completion of assessments under the Income Tax Laws (ITL) applicable to assessments and dispute resolution through the Dispute Resolution Panel (DRP) route (DRP Route). In this regard, the question before the HC was whether the mechanism to expedite resolution of disputes through the DRP Route is also to be carried out entirely within time limit prescribed under the ITL for the jurisdictional tax authority to complete scrutiny proceedings and pass an assessment order (General Timelines for Assessment).

Tax authority contended that DRP Route is a self-contained code in itself bearing a separate and independent procedure under the ITL which takes precedence, and it overrides the General Timelines for Assessment.

In this backdrop, the Bombay HC relied upon Division Bench Madras HC ruling in the case of Roca Bathroom Products Pvt. Ltd.<sup>2</sup> and held that General Timelines for Assessment would apply even also to a case where assessment is undertaken through DRP Route.

The HC further held that the DRP Route overrides the General Timelines for Assessment to a limited extent only at the stage of passing the final assessment order. The purpose of giving such preference to DRP Route is that even where larger time is available under General Timelines for Assessment, the tax authority has to pass the final assessment order within one month from the end of the month in which DRP's directions are received which is consistent with a fast-track mechanism intent of DRP Route.

<sup>1</sup> [[TS-431-HC-2023(BOM)]; Judgement dated 4 August 2023

<sup>2</sup> [2022] 140 taxmann.com 304 (Madras); Judgement dated 9 June 2022

# Legislative backdrop

## General Timelines for Assessment

- ▶ The Income Tax Laws (ITL)<sup>3</sup> lay down specific time limits within which the jurisdictional tax authority is required to complete scrutiny proceedings and pass an assessment order<sup>4</sup> in different scenarios as follows:
  - Assessments in the first instance (Original Assessment); and
  - Cases where the higher court remands the matter back to the tax authority for adjudication afresh in second round proceedings after giving taxpayer an opportunity of being heard (Remand Back Matter).
- ▶ Further, such limitation period is also extended in cases involving international transactions where a reference is made to the Transfer Pricing Officer (TPO) in order to determine whether such international transaction is appropriately priced on an arm's length basis [Transfer Pricing (TP) Adjustment]<sup>5</sup>.

## Assessment and dispute resolution through the DRP Route

- ▶ In order to expedite resolution of disputes, the ITL provides for a fast-track mechanism<sup>6</sup> in the form of DRP as an alternative to appellate forum of first appellate authority (FAA)<sup>7</sup> in cases involving either (i) TP Adjustment in cases of domestic company or other resident taxpayer; or (ii) a taxpayer being a non-resident.
- ▶ DRP Route provides for specific procedure. In this process the tax authority is required to issue first a draft assessment order to a taxpayer with the tax authority's proposal for additions or disallowances to total income offered in the tax return filed by the taxpayer, before passing the final assessment order. Besides TP additions, the additions may include corporate tax additions as well.
- ▶ In case taxpayer is aggrieved against the draft assessment order, it may file objections before DRP within 30 days and the DRP is required to adjudicate the matter and issue appropriate directions as it deems fit, within nine months of the issue of the draft assessment order by the tax authority after giving opportunity of being heard to the taxpayer.

- ▶ The tax authority is then required to issue the final assessment order in conformity with the DRP directions within one month from the end of the month in which the DRP directions are received regardless of the applicable General Timelines for Assessment as noted above.
- ▶ The entire alternate dispute resolution procedure from issue of draft assessment order to issue of final assessment order involves approximately 10/11 months.
- ▶ An appeal against the final assessment order passed pursuant to DRP directions lies before the Income Tax Appellate Tribunal (Tribunal) instead of the FAA.
- ▶ Thus, DRP Route is a fast forward dispute resolution mechanism to approach the Tribunal with an advantage that the demand raised basis proposed additions in draft assessment order remains in abeyance during DRP Route resolution.

