2023:DHC:8521-DB

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

Judgement reserved on: 09.10.2023

% ***Judgement pronounced on: 30.11.2023***

\+ **ITA 405/2022**

THE COMMISSIONER OF INCOME TAX - INTERNATIONAL TAXATION -1 ..... Appellant

Through: Mr Aseem Chawla, Sr. Standing Counsel, with Ms Pratishtha Chaudhary, Advocate.

versus

AUGUSTUS CAPITAL PTE. LTD. ..... Respondent

Through: Mr Mayank Nagi, Mr Tarun Singh and Mr Sandeep Singh, Advocates.

CORAM:
HON'BLE MR. JUSTICE RAJIV SHAKDHER
HON'BLE MR. JUSTICE GIRISH KATHPALIA
[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J.:

Background

1. This appeal concerns Assessment Year (AY) 2015-16. *Via* the instant appeal, the appellant/revenue seeks to assail the order dated 15.10.2020 passed by the Income Tax Appellate Tribunal [in short, "Tribunal"].

2. The short issue which arises for consideration is whether Explanations 6 and 7 appended to Section 9(1)(i) of the Income Tax Act, 1961, [in short, "the Act"], which was inserted by the Finance Act 2015 [in short, "FA 2015"] with effect from 01.04.2016, can operate retrospectively.

2.1 The Tribunal has held that the said Explanations would operate

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retrospectively and, in reaching this conclusion, has applied the mischief rule and taken into account the legislative history which propelled the insertion of two interconnected Explanations, i.e., Explanation 4 and 5, *via* the Finance Act 2012 [in short, FA 2012"]. Concededly, Explanations 4 and 5 were given a retrospective effect by the legislature by stating in no uncertain terms that they would apply from 01.04.1962.

3. Thus, the moot question that arose before the Tribunal, and now before us, is whether Explanations 6 and 7 are clarificatory or amendatory.

<u>Prefatory Facts</u>

4. To adjudicate this issue, the following broad facts are required to be noticed.

4.1 The respondent/assessee is a company incorporated under the laws of Singapore on 22.11.2011.

4.2 Between January 2013 and March 2014, the respondent/assessee invested in equity and preference shares of Accelyst Pte Ltd [in short, "APL"], a company incorporated in and resident of Singapore. The total value of the investments the respondent/assessee made in APL was Rs. 4,91,20,000/-.

4.3 The details of the investments made (which includes the percentage of ordinary and preference share capital held by the respondent/assessee in APL) are set forth hereafter:

Date of Purchase	Nature of Shares	Number of Shares Purchased	Value of purchase in INR	Percentage Interest held by Augustus in APE
09.01.2013	Ordinary	10,000	Rs. 220855.8/-	0.05%

	Shares			
09.01.2013 14.03.2014	Preference Shares	13,80,000 3,94,782	Rs.30,479,144.2/- Rs. 18,420,000/-	2.93%
Total		1,784,782	Rs. 4,91,20,000/-	2.98%

4.4 On 27.03.2015, the respondent/assessee sold its investment in APL to an Indian company, Jasper Infotech Pvt. Ltd., for Rs.41,24,35,969/-.

4.5 The Return of Income (ROI) for the AY in issue, i.e., AY 2015-16, was filed by the respondent/assessee on 31.10.2015. *Via* the said ROI, the respondent/assessee declared its income as "nil" and claimed a refund of Rs. 17,84,19,800/-.

4.6 The record shows that the respondent/assessee was served with a notice under Section 143(2), followed by a notice under Section 142(1) of the Act on 05.04.2016 and 01.07.2016 respectively, by the Assessing Officer (AO).

4.7 The record also discloses that queries were raised during the assessment proceedings, which led to the respondent/assessee filing written replies, *inter alia*, on 09.10.2017 and 24.11.2017. The sum and substance of the content of these replies was that the respondent/assessee had acquired only 0.05% of the ordinary share capital and 2.93% of the preference share capital of APL and had no right of management and control concerning the affairs of APL, and hence the capital gains arising on account of transfer of shares was not taxable in India.

4.8 The AO did not accept the aforesaid explanation, and accordingly, he passed a draft Assessment Order dated 27.12.2017 proposing an addition of Rs. 36,33,15,969/- towards long-term capital gains (LTGCs). The AO arrived at the said figure by adjusting the total sale consideration amounting

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to Rs. 41,24,35,969/- against the cost of acquisition, i.e., Rs. 4,91,20,000/-.

5. Being dissatisfied, the respondent/assessee filed its objections with the Dispute Resolution Panel (DRP) under Section 144C(2) of the Act on 02.02.2018. In line with the stand taken before the AO, the mainstay of the respondent/assessee's objection was that Explanation 7 of Section 9(1)(i) ought to have been given retrospective effect, and in not doing so, the AO had committed an error. The respondent/assessee asserted that Explanations 6 and 7 clarified Explanation 5, which was introduced *via* FA 2012.

