

**TAX PROBLEM FOR PARTICIPANTS OF NLS-TIOL TAXATION LAW MOOT COURT****IN THE HIGH COURT OF MADRAS****Writ Appeal No.325 of 2010****COMMISSIONER OF INCOME TAX****Vs****OLIVE GREEN MACHINES LTD****W.P. Nos.233, 374 & 1174 of 2011****OLIVE GREEN MACHINES LTD****Vs****CENTRAL BOARD OF DIRECT TAXES****COMMISSIONER OF INCOME TAX**

In 1987, Mr. Ganapathy Mahadevan, a young management graduate, saw a personal computer for the first time in his life in his brother-in-law's office in the United States of America. Seeing it handle large databases, organise data and process information with remarkable ease, he saw that this machine was the future of the world. Immediately, he came back to India, and set up a small company, Green Machines Pvt. Ltd. in Chennai, in December 1987, to market personal computers imported from the US. The company operated, in those years, with two employees, Mahadevan himself and Rajamanikyam, an engineering graduate from IIT, Madras.

Their initial clients were departments of the State of Tamil Nadu and the Central Government that were taking baby steps towards computerisation. While executing these projects, Mahadevan understood that he had to expand his model beyond just making the machines, and began to write code for the software also. The company grew for the first five years of its existence, but slowly, which meant that Mahadevan could concentrate on his other passion, cricket statistics, with equal fervour.

However, India's liberalisation changed all that. The opening up of the services sector meant that Green Machines, between the financial years 1994-95 and 1999-2000, registered a growth of at least 40% each year, even touching 100% in 1998-1999! The company went public in 1997, and the shares that had a face value of Rs. 10 traded, within three days of its listing, at Rs. 452. In 1999, wooed by new Chief Minister Chandrababu Naidu, Green Machines set up its largest office in Hyderabad, and when this was not found to be large enough to host its expansion, in 2002, amidst great fanfare, it set up offices of comparable magnitude in Bangalore and Mysore. Within that year, Green Machines expanded beyond India's borders acquiring companies in the US and the UK. In 2004, it became one of the few Indian companies to be traded on the NASDAQ.

The company had over 45,000 employees and was frequently referred to by Tamil Nadu's leaders as the state's "pride". Various incentives were given by the State to the company, including a relaxation of certain sales tax liabilities under a settlement scheme (after the decision of the Supreme Court in TCS), and vast lands allotted at decreased costs. Mahadevan, in turn, made huge grants to Government-run engineering colleges, including setting up an excellence centre at the National Institute of Technology, Trichy, and naming it Baby Centre for Research, after his Malayali wife.

In January 2005, Green Machines set up a 100% subsidiary, Green Dreams Pvt. Ltd., to enter into a Memorandum of Understanding with the Corporation of Chennai, for developing its ambitious new Metro Rail project. Along with collaborators from Japan and China, a new joint venture was formed, Chennai Metro Rail Ltd., where Green Dreams Pvt. Ltd. was a majority shareholder. The project took heavy loans from various banks and financial institutions, which insisted that Green Machines stand as guarantor for the loans. Green Machines obliged willingly, and the mindboggling profits it posted in the immediately preceding years meant that no investor or director questioned these decisions.

In March 2006, the company again posted profits of Rs. 3200 crores for FY 2005-06, a shade higher than its nearest competitors. In the wake of this achievement, Mahadevan announced three more mega-offices on Old Mahabalipuram Road in the outskirts of Chennai, in the southern town of Tirunelveli, and the sleepy coastal town of Nagapattinam that could potentially house 40,000 more employees. He announced, "People complain that Mahadevan has forsaken his State. People complain that he is too busy licking the feet of his US investors. I want to show that they are wrong. I want to prove that I am committed towards generating employment and revenues for my Tamil people. I want to show that the blood in my veins speaks the purest Tamil."

