
(2014) 02 DEL CK 0210
In the Delhi High Court
Case No : Criminal A. No. 40 of 2008

Mitsubishi Corporation

APPELLANT

Vs

Director of Enforcement

RESPONDENT

Date of Decision : 03-02-2014

Acts Referred:

Foreign Exchange Regulation Act, 1973 — Section 2(p)(iii) 29(2) 50 73 73(1)(d)

Citation : (2014) 3 AD 389 : (2014) 141 DRJ 142

Hon'ble Judges : S. Muralidhar, J

Bench : Single Bench

Advocate : Parag P. Tripathi, Mr. Avinash Mody, Ms. Ritika Pal and Ms. Monisha Handa, for the Appellant; P.K. Sharma, for the Respondent

Final Decision : Allowed

Judgement

S. Muralidhar, J.—This appeal is directed against the impugned order dated 30th October 2007 passed by the Foreign Exchange Appellate Tribunal ("AT"), dismissing the Appellant's Appeal No. 348 of 2004 directed against the adjudication order ("AO") dated 10th February 2004 passed by the Special Director, Enforcement Directorate ("ED") which held that the Appellant had contravened Section 8(1) of the Foreign Exchange Regulation Act ("FERA"), 1973 and imposed a penalty of Rs. 2,00,00,000 on it u/s 50 of the FERA. The Appellant is a liaison office ("LO") of Mitsubishi Corporation ("Mitsubishi"), Japan, which is an entity incorporated under the laws of Japan. It is stated that these LOs are not incorporated bodies in India and merely an extension of Mitsubishi, Japan. It is stated that the LOs of Mitsubishi function within the parameters of permissible activities for the LOs of a foreign company in India under the FERA, the Foreign Exchange Management Act, 1999 ("FEMA"), the rules and regulations framed thereunder, and the Circulars of the Reserve Bank of India ("RBI"). The LOs of Mitsubishi are subject to the terms and conditions on which the RBI has granted approval for their operation in India.

2. It is stated that, in the course of carrying out the liaison activities, Mitsubishi,

Japan deputed/seconded some of its employees from Japan to India. The Appellant states that the said expatriated employees, continue to be the employees of Mitsubishi and are not employees of the Appellant. Their salaries and emoluments are payable by the Head Office ("HO") in Japan. However, in order to enable the expatriate employees to meet their day-do-day expenses while they are in India, the Appellant pays the Indian component of their salaries from the amount remitted to it by the HO for that purpose.

3. On 27th January 1999, ED asked the LOs of Mitsubishi to furnish certain information and documents, and in particular, the details of the permission granted by the RBI, the total number of expatriated employees along with the details of the salary and perks paid to them, the details of the Income Tax/TDS paid, certified copies of the balance sheets etc. On 5th February 1999, Mitsubishi, for and on behalf of the LOs, furnished a reply to the ED, stating, inter alia, that the LOs of Mitsubishi have no source of income/profit in India and, therefore, there was no repatriation of income/profit abroad. It was further stated that during 1996-97, the salary payments by the HO to the seconded employees in India was to the extent of Rs. 9,39,15,608 and that the same was paid abroad. Further, a sum of Rs. 1,12,16,635 was paid in India by the Appellant to the employees of the HO seconded to India. Likewise, the figures for 1997-98 were Rs. 11,13,77,092, being the payments made abroad and Rs. 1,62,62,350, being payments made in India. Certain other documents were also furnished.

4. The ED, by a letter dated 26th May 2002, asked the LOs to furnish further details including whether the salaries paid abroad to the expatriated employees had been reflected in the applications made to the RBI by the Appellant seeking repatriation of profits/surplus funds abroad and whether the salaries paid abroad have been reflected in the tax returns.