## Madras HC ruling in Roca case

- ▶ The DRP Route has been a subject matter of litigation on various aspects over the years.
- ▶ One of the key issues of litigation which arose before the Madras HC in the case of Roca Bathroom Products Pvt. Ltd. (Roca Case), was whether the alternative of DRP Route (taking 10/11 months) is governed by General Timelines for Assessment or, it is separate code in itself without applicability of General Timelines for Assessment such that any final assessment order passed post DRP directions beyond General Timelines for Assessment is valid.
- ▶ The facts in the Roca Case pertained to a situation where second round of assessment was required pursuant to remand back of the matter by the Tribunal to the tax authority who was again directed to refer the matter to the DRP. However, both the tax authority and the DRP failed to take any action in the course of such remand back proceedings until more than 3 years after the expiry of the General Timelines for Assessment.
- ▶ In this backdrop, the Single Judge Bench<sup>8</sup> of the HC, and later the Division Bench of the HC (*supra*) rejected the contention of the tax authority that there was no timeline prescribed<sup>9</sup> to complete the proceedings under DRP Route. Instead, HC held that while the DRP Route

<sup>3</sup> Income-tax Act, 1961 r.w. Income-tax Rules, 1962

<sup>4</sup> S. 153

<sup>5</sup> S. 92CA

<sup>6</sup> S. 144C

<sup>7</sup> CIT(A)/ Jt. CIT(A)

<sup>8</sup> [2021] 127 taxmann.com 332 (Madras); Judgement dated 23 December 2020

<sup>9</sup> In this backdrop, it was the contention of the tax authority that the Alternative Procedure did not lay down a timeline to pass a draft assessment order and any timelines mentioned therein

overrides the General Timelines for Assessment, such override applies only at the stage of passing the final assessment order. This only implies that, the final assessment order post DRP directions must be made within 30 days only as prescribed under DRP Route even though, a larger time limit may be available under General Timelines for Assessment as DRP Route is a fast-track dispute resolution mechanism. Since, in the Roca Case, even the draft assessment order, DRP proceedings and DRP directions would have been passed beyond the General Timelines for Assessment, HC declared the assessment be time barred under the ITL.

## Facts:

- ▶ The Taxpayer, a non-resident incorporated in Cayman Islands, is engaged in the business of shallow water drilling for clients engaged in the oil and gas industry.
- ▶ For the tax year 2013-14, the Taxpayer deviated from its practice to offer income on presumptive basis. Instead, in its return, the Taxpayer had exercised the option to consider actual losses for tax purposes on the basis of audited accounts.
- ▶ In the first round of assessment, tax authority passed a final assessment order (based on DRP directions) rejecting the Taxpayer's audited accounts and instead considering presumptive profits.
- ▶ On appeal against such final assessment order the Tribunal vide its order dated 4 October 2019 disapproved the actions of the tax authority and the DRP and it remanded the matter back to the tax authority for fresh adjudication.
- ▶ Subsequently, in the second round of assessment proceedings, post granting the Taxpayer an opportunity of being heard, tax authority passed a draft assessment order on 28 September 2021. General Timelines for Assessment in this case of Remand Back Matter were to lapse on 30 September 2021<sup>10</sup>.
- ▶ Similarly, another fact-pattern before the HC pertained to a case of the Taxpayer's associate entity wherein, a draft order was passed on 29 September 2021 in the course of original Assessment where too the General Timelines for Assessment were to lapse on 30 September 2021.
- ▶ Against such draft assessment order, the Taxpayer filed objections before the DRP on 27 October 2021. Simultaneously, the Taxpayer also filed the instant writ petition before the Bombay HC challenging the draft assessment

were derived from the date of draft assessment order and were hence not bound by limitation.

<sup>10</sup> After considering various extensions to limitation period considering the onset of the COVID-19 pandemic.

order. The Taxpayer's contention for the challenge was on time barring of the proceedings as the final assessment order would not be passed within the General Timelines for Assessment which lapsed on 30 September 2021. For this contention, the Taxpayer relied upon division bench ruling of Madras HC in the Roca Case.

## Tax authority's contentions:

- ▶ The DRP Route is a self-contained code in itself<sup>11</sup>, bearing a separate and independent procedure under the ITL and takes precedence. Thus, it is not bound by the General Timelines for Assessment. Since there was no time limit prescribed to pass the draft assessment order under DRP Route, General Timelines for Assessment cannot bar the assessment.
- ▶ Alternatively, it may be stated that the General Timelines for Assessment only prescribe a limitation period to pass the draft assessment order. Subsequent timelines provided under the DRP Route procedure is in addition to General Timelines for Assessment.
- ▶ Adoption of view of Madras HC Ruling in the Roca Case, will make many final assessment orders passed in the earlier years ever since the inception of the DRP regime as time barred and will be against the commonly accepted understanding of the provisions of the ITL.
- ▶ Any interpretation making key machinery provisions unworkable should not be accepted as Taxpayers do not have any vested right in procedural aspects of ongoing assessments.