However, the regime change that followed in the Tamil Nadu State Government elections in 2006 meant that the permissions for this expansion took much longer than expected. The huge loans taken for these three offices could not be utilised, while repayment schedules kicked in. The offices have not started operating to this day. Further, Green Dreams defaulted on two payments in its loan repayment schedule to a bank, and Green Machines was required to step in with some ad-hoc payments to placate the bank. Despite this, for the FY 2006-07, Green Machines declared profit before tax of Rs. 3,776 crores, a significant increase over the previous year. Its stock price in the Bombay Stock Exchange reached an all-time high of Rs. 1,788 per share in April 2007.

In late 2007, the recession hit, and Green Machines' share price took a sharp downturn. Alarm bells were rung, and in March 2008, Mahadevan admitted that its business had slowed down. In a characteristically ebullient statement, he said, "I do not want to hide anything from my shareholder family. You are my brothers and sisters, my fathers, mothers and children... We have taken a hit, like the rest of the industry, in this recession. Our orders have come down. Our clients have deserted us, because they cannot afford us any more. Many clients, some really large corporations, have shut down their businesses. Still, I don't think there is any cause for panic. We have still managed to post profits in FY 2007-08 of Rs. 2,988 crores. We do not have enough work to keep all our employees busy, but we promise that we will not retrench a single one. Hiring will be slow this year, yes, but those with jobs will remain for as long as they wish to remain. I will keep my solemn promise to them."

However, the company worst affected by the recession was Green Dreams, which could not keep up with its working capital requirements to meet targets. The post-election regime, which had other favourites for executing the Metro Rail projects, immediately terminated the contracts granted to Chennai Metro Rail Ltd. and called for fresh tenders. The creditors of this company, who had extended deadlines to make loan repayments moved winding-up petitions in the Madras High Court against Chennai Metro Rail Ltd., and sent notices demanding payment from its guarantors - Green Machines.

Amidst these mounting pressures from all quarters, in July 2008, Mahadevan announced that he would have to majorly scale-down operations in Bangalore and Mysore. There was furore from the employees, and to avoid protracted litigation, Mahadevan announced that Green Machines would pay compensation of twice the amount agreed in the respective employment agreements.

On December 29, 2008, Mahadevan called for an unexpected press conference at his office. There, he read out from a letter he was sending to the Board. The contents of the letter are:

*"Dear Members of the Board,*

*I state with regret that I have been failing in my duty to you and the rest of the Green Machines family. For many years now, I have not been presenting a true picture of the accounts of the company. I would like to state a few facts:*

1. *The Balance Sheet as on September 30, 2008 had inflated cash and bank balances of Rs. 8,466 crores.*

2. *These carry fictitious interest income of Rs. 692 crores.*

*Over the years, I have been inflating the profits marginally for various purposes – to maintain the share prices at respectable levels, to make it easier to raise loans from banks and financial institutions, to fund other ventures such as Green Dreams.*

*I was hoping, that with capital expenditure to expand business, we would be able to fill this gap over the years, but the recession has ensured that this is not possible. I have betrayed my people, and I do not know what to do about it.*

*I wish to clarify a few things, though:*

1. *I have not made a single rupee from this fraud. This was only made in the interests of the company, and I (or my family members) have not benefitted from this one bit.*

2. *I have kept all the members of the board, senior executives, employees, etc. in the dark about this. Only myself and Rajamanikyam have engineered this scam. This was done, as I have repeatedly said, only in the interests of the company.*

3. *Shares held by me have been pledged to various persons, and loans have been raised that Rajamanikyam has managed to pump into the company through complicated legal structures. This money, amounting to Rs. 1800 crores has not been reflected in the books of the company anywhere. However, despite this, the gap, as mentioned above, is Rs. 3,466 crores.*

*I do not know what to do now, but to fold my palms, prostrate before my Green Machines family and beg for forgiveness.*

*Warm Regards,*

*Ganapathy Mahadevan."*

The next morning, it was reported that Rajamanikyam had committed suicide in his Adyar residence, leaving a cryptic note that only said, "I have left through the window."

The Central Government took immediate action, and under the orders of the Company Law Board, took over the management of the company and appointed a fresh Board of Directors comprising of top Government officials and leading business persons and Chartered Accountants. The new Board took the following steps on appointment:

1. Appointed JHGB, one of the world's leading Accountant firms to conduct an audit and restate the accounts for the financial years 2003-04 to 2004-05.