6. The DRP, however, was not persuaded by the arguments put forth by the respondent/assessee and, accordingly, rejected the objections it preferred via an order dated 14.09.2018.

7. As per the order of the DRP, the AO framed the final assessment order on 30.10.2018 under the provisions of Section 143(3) read with 144C of the Act. Consequentially, the respondent/assessee's taxable income was pegged at Rs.36,33,15,970/-.

8. This impelled the respondent/assessee to file an appeal with the Tribunal. As noticed right at the beginning, the Tribunal ruled in favour of the respondent/assessee and thus directed the deletion of the impugned addition.

9. Against this backdrop, the appellant/revenue has lodged the instant appeal.

Submissions of Counsel

10. Arguments on behalf of the appellant/revenue were advanced by Mr Aseem Chawla, learned Senior Standing Counsel, while Mr Mayank Nagi made submissions on behalf of the respondent/assessee.

11. Mr Chawla's submissions can be broadly paraphrased as follows:

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(i) It is a cardinal principle of a statute concerning tax that the law to be applied is the one which is in force in the AY in issue unless provided otherwise, either expressly or by necessary implication. [See ***Reliance Jute & Industries Ltd. v CIT (1979) 120 ITR 921 (SC)***]

(ii) The law enacted by Parliament must have regard to the language used in the provision and construed in the background of the scheme and the object of both the statute and the provision in issue. Therefore, if Parliament chooses to confer a benefit through an amendment, it does not necessarily imply that it should be given retrospective effect, even without a legislative declaration. [See ***Commissioner of Wealth Tax v. Vardharaja Theaters (P.) Ltd, (2009) 250 ITR 523 (Madras)].*** This principle is also applicable where Parliament seeks to remove hardship through amendment. [See ***Commissioner of Wealth Tax v Atma Ram Properties (P.) Ltd (2017) 399 ITR 380 (Delhi)]***

(iii) An Explanation, which is clarificatory, must be read into the main provision, with effect from the date when the main provision came into force. However, if the clarificatory explanation brings about a change in law, it cannot be presumed that it would have a retrospective effect. [See ***Sedco Forex International Drill Inc v. Commissioner of Income-Tax, Dehradun (2005) 279 ITR 310 (SC)***]

(iv) Even where an amendment to the law is described as clarificatory, it is not always given a retrospective effect if it results in a substantial amendment. Explanations 6 and 7 appended to Section 9(1)(i) are thus not merely declaratory or clarificatory but introduce a new set of exemptions *for* small taxpayers and, therefore, are like substantive amendments, which can only apply prospectively.

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(v) Merely because legislation is framed with reference to a legal relationship or thing that occurred before the legislation came into force, it cannot automatically be said to operate retrospectively. [See ***Grenada UK Rental and Retail Ltd v Pensions Regulator (2018) UKUT 164 (TCC)]***

(vi) Because of ambiguity in Explanation 5 of Section 9(1)(i), the issue was referred to an Expert Committee, which was constituted under the Chairmanship of Mr Parthasarathy Shome, [hereafter referred to as "Shome Committee"], which led to the insertion of Explanations 6 and 7 *via* FA 2015. However, the Amendments did not expressly state that they would operate retrospectively, unlike Explanation 5, which was inserted by FA 2012.

12. In rebuttal, Mr Nagi, while relying upon the order passed by the Tribunal, emphasised the following aspects of the matter:

(i) Explanation 5 was introduced by FA 2012, with effect from 01.04.1962, to get over the impact of the judgment rendered by the Supreme Court in ***Vodafone International Holdings BV v Union of India 341 ITR (1) SC***. *Via* the amendment, the legislature inserted a legal fiction by imputing situs to the share/interest transferred outside the country by correlating it with the underlying assets in India. However, Explanation 5 was both ambiguous and arbitrary since it neither defined the expression "share or interest" nor "substantially", which had the effect of bringing a transaction executed outside India within the ambit of Section 9(1)(i) of the Act.

(ii) Thus, dehors Explanation 7, even the transfer of a single share of a company incorporated outside India, which derived its value substantially from assets located in India, would have resulted in taxable gain in India,

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entailing undue hardship to small investors. Furthermore, the expression "substantially" conferred uncanalised power on the AO. It is in this context that the matter was referred to the Shome committee by the Government of India. The recommendations of the Shome Committee led to amendments being brought about *via* FA 2015. *Via* Explanation 6, it was clarified what would be deemed as an acquisition of assets of substantial value located in India upon the transfer of shares and interest in a company or entity registered or incorporated outside India. Furthermore, *via* Explanation 7, a de minimis clause was introduced which, in effect, excluded transactions where neither the transfer of shares or interest exceeded 5% of the total voting power or total share capital or total interest of the company whose share or interest was being transferred, nor did the transferor have the right of management or control *qua* such company in the 12 months preceding the date of transfer.

(iii) Therefore, all that Explanations 6 and 7 did was to cure the unintended consequences flowing from Explanation 5, which was introduced via FA 2012. Given this context, Explanations 6 and 7 should be made applicable retrospectively from when Explanation 5 became operational. Otherwise, the mischief sought to be cured would persist for the period preceding 01.04.2016, when FA 2015 was brought into force.