5. By a letter dated 29th May 2002, Mitsubishi, on behalf of the LOs, clarified to the ED that it had never been engaged in the trade of business activity in India and that the LOs "are solely dependent on the remittances from the Head Office to meet the expenses of the Liaison Offices." It was clarified that they "have no source of income/profit in India and therefore there is no possibility of any repatriation of income/profit abroad." It was further clarified that "The salaries of the Indian employees and payment to the employees deputed/seconded by the Head Office to India were paid in Indian Rupees from the remittance received from the Head Office."

6. A show cause notice was issued on 31st May 2002 by the ED to the LOs stating that a portion of the salaries paid abroad to the seconded employees was actually payable by the LOs but were paid through the HO outside India without the necessary permission/exemption of RBI. It was accordingly alleged that the LOs were required to pay to the HO such portion of the salaries already paid by the HO on behalf of the LO. It was alleged that the causing of the payment overseas of a part of the salaries of the employees seconded to India, by the HO

without the previous permission/exemption of RBI, was a contravention of Sections 8(a) and 9(1)(c) of FERA.

7. In the reply dated 28th June 2002, Mitsubishi, for its LOs, contended that the HO did not make payments of the salary on behalf of the LOs and that the LOs were not required to repay to the HO the amounts so paid by the HO to the employees seconded to the LOs. The copies of the Notifications dated 1st January 1974, 24th November 1977 and 26th April 1993 of the RBI were enclosed with the reply.

8. The AO dated 10th February 2004, passed by the Special Director, ED after hearing the Appellant, first held that "(I) the Parent Corporation abroad has paid a part of the salary to the expatriate employees working with the noticee Corporation and (II) The noticee was only a liaison office of M/s. Mitsubishi Corporation, Japan, and was not a separate legal entity having any separate identity". The AO then proceeded to discuss para 11.D.3 of the Foreign Exchange Control Manual ("FECM") and observed that the expatriated employees of the parent company, while holding the post with the Indian Liaison Office "should receive all their salary in India and out of such receipt only 75% of their net salary after deduction of contribution to provident fund and tax payable etc. can be remitted".

9. Referring to Section 2(p)(iii) FERA, it was observed that the LO was a person resident in India and, hence, the expatriated employees were also the persons resident in India. Therefore, the restrictions under the FERA were applicable to foreign companies operating in India by virtue of their being a person resident in India. It was held that by arranging a part of the salary of expatriated employees outside India, the LO operating in India had "otherwise acquired and transferred foreign exchange from its foreign parent corporation outside India or at its behest without any general or specific permission of RBI has violated the provisions of section 8(1) of FERA." As regards Section 9(1)(c) FERA, it was held that since the LO was only a representative of the parent company and both the offices are one and the same, the question of the amounts paid as salaries to the employees of Mitsubishi by the HO being repaid by the LO to the HO did not arise. Therefore, it could not be said that "the noticee company had created and acknowledged, a debt and that the foreign parent company had a right to receive the payment of the same amount from them." Accordingly, it was held that the ingredients of Section 9(1)(c) of the FERA were not satisfied. The AO then proceeded to hold the Appellant liable to penalty u/s 50 of the FERA and imposed a penalty of Rs. 2,00,00,000.

10. The AT, in the impugned order dated 30th August 2007, first held that in terms of Section 2(p)(iii) read with Section 73 of the FERA, the employees seconded to the Indian LOs of Mitsubishi were persons resident in India. They were temporary residents. It was further held that the LO was a branch office and, therefore, deemed to be a corporate body. As the LO was also a subordinate office of the foreign principal, "they will engage in the business activities." Since

both the branch office and the LO were "doing the same thing, i.e., conducting the business of the principal office either by conducting the main business itself as of banking or by engaging for the purposes of advancing the business, including the profits. Thus, as a consequence to above, the Liaison Office also assumes the character of body corporate u/s 73(1)(d) FER Act, 1973."

11. It was then held by the AT that since the payment of a part of the salary was being made in foreign currency to the expatriate employees in a foreign land by the foreign principal, such liability was "clearly of the appellant herein", and "an inference of agency from the circumstances is permissible and can appropriately be drawn." It was further held that "Once agency is available on facts and circumstances with the payment made to discharge the liability, which otherwise as discussed above is of the borrower, can certainly imply possession enjoyment of the paid foreign currency wherefrom acquisition will automatically be inferred."