## Bombay HC Ruling:

The HC accepted Taxpayer's contention that its assessment turned time barred when final assessment order could not be passed within General Timelines for assessment prescribed under ITL for following reasons.

- ▶ The HC recognized that the DRP Route is a self-contained code of assessment, wherein time limits are specified at each stage of the procedure. The DRP Route was included bearing in mind the necessity for an expert body to look into the intricate matters concerning valuation and TP. Hence, specific timelines have been drawn within the framework to ensure prompt and expeditious finalization of special assessment. Despite that the General Timelines for Assessment cannot be ignored.
- ▶ Wherever Legislature desired, it has provided for extended time limit beyond the Timelines for

<sup>11</sup> This view is also accepted by Single Judge Bench ruling in Roca Case

Assessment. For instance, extension of General Timelines for Assessment qua TP Adjustments cases or cases where a stay on assessment proceedings is granted by any court. However, the ITL does not provide for any extension of General Timelines for Assessment regarding time taken under the DRP Route

- ▶ Any contention that no time limit is prescribed for completion of proceedings under DRP Route, will run counter to the object basis which, the DRP Route was introduced in the ITL to provide a fast-track mechanism.
- ▶ Further, the HC also reiterated the conclusion reached by the Madras HC in the Roca Case that when DRP Route overrides the General Timelines for Assessment, such override applies only at the stage of passing the Final Assessment Order. The basic purpose of such overriding is that even where larger time is available under General Timelines for Assessment, the tax authority has to pass the final assessment order within one month from the end of the month in which DRP's directions are received.
- ▶ The object is to conclude the DRP Route proceedings as expeditiously as possible. Hence, there is a limit prescribed under the statute and it is the duty of the tax officer to pass an order in time. Accordingly, considering that the time limit for passing the final assessment order lapsed as on 30 September 2021, the tax officer had no authority to pass the final assessment order in the instant case. Accordingly, the proceedings were time barred.

## Comments

The instant Bombay HC ruling has a far-reaching effect. Effect of HC ruling is that the time taken of 10/11 months to complete proceedings under DRP Route will have to be factored in the overall limitation period provided under General Timelines for Assessment prescribed for assessments. So construed, many of the past assessments under DRP Route may turn invalid where final assessment order post DRP directions are passed beyond the General Timelines for assessment prescribed under the law.

Hitherto, there has been general understanding of the tax authority and taxpayers that General Timelines for Assessment prescribed is applicable to draft assessment order and once draft assessment order is passed within the General Timelines for Assessment, proceedings before DRP Route and issue of final assessment order can be undertaken passed beyond such General Timelines for Assessment but within the specific timelines provided for DRP Route. The HC ruling has shaken such a practice which was prevalent for more than a decade period since the introduction of DRP Route in 2009.

The turning point was the decision of Madras HC in Roca's case wherein tax authority showed unreasonable leniency in giving effect to appellate authority's directions to redo the assessment post setting aside the original assessment order passed pursuant to DRP's directions. Ordinarily, in case of set aside assessments as well, the ITL provides for General Timelines for Assessment within which such assessment is to be completed. However, in Roca's Case, HC noted complete breach of limitation provisions.

The present HC ruling applied the ratio of Roca ruling in both Remand Back Matters as well as Original Assessments where the HC found that, while draft assessment order itself was passed by the tax authority couple of days before the limitation period, issue of final assessment order post DRP procedure would have clearly gone beyond the General Timelines for Assessment. Basis this, the HC declared the assessment as time barred.

It may be noted that the SC has admitted an SLP of the tax authority against the Madras HC ruling in the Roca Case which is pending for hearing. In the meanwhile, tax authority found valid concern arising out of present HC ruling which has, as aforesaid, the effect of many past assessment orders under DRP Route turning time barred. In many jurisdictions, request has been made to respective Tribunals to grant adjournment to tax authority in appeals pending before the Tribunals against final assessment order post DRP directions until the matter is decided by the SC in Roca's case.

Considering the far-reaching effect of the HC ruling, scope of a retrospective amendment to ITL to clarify the intent cannot be ruled out.

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