(iv) Contrary to the stand taken by the appellant/revenue, Explanations 6 and 7 have not brought about a substantive amendment. This is evident upon perusal of the opening words of Explanations 6 and 7, which begin with the expression "For the purpose of this clause…". Quite clearly, Explanations 6 and 7 are not standalone provisions. The provision made by the legislature *via* Explanations 6 and 7 will have no meaning if it is not tied in with

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Explanation 5. In other words, the provisions of Section 9(1)(i) read with Explanations 4,5,6 and 7 form a complete code, whereby situs of share or interest transferred outside India is deemed to be located in India, provided a substantial value of the underlying assets, as defined in Explanation 6, is located in India and where the transfer of share and interest exceeds the percentage provided in Explanation 7 and the transferor exercises a right of management and control in the company whose share and interest is being transferred.

(v) The judgment of the coordinate bench of this Court rendered in the matter of ***DIT v Copal Research Ltd., Mauritius (2014) taxmann.com 125 (Delhi),*** which was rendered before the insertion of Explanations 6 and 7 *via* FA 2015, opined that Explanation 5 had to be construed restrictively and that the tax net on gains or income arising from transfer of shares outside India, where the bulk value of the assets of the companies whose shares are being transferred are located outside India, should not be enlarged by taking recourse to Section 9(1)(i) of the Act.

(vi) In concluding one way or the other as to whether a particular amendment is clarificatory or curative, it is vital to bear in mind the history of the amendment made, the circumstances in which it was passed and the mischief it sought to overcome. Furthermore, it is well-established that the presumption against retrospectivity does not apply to curative amendments. The absence of a provision that expressly states that the amendment is retrospective is necessarily not a determinative factor. Likewise, merely because a date is provided from which an amendment is made operative does not conclusively indicate that it is not a clarificatory or curative amendment. [See ***Chettian Veetil Ammad & Anr. vs. Taluk Land Board &***

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Ors., (1980) 1 SCC 499; ***Zile Singh vs. State of Haryana & Ors.***, (2004) 8 SCC 1; ***Allied Motors (P.) Ltd. vs. Commissioner of Income Tax,*** (1997) 3 SCC 472; ***Commissioner of Income Tax vs. Alom Extrusions Ltd., (2008) 319 ITR 306 (SC)***; ***Commissioner of Income Tax, Kolkata XII vs. Calcutta Exports Company***, (2018) 16 SCC 686; ***Commissioner of Income Tax I, Ahmedabad vs. Gold Coin Health Food Private Ltd***., (2008) 9 SCC 622; ***Sree Sankaracharya University of Sanskrit & Ors. vs. Dr. Manu & Anr.***, 2023 SCC OnLine SC 640; ***Commissioner of Income Tax v. Naresh Kumar***, (2014) 362 ITR 256 (Delhi); ***Ghanashyam Mishra & Sons Private Limited vs. Edelweiss Asset Reconstruction Co. Ltd***., (2021) 9 SCC 657]

(vii) There is no impediment in law in Courts relying upon speeches made by the concerned Minister while introducing legislation [See ***Ghanshyam Mishra & Sons Private Limited vs Edelweiss Asset Reconstruction Co. Ltd***., (2021) 9 SCC 657].

Reasons and Analysis

13. Having heard the learned counsel for the parties, as indicated right at the outset, the only aspect that arises for consideration is whether Explanations 6 and 7 are clarificatory and curative and, therefore, should be given retrospective effect.

14. In this context, it is required to be emphasised that Section 9(1)(i) of the Act *inter alia* seeks to impose tax *albeit via* a deeming fiction *qua* all income accruing or arising, whether directly or indirectly, through or from any property in India or through or from any asset or through transfer of asset situate in India, or the transfer of a capital asset situated in India.

15. The judgment of the Supreme Court rendered in ***Vodafone***, however, excluded from the scope and ambit of Section 9(1)(i) of the Act gain or

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income arising from the transfer of shares of a company located outside India, although the value of the shares was dependent on assets which were situated in India. It is to cure this gap in the legislation, Explanations 4 and 5 were introduced *via* FA 2012, which were given effect from 01.04.1962. For convenience, Explanations 4 and 5 are culled out hereafter:

> *"Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*
>
> *Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any **share** or **interest** in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its **value substantially from the assets** located in India:*
> *[**Provided** that nothing contained in this Explanation shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in a Foreign Institutional Investor as referred to in clause (a) of the Explanation to section 115AD for an assessment year commencing on or after the 1st day of April, 2012 but before the 1st day of April, 2015:]*
> *[**Provided further** that nothing contained in this Explanation shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992).]"*

16. Explanations 4 and 5 presented difficulties in that the expressions "share and interest" and "substantially" found in the explanations were vague, resulting in undue hardship for transferors/assessees where the percentage of share or interest transferred was insignificant.