2. Made an application to the Company Law Board to grant an extension of time to file restated reports of the company and comply with all relevant statutory requirements under the Companies Act.

3. Invited bids from companies/ corporate houses to take over the affairs of the company, and ensure its smooth transition.

The Central Bureau of Investigation (CBI), which was appointed by the Central Government, referred it to its Serious Frauds Investigation Office (SFIO) to make a complete report of the nature and extent of the fraud committed by Mahadevan.

The SFIO, on July 19, 2009, came out with its report with the following findings:

1. Overstatement of income was done through fictitious invoicing. Invoices were either raised in the names of parties that did not exist, or fictitious invoices were notionally raised on existing parties. The amounts were shown as collected, and added to the Green Machines' cash and bank balances.
2. These cash and bank balances were invested in fictitious fixed deposits. The notional interest income from these fixed deposits were also added to the profits of the company.
3. On foreign invoices, credit for taxes paid was claimed under the relevant Double Taxation Avoidance Agreements by showing fictitious tax credit certificates.
4. The total fictitious income is as follows:

<b>Financial Year</b>	<b>Profits from Fictitious Invoicing</b>	<b>Fictitious Interest</b>
2002-03	178	54
2003-04	998	71
2004-05	1221	101
2005-06	1287	104
2006-07	1214	98
2007-08	2338	209
2008-09	2801	183
<b>Total</b>	<b>10037</b>	<b>820</b>

On August 23, 2009, the company-appointed JHGB also came out with its report. While it agreed with the SFIO completely on the modus operandi, its figures were slightly off the SFIO 's figures. JHGB computed the fictitious income as follows:

<b>Financial Year</b>	<b>Profits from Fictitious Invoicing</b>	<b>Fictitious Interest</b>
2002-03	181	51
2003-04	937	72
2004-05	1210	121
2005-06	1288	91
2006-07	1213	98
2007-08	2401	211
2008-09	2566	176
<b>Total</b>	<b>9796</b>	<b>820</b>

On September 24, 2009, Olive Branch Ltd., another large software company, with group interests in various businesses such as manufacturing, chemicals and automobiles successfully bid for control of Green Machines, and acquired the erstwhile promoters ' share in the company at a price of Rs. 79 per share. The market price for the share on that date was Rs. 57 per share.

Mr. Mahesh Alvares D'Cunha (known in the business circles as "Mr. MAD"), the CEO of Olive Branch Ltd. stated on that day in a press interview, "Green Machines, apart from its fraud, is a robust company with an extraordinary client base, inspiring work ethic and a team of enterprising and highly skilled employees. I am sure it will take us no time to get this company back on track. " And he added with a wink, "We can now call it Olive Green Machines. How apt!"

The first step Mr. MAD took was to negotiate a settlement with the US shareholders who had filed a class-action suit against the company, under the relevant US securities laws. Under this settlement agreement dated 15 November 2009, Olive Green Machines would pay a lumpsum to a receiver appointed by the New York District Court, and this receiver would distribute the amount to the shareholders as per the terms agreed amongst themselves.

Before this amount could be paid, on 8 November, 2009, Olive Green Machines received the following notice from the Commissioner of Income-tax – II (TDS):

*"Respected Sir,*

*It has come to my notice that a sum of approximately Rs. 182 crores is being paid as a settlement to shareholders in the United States, but no tax is being deducted under s 195 of the Income-tax Act, 1961. You are advised to deduct tax at source before making such payment, failing which, the consequences under the Act are likely to follow.*

*Regards,*

*V.K. Shukla,  
Commissioner of Income Tax – II (TDS)"*

On advice from its young, green tax lawyer, Sandeep Venkatesan, Olive Green Machines took a stand that no tax needed to be deducted under s 195. As abundant caution, it filed a writ petition, W.P. No. 19862 of 2009, challenging this letter dated 8 November 2009. The writ came up for admission before a Single Judge of the Madras High Court, and the Single Judge ordered notice to the Department.