12. The AT held that since the contraventions under Sections 8(1) and 9(1)(c) of the FERA were distinct and separate, the mere fact that the Appellant was not found to be in contravention of Section 9(1)(c) did not mean that it should not be held to be in contravention of Section 8(1) of the FERA. The AT proceeded on the footing that the expatriated employees were "borrowed employees whose liability to pay the salary is on the Appellant." The payment of salary to such expatriated employees in foreign currency would "have to be taken as acquisition of foreign currency by the appellant without permission from Reserve Bank of India in contravention of the provisions of Section 8(1) FER Act, 1973." As regards the question of penalty, it was held that the contravention of the statute had occurred and, therefore, there had to be a deterrent punishment.

13. This Court has heard the submissions of Mr. Parag P. Tripathi, learned Senior counsel and of Ms. Monisha Handa, learned counsel for the Appellant. The Court has also perused the written submissions filed by Mr. P.K. Sharma, learned counsel for the Respondent, which raise similar contentions as those put forth before the AT.

14. At the outset, Mr. Tripathi stated that on legal advice, the Appellant had paid the income tax as per the Income Tax Act, 1961 on the entire salaries paid to the expatriated employees by the parent corporation. He clarified, however, that this should not be construed to be an admission by the Appellant of its liability to pay such salaries. According to him, there was a fundamental error in both the AO passed by the Special Director, ED, as well as the impugned order of the AT in treating the employees of the parent corporation, seconded to the LO, as employees of the LO. The consequent error was in holding that the liability to pay the salaries of the seconded employees of Mitsubishi was that of the Appellant. Such conclusion had no factual basis.

15. Mr. Tripathi stated that although in the grounds of appeal, the Appellant has seriously contested the finding that the Appellant was "a person resident in India", in terms of Section 2(p)(iii) read with Section 73(1)(d) FERA, the

Appellant was prepared, on the basis of the present proceedings, to assume, without admitting, that it was a person resident in India. Even if the Appellant was presumed to be a person resident in India, there was no violation of Section 8(1) of the FERA in the facts and circumstances of the case.

16. In order to appreciate the above submissions, an analysis is proposed to be undertaken of Section 8(1) of the FERA, which reads as under:

Except with the previous general or special permission of the Reserve Bank, no person other than an authorized dealer shall in India, and no person resident in India other than an authorized dealer shall outside India, purchase or otherwise acquire or borrow from, or sell, or otherwise transfer or lend to or exchange with, any person not being an authorized dealer, any foreign exchange.....

17. u/s 8(1)(b) FERA, there is a prohibition on a person "other than an authorized dealer" purchasing, acquiring or borrowing or selling or otherwise transferring or lending or exchange with any person not being an authorized dealer, any foreign exchange either in India or outside India. The question that then arises is whether on the facts of the present case, the Appellant can be said to have "purchased or otherwise acquired or borrowed" any foreign exchange in India.

18. The AT has proceeded on the basis that the employees of the parent corporation, seconded to the Appellant, are its "borrowed employees". The fact of the matter is that the expatriated employees of the HO, are posted in India with the LO, continue to be employees of the parent corporation. The salaries payable to them by the parent corporation were partly paid in India, and for that limited purpose, the funds were remitted by Mitsubishi, Japan which were then disbursed by the Appellant to such seconded employees. By no means, could it be said that the expatriated employees upon being seconded to the Appellant ceased to be the employees of the parent corporation. They were only seconded to the Appellant. They could not be termed as "borrowed employees" of the Appellant. The liability to pay their salaries continues to be that of the parent corporation. Since there was no privity of contract between the Appellant and the expatriated employees of the HO, there was no liability on the Appellant to pay their salaries. In the circumstances, the question of the Appellant "acquiring" any foreign exchange as a result of Mitsubishi Japan remitting funds to the Appellant for disbursement of the salaries of the employees seconded to it does not arise. Further, the question of the Appellant "repaying" Mitsubishi, Japan the sum paid as salaries also does not arise.