17. Thus, based on representations received in this behalf, GOI referred this matter to the Shome Committee. The relevant parts of the record of the Shome Committee are extracted hereafter:

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"(2) Section 9(1)(i) of the Act is a general source rule for a non-resident. It provides, inter alia, that any income accruing or arising, directly or indirectly, through transfer of a capital asset situated in India shall be deemed to accrue and arise in India and consequently be taxable. The words used in the clause, namely, "through", "transfer", "capital asset" and "situated in India" have been assigned additional meaning through insertion of Explanations vide Finance Act, 2012. As discussed in the Report, these Explanations need further clarifications as under –

(i) The phrase, "the share or interest in a company or entity registered or incorporated outside India," in Explanation 5 to Section 9(1)(i) of the Act should mean and include only such share or interest which results in participation in ownership, capital, control or management. Therefore, all other types including mere economic interest should not be contemplated within the ambit of Explanation 5.

(ii) The word "substantially" used in Explanation 5 should be defined as a threshold of 50 per cent of the total value derived from assets of the company or entity, as proposed in DTC Bill 2010. In other words, a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value from the assets located in India being more than 50% of the global assets of such company or entity.

(iii) The phrase "directly or indirectly" in Explanation 5 may be clarified to represent a "look through" approach which implies that, for the determination of value of a share of a foreign company, all intermediaries between the foreign company and assets in India may be ignored.

(iv) For the purposes of Explanation 5 –

(a) the value should refer to fair market value as may be prescribed;

(b) the value is to be ascertained based on net assets after taking into account liabilities as well;

(c) for determination of value, both tangible assets as well as intangible assets are to be considered; and

(d) the value is to be determined at the time of the last balance sheet date of the foreign company with appropriate adjustments made for significant disposal/acquisition, if any, between the last balance sheet date and the date of transfer.

(v) The phrase "an asset or" juxtaposed on the phrase "capital assets" in Explanation 5 to section 9(1)(i) of the Act appears to be an insertion to buttress the concept of capital assets. Since the objective is taxation of the transfer of capital assets alone, the phrase "an asset or" may be omitted. Indeed, it may lead to unintended consequences such as taxation of dividends paid by a foreign company.

(vi) As the provisions of section 9(1)(i) read with Explanation 5 of the Act

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specifically deals with transfer of shares of a foreign company having underlying assets in India, the general provisions of section 2(47) relating to transfer should not be applied on a stand alone basis.

(vii) The taxation of capital gains on indirect transfer should be restricted only to capital gains attributable to assets located in India. Thus capital gains should be taxed on a basis of proportionality between fair market value of the Indian assets and global assets of the foreign company, as proposed in DTC Bill 2010.

(3) In order to avoid undue hardship to small shareholders, it is recommended that, where shares or interest in a foreign company or entity derive, directly or indirectly, its value substantially from assets located in India, then the transfer of shares or interest in such company or entity outside India would not be subject to tax in India under section 9(1)(i) of the Act, if,

> *(a) in case such company or entity is the immediate holding company of the assets situated in India, the voting power or share capital of the transferor along with its associated enterprises in such company or entity is less than 26%3 of total voting power or share capital of the company or entity during the preceding 12 months; or*
>
> *(b) in other cases, the voting power or share capital of the transferor in such company or entity along with its associated enterprises during the preceding 12 months does not exceed such percentage which results in 26% of total voting power or share capital of the immediate holding company of the assets situated in India."*
>
> *xxx xxx xxx*
>
> *<u>Recommendations</u>*
>
> *The word "substantially" used in Explanation 5 should be defined as a threshold of 50 per cent of the total value derived from assets of the company or entity. In other words, a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value from the assets located in India being more than 50% of the global assets of such company or entity. This has been explained through the above illustration.*
>
> *xxx xxx xxx*
>
> *<u>Recommendations</u>*
>
> *In view of the above, it is recommended that where share or interest in a foreign company or entity derives, directly or indirectly, its value substantially from assets located in India, then transfer of such share*

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> *or interest in the company or entity outside India would not be subject to tax in India under section 9(1)(i) of the Act, if,*
>
> *in case such company or entity is the immediate holding company, the voting power or share capital of the transferor along with its associated enterprises in such company or entity does not exceed 26% of total voting power or share capital of the company or entity during the preceding 12 months; or*
> *(ii) in other cases, the voting power or share capital of the transferor in such company or entity along with its associated enterprises during the preceding 12 months does not exceed such percentage which results in 26% of total voting power or share capital of the immediate holding company having underlying assets in India."*

18. As evident upon perusal of Explanations 6 and 7, some recommendations were accepted. The Finance Minister's Speech while introducing the amendments *via* FA 2015 is revelatory since a dim view was taken of the retrospective amendment brought about by Explanations 4 and 5, effective from 01.04.1962.