On the next date of hearing, the Department took a preliminary objection that the writ was not maintainable at all, since no order had been passed and only a "warning" had been issued. The maverick judge, taking offence at the language used, made this order on January 16, 2010:

*"Without ruling on the issue of whether this writ petition is maintainable, I want to record my shock that the Income-tax Department, behaving like a gangster, is issuing "warnings" to assessees. In any case, since the payment is made to a receiver appointed by the Court, the Petitioner is not "responsible for paying a sum chargeable to tax" since such responsibility, if any, as the Petitioner correctly contends, lies with the receiver. Therefore, no obligation on the Petitioner can arise under s 195 of the Act.*

*The letter is, therefore, quashed and the Writ Petition is ordered as prayed for."*

The Department did not file any appeal against this order. However, on January 18, 2010, it issued a notice under s 201 of the Income-tax Act to Olive Green Machines Ltd. treating them as assessee-in-default for not deducting tax while making a payment to the receiver. Olive Green Machines immediately filed a writ petition, W.P. No. 883 of 2010, challenging this notice. The Petitioner contended that in the face of the clear finding of the Single Judge on the issue of there being no obligation under s 195, the Department could not now treat them as an assessee-indefault.

The Department contended that the order in the earlier writ petition only dealt with the quashing of the "warning" letter, and that proceedings had not been barred by the Court. The Single Judge, enraged by the Department disobeying his own order, quashed proceedings under s 201. The Department filed Writ Appeal No. 325 of 2010. The matter is pending.

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Mr. MAD found that since there was fictitious income according to both the SFIO report and its own internal auditor's reports, it had paid heavy taxes on income it had never earned.

After consulting with various experts, Olive Green Machines made an application to the Central Board of Direct Taxes under s 119(2)(b) on January 31, 2010 praying that the assessment orders for the years 2003-04, 2004-05, 2005 -06 and 2006-07 be treated as non est since they were obtained by fraud. Since there was no valid assessment order, it prayed that the time for filing a revised return under s 139(5) be extended, and the company be permitted to file revised returns ignoring the fictitious income.

The assessment for 2007-08 not being complete at all, the company prayed that it be allowed an extension of time to file a revised return in light of the reports of the SFIO and the internal auditor.

As an alternative, it prayed that the time limit for filing a refund application under s 239 be extended, and the company be allowed to make a fresh claim of refund of the taxes paid on fictitious income. It relied on, amongst other grounds, Article 265 of the Constitution of India, and the "real income theory".

After hearing the applicant for three days, the CBDT, on December 21, 2010 disallowed the prayers on the following grounds:

1. The scope of powers under s 119(2)(b) were not wide enough to make such orders.
2. A person cannot take advantage of his own wrong, and Olive Green Machines, which had voluntarily filed fictitious returns could not now seek to have them declared as void.
3. Olive Green Machines was not the victim of the fraud; but the perpetrator of fraud and not entitled to any concessions under equity.
4. Olive Branch Ltd. had invested in the company knowing fully well that it had engaged in unprecedented fraud, and could not now wriggle out of tax demands by citing "previous management fraud".
5. The reports of the SFIO and internal auditors are unreliable since they expressed many reservations, including that "all material was not available before them", and that the report is made based on "limited materials available", and that the report, in some places is "an approximation based on available data".

The company filed W.P. No. 233 of 2011 on January 16, 2011, challenging this order.

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Earlier, on 25 December 2009, the Department sent notices under s 148 reopening the completed assessments for the assessment years 2003-04, 2004-05, 2005-06 and 2006-07. The notice read as follows:

*"Respected Sir,*

*It has come to our notice that income has escaped assessment for the years 2003-04, 2004-05, 2005-06 and 2006-07. You are requested to file your returns within fifteen days from the date of receipt of this notice.*

*Regards, H.S. Bhalla  
Commissioner of Income-tax"*

Olive Green Machines replied on 9 January 2010 as follows:

*"Respected Sir,*

*As per the decision of the Supreme Court in GKN Driveshafts India Ltd. v ITO (259 ITR 19) = ([2002-TIOL-634-SC-IT](#)), we request you to furnish your reasons for reopening the assessment.*

*Regards,*

*Mr. Mahesh Alvares D'Cunha ("Mr. MAD"),  
CEO"*

On April 5, 2010, the Department sent a detailed letter giving its reasons for reopening

assessments. The letter stated that the CBI, in its chargesheet against Mr. Ganapathy Mahadevan, based on the SFIO report, noted that various credits of foreign taxes paid had been claimed. In many cases, no foreign tax credit certificate had been produced. Where tax credit certificates had been produced, they are found to be fake. This has led to escapement of income.