19. The show cause notice dated 31st May 2002 issued to the Appellant proceeded on the basis that "M/s. Mitsubishi Corporation have to repay the amount of Rs. 20,52,92,700 to their principal/head office" being the salary payable to the expatriated employees during the financial year 1996-97 and 1997-98. As noticed hereinbefore, there was no such obligation on the Appellant to repay any amount to the HO. In fact, Notification No. FERA 1/74 dated 1st

January 1974 states that Section 8(1) of the FERA shall not apply to the maintenance of and operations on account, expressed in a foreign currency, by foreign citizens in or resident in India but not permanently resident therein. Para 11.A.13 of the FECM provides that foreign nationals who are resident but not permanently resident in India are exempted from maintenance of and operations on their foreign currency bank accounts outside India. Further, the RBI clarified in a letter dated 3rd December 1999 addressed to M/s. Arthur Andersen & Co. that "in the case of employees deputed by foreign companies to Indian entities where the Indian company is not required to pay any remuneration to such persons except for their local expenses, the entire remuneration can be paid abroad by the overseas company."

20. The Court finds that both the AO and the AT erred in proceeding on the basis that the employees of the parent corporation, seconded to the Appellant, were "borrowed employees." There is no question of the Appellant being an "agent" of Mitsubishi, Japan. The Appellant, as a LO, is not permitted to undertake any commercial activity. The letter dated 30th January 1976, issued by the RBI u/s 29(2) of the FERA granting permission to the LO to operate clearly states that the LO would only undertake the liaison activities relating to import/export trade, collection of commercial, industrial and other business information in Tokyo etc. and that "Excepting the said promotional work, the Indian offices will not undertake any activity of a trading commercial or industrial nature without the prior permission of the Reserve Bank of India."

21. Significantly, with the AO itself finding the Appellant not liable u/s 9(1)(c) of the FERA on the ground that there was no debt owed by the Appellant to the parent company, it could not have held that there was a liability owed by the LO to the parent company for the purposes of Section

22. The Division Bench of the Kerala High Court in Central Government Vs. Abdul Mohammed and Others, has explained that the expression "otherwise acquired" in Section 4(1) of the FERA 1947, (corresponding to Section 8(1) FERA) has the same meaning as "buy or borrow." In the instant case, there was no question of the Appellant having acquired or borrowed from the parent company any foreign exchange to meet any liability owed by the Appellant to the expatriated employees, seconded to it by the parent company. Consequently, the AD and the impugned order of the AT holding the Appellant to be in violation of Section 8(1) (b) FERA are unsustainable in law.

23. Section 50 of the FERA envisages a penalty "not exceeding five times the amount or value involved in any such contravention or five thousand rupees, whichever is more as may be adjudged by the Director of Enforcement....." being imposed, consequent upon a finding of contravention of Section 8(1)(b) of FERA. The word "adjudged" would require application of mind by the Adjudicating Officer of the ED to the relevant facts. In the instant case, the basis for arriving at the penalty amount of Rs. 2,00,00,000 has not been explained in the AO. It appears to be an arbitrary figure. The learned AT was in error in

concurring with the said determination, without insisting that the power u/s 50 of FERA has to be exercised judicially by setting out the relevant factors and the basis for arriving at the penalty amount. Consequently, even the determination of the penalty amount u/s 50 of FERA in the AO, as affirmed by the AT, is unsustainable in law. For the aforementioned reasons, the AO dated 10th February 2004 and the impugned order dated 30th October 2007 of the AT are hereby set aside. The appeal is allowed. Any amount that may have been deposited with the AT or the ED pursuant to the AO shall be refunded to the Appellant, together with interest, if any, accrued thereon, within a period of eight weeks, in accordance with law.