> ***"114.** The provision relating to indirect transfers in the Income-tax Act which is a legacy from the previous government contains several ambiguities. This provision is being suitably cleaned up. Further, concerns regarding applicability of indirect transfer provisions to dividends paid by foreign companies to their shareholders will be addressed by the Central Board of Direct Taxes through a clarificatory circular. These changes would eliminate the scope for discretionary exercise of power and provide a hassle free structure to the taxpayers. I reiterate what I had said in the last Budget that ordinarily retrospective tax provisions adversely impact the stability and predictability of the taxation regime and resort to such provisions shall be avoided."*

19. Therefore, in our opinion, the legislature took a curative step regarding the vague expressions used in Explanation 5, i.e., "share/interest" and "substantially".

20. The argument advanced on behalf of the appellant/revenue, shorn of gloss, boils down to the fact that the insertion of Explanations 6 and 7 *via*

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FA 2015 was to take effect from 01.04.2016 and could only be treated as a prospective amendment. The argument advanced in support of this plea was that Explanations 6 and 7 brought about a substantive amendment in Section 9(1)(i) of the Act. In our view, this submission is misconceived because Explanations 6 and 7 alone would have no meaning if they were not read along with Explanation 5. Therefore, if Explanations 6 and 7 have to be read along with Explanation 5, which concededly operates from 01.04.1962, they would have to be construed as clarificatory and curative.

21. The legislature took recourse to the mischief rule to clarify Explanation 5, which otherwise was in danger of being struck down as vague and arbitrary. If Explanations 6 and 7 are not read along with Explanation 5, no legislative guidance would be available to the AO regarding what meaning to give to the expression "share/interest" or "substantially" found in Explanation 5.

22. There is good authority for us to conclude that although Explanations 6 and 7 were indicated in FA 2015 to take effect from 01.04.2016, they could be treated as retrospective, having regard to the legislative history which led to the insertion of Explanations 6 and 7.

23. The observations made in ***Commissioner of Income Tax vs Alom Extrusions Ltd.,*** (2010) 1 SCC 489 and ***Commissioner of Income Tax I, Ahmedabad vs Gold Coin Health Food Private Ltd***., (2008) 9 SCC 622 being relevant, are extracted hereafter:

Alom Extrusions Ltd.

*"**15.** By the Finance Act, 2003, the amendment made in the first proviso equated in terms of the benefit of deduction of tax, duty, cess and fee on the one hand with contributions to the Employees' Provident Fund, superannuation fund and other*

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welfare funds on the other. However, the Finance Act, 2003, bringing about this uniformity came into force with effect from 1-4-2004. Therefore, the argument of the assessee(s) is that the Finance Act, 2003, was curative in nature, it was not amendatory and, therefore, it applied retrospectively from 1-4-1988, whereas the argument of the Department was that the Finance Act, 2003, was amendatory and it applied prospectively, particularly when Parliament had expressly made the Finance Act, 2003 applicable only with effect from 1-4-2004.

***16.** It was also argued on behalf of the Department that even between 1-4-1988 and 1-4-2004, Parliament had maintained a clear dichotomy between payment of tax, duty, cess or fee on one hand and payment of contributions to the welfare funds on the other. According to the Department, that dichotomy continued up to 1-4-2004, hence, looking to this aspect, Parliament consciously kept that dichotomy alive up to 1-4-2004, by making the Finance Act, 2003 come into force only with effect from 1-4-2004. Hence, according to the Department, the Finance Act, 2003 should be read as amendatory and not as curative (retrospective) with effect from 1-4-1988.*

***17.** We find no merit in these civil appeals filed by the Department for the following reasons: firstly, as stated above, Section 43-B (main section), which stood inserted by the Finance Act, 1983, with effect from 1-4-1984, expressly commences with a non obstante clause, the underlying object being to disallow deductions claimed merely by making a book entry based on mercantile system of accounting. At the same time, Section 43-B (main section) made it mandatory for the Department to grant deduction in computing the income under Section 28 in the year in which tax, duty, cess, etc. is actually paid. However, Parliament took cognisance of the fact that accounting year of a company did not always tally with the due dates under the Provident Fund Act, the Municipal Corporation Act (octroi) and other tax laws. Therefore, by way of first proviso, an incentive/relaxation was sought to be given in respect of tax, duty, cess or fee by explicitly stating that if such tax, duty, cess or fee is paid before the date of filing of the return under the Income Tax Act (due date), the assessee(s) then would be entitled to deduction. However, this relaxation/incentive was restricted only to tax, duty, cess and fee. It did not apply to contributions to labour welfare funds. The reason appears to be that the employer(s) should not sit on the collected contributions and deprive the workmen of the rightful benefits under social welfare legislations by delaying payment of contributions to the welfare funds.*

***18.** However, as stated above, the second proviso resulted in implementation problems, which have been mentioned hereinabove, and which resulted in the enactment of the Finance Act, 2003, deleting the second proviso and bringing about uniformity in the first proviso by equating tax, duty, cess and fee with contributions to welfare funds. Once this uniformity is brought about in the first proviso, then, in our view, the Finance Act, 2003, which is made applicable by Parliament only with effect from 1-4-2004, would become curative in nature, hence, it would apply retrospectively with effect from 1-4-1988.*