The company then filed objections to these reasons on 18 April, 2010 stating:

1. With respect to AY 2003-04, the proceedings were beyond limitation, since the reasons for reopening were not received within the six-year period prescribed under s 149. The assessee relied on the decision in *Haryana Acrylic Manufacturing Co. v CIT 308 ITR 38 = (2008-TIOL-555-HC-DEL-IT)*.
2. That there had been, in the relevant assessment years, according to the Central Government's own SFIO report, vast fictitious incomes that had been brought to tax, and that if such additional tax paid was set off against the fictitious tax credits, the assessee would in fact be entitled to a refund of taxes. Therefore, there was no "escapement of income".
3. The assessee also filed a return in response to the s 148(2) notice restating its entire income as per the SFIO's report and claiming a refund.

The Department disposed off these objections on 3 January 2011, stating the following:

1. The decision in Haryana Acrylic is not correct, and has been dissented from by the Andhra High Court.
2. The assessee had itself committed the fraud, and could not take advantage of it.
3. The reports of the SFIO are not reliable, as stated by the CBDT, since there are numerous reservations and limitations expressed therein.
4. In a reassessment, in any case, as per the decision of the Supreme Court in *CIT v Sun Engineering (198 TTR 297) = (2002-TIOL-242-SC-IT)*, concluded items cannot be reopened. The scope is only to consider "escapement of income" and nothing else.

The company challenged this order disposing off the reasons in W.P. No. 374 of 2011 filed on January 29, 2011.

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When W.P. Nos. 233 of 2011 and 374 of 2011 came up for admission on February 6, 2011, the High Court referred the entire issue to a Division Bench, and tagged along W.A. No. 325 of 2010. As an interim measure, the Petitioner was asked to furnish a bank guarantee for Rs. 800 cr. On furnishing this bank guarantee, the Court ordered that no assessment or recovery proceedings should be taken until the disposal of the writ petitions.

However, by an order dated February 5, 2011 (but delivered to the company on February 14, 2011), the Assessing Officer attached all the immovable assets of Olive Green Machines under s 281B of the Income-tax Act. On the very next day, officers of the tax department started pasting notices on all the buildings and other immovable properties of the company stating that they had been attached under s 281B of the Income-tax Act.

The company filed a writ petition, W.P. No. 1174 of 2011 on February 23, 2011 stating that an order under s 281B could not have been made when the High Court's stay order was in operation. The company alleged in its writ petition that it was highly suspicious that an order of this sort could have been passed precisely one day before the stay order was passed, especially in light of the fact that the order was only delivered to the company much later. The company also stated that the order should have been brought to the notice of the Court at the hearing on February 6, 2011. In any case, the company argued, that on merits, no case for an extreme remedy such as s 281B was made out by the Department.

An interim stay of the order under s 281B was granted by the High Court. The Department, on March 19, 2011, filed a counter-affidavit in which it took the stand that various demands were likely to be made on the company which could easily exceed the Rs. 800 cr deposited by the company. The Department also pointed out that the stay order dated February 5, 2011 only pertained to "recovery and assessment proceedings", and that the procedure under s 281B was neither recovery nor assessment.

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The four matters are now listed for final hearing before a Division Bench of the Madras High Court.

For the Law students who would like to have complimentary access to TIOL database for research with respect to the problem given above, you may send us your request at [editor@taxindiaonline.com](mailto:editor@taxindiaonline.com) with the necessary details like name, admission number, roll number, name of the college and one of the faculty members (with mobile number) who has been coordinating with the team for participation in the 'NLS-TIOL TAXATION LAW MOOT COURT' event to be held from Jan 4 to Jan 7, 2013.