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__19.__ Secondly, it may be noted that, in Allied Motors (P) Ltd. v. CIT [(1997) 3 SCC 472 : (1997) 224 ITR 677] , the scheme of Section 43-B of the Act came to be examined. In that case, the question which arose for determination was, whether sales tax collected by the assessee and paid after the end of the relevant previous year but within the time allowed under the relevant sales tax law should be disallowed under Section 43-B of the Act while computing the business income of the previous year? That was a case which related to Assessment Year 1984-1985. The relevant accounting period ended on 30-6-1983. The Income Tax Officer disallowed the deduction claimed by the assessee which was on account of sales tax collected by the assessee for the last quarter of the relevant accounting year. The deduction was disallowed under Section 43-B which, as stated above, was inserted with effect from 1-4-1984.

__20.__ It is also relevant to note that the first proviso which came into force with effect from 1-4-1988 was not on the statute book when the assessments were made in Allied Motors (P) Ltd. [(1997) 3 SCC 472 : (1997) 224 ITR 677] However, the assessee contended that even though the first proviso came to be inserted with effect from 1-4-1988, it was entitled to the benefit of that proviso because it operated retrospectively from 1-4-1984, when Section 43-B stood inserted. This is how the question of retrospectivity arose in Allied Motors (P) Ltd. [(1997) 3 SCC 472 : (1997) 224 ITR 677]

__21.__ <u>This Court, in Allied Motors (P) Ltd. [(1997) 3 SCC 472 : (1997) 224 ITR 677] held that when a proviso is inserted to remedy unintended consequences and to make the section workable, a proviso which supplies an obvious omission in the section and which proviso is required to be read into the section to give the section a reasonable interpretation, it could be read retrospective in operation, particularly to give effect to the section as a whole. Accordingly, this Court, in Allied Motors (P) Ltd. [(1997) 3 SCC 472 : (1997) 224 ITR 677] , held that the first proviso was curative in nature, hence, retrospective in operation with effect from 1-4-1988.</u>

__22.__ It is important to note once again that, by the Finance Act, 2003, not only is the second proviso deleted but even the first proviso is sought to be amended by bringing about a uniformity in tax, duty, cess and fee on the one hand vis-à-vis contributions to welfare funds of employee(s) on the other. This is one more reason why we hold that the Finance Act, 2003 is retrospective in operation. Moreover, the judgment in Allied Motors (P) Ltd. [(1997) 3 SCC 472 : (1997) 224 ITR 677] was delivered by a Bench of three learned Judges, which is binding on us. Accordingly, we hold that the Finance Act, 2003 will operate retrospectively with effect from 1-4-1988 (when the first proviso stood inserted).

__23.__ <u>Lastly, we may point out the hardship and the invidious discrimination which would be caused to the assessee(s) if the contention of the Department is to be accepted that the Finance Act, 2003, to the above extent, operated prospectively.</u> Take an example, in the present case, the respondents have deposited the contributions with RPFC after 31st March (end of accounting year) but before filing of the returns under the Income Tax Act and the date of payment falls after

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the due date under the Employees' Provident Fund Act, they will be denied deduction for all times. In view of the second proviso, which stood on the statute book at the relevant time, each of such assessee(s) would not be entitled to deduction under Section 43-B of the Act for all times. They would lose the benefit of deduction even in the year of account in which they pay the contributions to the welfare funds, whereas a defaulter, who fails to pay the contribution to the welfare fund right up to 1-4-2004, and who pays the contribution after 1-4-2004, would get the benefit of deduction under Section 43-B of the Act.

***24.** In our view, therefore, the Finance Act, 2003, to the extent indicated above, should be read as retrospective. It would, therefore, operate from 1-4-1988, when the first proviso was introduced. It is true that Parliament has explicitly stated that the Finance Act, 2003, will operate with effect from 1-4-2004. However, the matter before us involves the principle of construction to be placed on the provisions of the Finance Act, 2003.*

***25.** Before concluding, we extract hereinbelow the relevant observations of this Court in CIT v. J.H. Gotla [(1985) 4 SCC 343 : (1985) 156 ITR 323] which reads as under: (SCC p. 360, para 47)*

> *"47. ... we should find out the intention from the language used by the legislature and if strict literal construction leads to an absurd result i.e. result not intended to be subserved by the object of the legislation found in the manner indicated before, and if another construction is possible apart from strict literal construction then that construction should be preferred to the strict literal construction. Though equity and taxation are often strangers, attempts should be made that these do not remain always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction."*

***26.** For the aforestated reasons, we hold that the Finance Act, 2003, to the extent indicated above, is curative in nature, hence, it is retrospective and it would operate with effect from 1-4-1988 (when the first proviso came to be inserted). For the above reasons, we find no merit in this batch of civil appeals filed by the Department which are hereby dismissed with no order as to costs."*

[Emphasis is ours]

<u>Gold Coin Health Food Private Ltd.</u>

***"8.** It would be of some relevance to take note of what this Court said in Virtual case [(2007) 9 SCC 665] . Pointing out one of the important tests at para <u>51 it was observed that even if the statute does contain a statement to the effect that the amendment is clarificatory or declaratory, that is not the end of the matter. The Court has to analyse the nature of the amendment to come to a conclusion whether it is in reality a clarificatory or declaratory provision. Therefore, the date from which the amendment is made operative does not conclusively decide</u>*

the question. The Court has to examine the scheme of the statute prior to the amendment and subsequent to the amendment to determine whether amendment is clarificatory or substantive.

xxx xxx xxx

18. *As noted by this Court in CIT v. Podar Cement (P) Ltd. [(1997) 5 SCC 482] the circumstances under which the amendment was brought in existence and the consequences of the amendment will have to be taken care of while deciding the issue as to whether the amendment was clarificatory or substantive in nature and, whether it will have retrospective effect or it was not so.*

19. *In Principles of Statutory Interpretation, 11th Edn., 2008, Justice G.P. Singh has stated the position regarding retrospective operation of statutes as follows:*

> *"The presumption against retrospective operation is not applicable to declaratory statutes. As stated in Craies and approved by the Supreme Court:'For modern purposes a declaratory Act may be defined as an Act to remove doubts existing as to the common law, or the meaning or effect of any statute. Such Acts are usually held to be retrospective. The usual reason for passing a declaratory Act is to set aside what Parliament deems to have been a judicial error, whether in the statement of the common law or in the interpretation of statutes. Usually, if not invariably, such an Act contains a preamble, and also the word "declared" as well as the word "enacted".' But the use of the words 'it is declared' is not conclusive that the Act is declaratory for these words may, at times, be used to introduce new rules of law and the Act in the latter case will only be amending the law and will not necessarily be retrospective. In determining, therefore, the nature of the Act, regard must be had to the substance rather than to the form. If a new Act is 'to explain' an earlier Act, it would be without object unless construed retrospective. An explanatory Act is generally passed to supply an obvious omission or to clear up doubts as to the meaning of the previous Act. It is well settled that if a statute is curative or merely declaratory of the previous law retrospective operation is generally intended. The language 'shall be deemed always to have meant' or 'shall be deemed never to have included' is declaratory, and is in plain terms retrospective. In the absence of clear words indicating that the amending Act is declaratory, it would not be so construed when the amended provision was clear and unambiguous. An amending Act may be purely clarificatory to clear a meaning of a provision of the principal Act which was already implicit. A clarificatory amendment of this nature will have retrospective effect and, therefore, if the principal Act was existing law when the Constitution came into force, the amending Act also will be part of the existing law."*

[Emphasis is ours]

24. Furthermore, as correctly pointed out on behalf of the

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respondent/assessee, a coordinate bench of this Court in Copal, even before the amendment was brought about by FA 2015, has taken the view that Explanation 5 had to be construed narrowly. The following observations made therein being apposite, are extracted hereafter:

> *"26. It is apparent from the above that only a fraction of the value of shares of Copal-Jersey was derived indirectly from the value of the shares of CRIL and Exevo-India. The question, thus, arises is whether the sale of shares of an overseas company which derives only a minor part of its value from the assets located in India could be deemed to be situated in India by virtue of Explanation 5 to Section 9(1)(i) of the Act. This question can be answered by reference to the express language of Section 9(1)(i) of the Act as well as by applying the principle that income sought to be taxed under the Act must have a territorial nexus with India. By virtue of Section 9(1)(i) of the Act all income arising from transfer of a capital asset situated in India would be deemed to accrue or arise in India and would thus be exigible to tax under the Act. A share of a company incorporated outside India is not an asset which is situated in India and, but for Explanation 5 to Section 9(1)(i) of the Act, the gains arising out of any transaction of sale and purchase of a share of an overseas company between non-residents would not be taxable in India. This would be true even if the entire value of the shares of an overseas company was derived from the value of assets situated in India. This issue arose in the case of* ***Vodafone International Holdings BV v. Union of India and Anr.: (2012) 6 SCC 613*** *and the Supreme Court held that the transaction of sale and purchase of a share of an overseas company between two non-residents would fall outside the ambit of Section 9(1)(i) of the Act. Subsequently, Section 9(1) was amended by virtue of Finance Act, 2012 by introduction of Explanations 4 & 5 to Section 9(1)(i) of the Act, which read as under:-*
>
>> *"Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*
>>
>> *Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India;"*

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27. The notes to clauses explained the introduction of the Explanations 4 and 5 to Section 9(1)(i) of the Act as being clarificatory. A plain reading of Explanation 5 also indicates that the given reason for its introduction was for removal of any doubts. In other words, the language of the said legislative amendment suggests that it was always the intention of the legislature that an asset which derives its value from assets in India should be considered as one which is situated in India. The clear object of Section 9(1)(i) of the Act is inter alia to cast the net of tax also on income which arises from transfer of assets in India irrespective of the residential status of the recipient of the income. Since the assets are situated in India, the entire income arising from their transfer could be said to arise in India. Explanation 5 introduced a legal fiction for the limited purpose of imputing that assets which substantially derive their value from assets situated in India would also be deemed to be situated in India.

28. It is trite law that a legal fiction must be restricted to the purpose for which it was enacted. The object of Explanation 5 was not to extend the scope of Section 9(1)(i) of the Act to income, which had no territorial nexus with India, but to tax income that had a nexus with India, irrespective of whether the same was reflected in a sale of an asset situated outside India. Viewed from this standpoint there would be no justification to read Explanation 5 to provide recourse to section 9(1)(i) for taxing income which arises from transfer of assets overseas and which do not derive bulk of their value from assets in India. In this view, the expression "substantially" occurring in Explanation 5 would necessarily have to be read as synonymous to " principally", "mainly" or at least "majority". Explanation 5 having been stated to be clarificatory must be read restrictively and at best to cover situations where in substance the assets in India are transacted by transacting in shares of overseas holding companies and not to transactions where assets situated overseas are transacted which also derive some value on account of assets situated in India. In our view, there can be no recourse to Explanation 5 to enlarge the scope of Section 9(1) of the Act so as to cast the net of tax on gains or income that may arise from transfer of an asset situated outside India, which derives bulk of its value from assets outside India.

29. It is also relevant to refer to the draft report submitted by the expert committee appointed by the Prime Minister in 2012 to report on the retrospective amendment relating to indirect transfer of assets (Shome Committee). The said Committee had, in its draft report, considered the import of the expression 'substantially' as used in Explanation 5 to Section 9(1)(i) of the Act. The Committee considered the submissions of stakeholders that the expression 'substantially' did not have any fixed meaning and was vague. After analysis, the Committee noted that it was necessary to pin down a definition of the said expression and for that purpose, there were no reason

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to depart from the Direct Tax Code Bill, 2010 (DTC) that had been put in the public domain. Under the DTC, gains from the sale of assets situated overseas, which derived more than 50% of their value from assets situated in India, were liable to be taxed in India. The Shome Committee in its draft report recommended as under:-

> *"The word "substantially" used in Explanation 5 should be defined as a threshold of 50 per cent of the total value derived from assets of the company or entity. In other words, a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value from the assets located in India being more than 50% of the global assets of such company or entity. This has been explained through the above illustration."*

30. In addition to the above, the 'United Nations Model Double Taxation Convention between Developed and Developing Countries' and the 'OECD Model Tax Convention on Income and on Capital' may also be referred to since the said conventions deal with a regime whereunder the right to tax capital gains can be fairly and reasonably apportioned between contracting States. Since the models propose a regime which is generally accepted in respect of indirect transfers, the same, although not binding on Indian authorities, would certainly have a persuasive value in interpreting the expression 'substantially' in a reasonable manner and in its contextual perspective. The 'United Nations Model Double Taxation Convention between Developed and Developing Countries' and the 'OECD Model Tax Convention on Income and on Capital' provide that the taxation rights in case of sale of shares are ceded to the country where the underlying assets are situated only if more than 50% of the value of such shares is derived from such property

31. Paragraph (4) of Article 13 of the United Nations Model Double Taxation Convention between Developed and Developing Countries provides that a Contracting State is allowed to tax a gain on alienation of shares of a company or on alienation of interests in other entities the property of which consists principally of immovable property situated in that State. For this purpose, the term 'principally' in relation to the ownership of an immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by such company, partnership, trust or estate. It is also relevant to note that India has signed a treaty with Korea incorporating this clause. The relevant portion of Article 13 of the said UN Convention is quoted below:-

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"Article 13
CAPITAL GAINS

xxxx xxxx xxxx xxxx

4. Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:

(1) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.

(2) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate."

32. The 'OECD Model Tax Convention on Income and on Capital' provides a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation. Article 13 of the said Convention deals with the taxes on capital gains. Article 13(1) provides that the gains derived by a resident of a Contracting State from the alienation of immovable property situated in another Contracting State may be taxed in that other State. Article 13(4) of the said Convention provides that the 'gains derived by a resident of a Contracting State from the alienation of shares or comparable interests deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.'

33. In view of the above, gains arising from sale of a share of a company incorporated overseas, which derives less than 50% of its value from assets situated in India would certainly not be taxable under section 9(1)(i) of the Act read with Explanation 5 thereto."

24.1 We are informed that the appellant/revenue has preferred an appeal concerning the aforesaid judgment, which has been admitted, although no stay has been granted.

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25. Thus, for the foregoing reasons, we are not inclined to interfere with the order passed by the Tribunal. According to us, no substantial question of law arises for consideration.

26. The appeal is disposed of, in the aforesaid terms.

(RAJIV SHAKDHER)
JUDGE

(GIRISH KATHPALIA)
JUDGE

NOVEMBER 30, 2023
aj

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