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BETTER LAWS. BETTER GOVERNANCE

SUPPLEMENTARY SUBMISSIONS TO THE HIGH LEVEL COMMITTEE HEADED BY JUSTICE AP SHAH, TO EXAMINE THE MATTER RELATING TO LEVY OF MAT ON FIIS FOR THE PERIOD PRIOR TO 01.04.2015

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EXECUTIVE SUMMARY

Subsequent to our prior submission on 01.07.2015 relating to the imposition of Minimum Alternate Taxes (MAT) on FIIs, we had an interaction with High Level Committee (HLC) on 04.07.2015 regarding our submission. The HLC had certain queries regarding the interpretation of the term "place of business" in Section 591 of the Companies Act, 1956 and whether the amendment to Section 115JB of the Income Tax Act, 1961 by way of Finance Act, 2015 will have any impact on the interpretation of scope of Section 115JB prior to the amendment, i.e, prior to 01.04.2015. This supplementary submission is a detailed response to those queries.

The insertion of clause (iia) to Explanation 1 of Section 115JB, exempting applicability of MAT on the capital gains of FIIs on shares held in India is clarificatory and therefore retrospective in nature. Applying the tests laid down by the Hon'ble Supreme Court of India in its Five Judge Bench judgment in *Commissioner of Income Tax v Vatika Township (*(2015) 1 SCC 1), it is evident that the amendment to Section 115JB is merely clarificatory in nature to state that Section 115JB does not apply to capital gains income of FIIs. In addition, the said amendment is a benefit that the Parliament intended to give to the assessee and must therefore be given retrospective effect as well. The only reason why cannot be given retrospective effect is if Parliament, in its original intent of Section 115JB never intended to give the benefit of exemption from taxation of capital gains in the sale of securities to FIIs.

In appreciating the intended scope of Section 115JB, the term "place of business" as it occurs for the purposes of Section 591 of the Companies Act, 1956 has to be examined. However, examining the term "place of business" as it occurs in the Indian and the UK laws relating to Companies, it is evident that there are two requirement which are necessary to be satisfied for a foreign company to have a "place of business" in India; permanence and physical presence. Therefore, applying the tests laid down by the Courts in India and the UK to the term "place of business", unless an FII has a permanent, physical presence in India, from which the business of the FII (or an activity ancillary to the business of the FII) is carried on, it would not be possible to conclude that the FIIs are subject to MAT in India, prior to 01.04.2015. While we do not wish to comment on the individual merits of the show-cause notices issued to FIIs for payment of MAT, it is our view that unless an FII has been shown to have had a permanent, physical presence along the lines indicated above, such show cause notices would not be lawful.

For these reasons, in addition to the submissions dated 01.07.2015, we are of the view that the imposition of MAT on FIIs, which don't have a physical presence in India, from which they are carrying out the business of buying and selling shares would not be in accordance with the Income Tax Act, 1961.

INTRODUCTION

Vidhi Centre for Legal Policy, in response to the call for submissions by the High Level Committee headed by Justice AP Shah on Direct Tax Matters, had sent in submissions to the Committee on the issue of imposition of Minimum Alternate Tax (MAT) on Foreign Institutional Investors (FIIs). These submissions, sent in on 01.07.2015, had focussed on three legal aspects of the issue, namely the legislative history of Section 115JB, the interpretation of Section 115JB in light of the Double Taxation Avoidance Agreements (DTAAs) and the contradictory judicial interpretation of Section 115JB by the Authority for Advance Rulings (AARs) in its applicability to foreign companies. During the course of our interaction with the Committee on 04.07.2015, issues relating to the interpretation of the term "place of business" in Section 591 of the Companies Act, 1956 and the effect of the amendment of Section 115JB(2) by way of Finance Act, 2015 on interpretation of the scope of Section 115JB came up. Desirous of making further submissions on these two points as well, we have prepared these supplementary submissions to our earlier submission.

The first chapter will cover the impact of the insertion of the amendment to Section 115JB as inserted by the Finance Act, 2015 and whether it can be used to appreciate the scope of Section 115JB prior to 01.04.2015 in the context of application of MAT to FIIs. In this Chapter, we have focussed on the Supreme Court and High Court cases concerning the interpretation of provisions of the Income Tax Act and the principles laid down therein. The second chapter of these supplementary submission deals with the interpretation of the term "place of business" as it occurs in Section 591 of the Companies Act, 1956 and the tests that would require to be satisfied in order to find that a foreign company has a "place of business" in India. This will examine case law in India and elsewhere relating to the interpretation of the term to see if a clear and objective test can be laid out on the manner in which this particular requirement can be fulfilled.

The last part is a summary of our conclusions, briefly re-iterating what we had said in the earlier submissions and recapitulating the conclusions drawn from the first and second chapters.

I. IMPACT OF AMENDMENT TO SECTION 115JB OF THE INCOME TAX ACT, 1961 BY FINANCE ACT, 2015

1. Scope of the Amendment of Section 115JB

As stated in the main submissions, the Finance Act, 2015 inserted two provisions to Section 115JB in this regard. Clause (iid) in Explanation 1 provides that the amount of income from the transactions in securities accrued or arising to an assessee being a foreign company, if any such amount is credited to the profit and loss account, shall be reduced from the book profits. A corresponding provision (Clause (fb) in Explanation 1) increases the book profit by the amount of expenditure relatable to the income from such transaction.

The text of the relevant amendments of the Finance Act, 2015 is as follows-

> *Section 30. In section 115JB of the Income-tax Act, in the Explanation 1 below sub-section (2), with effect from the 1st day of April, 2016,—*
>
> *…*
>
> *(c) after clause (iib), the following clauses shall be inserted, namely:—*
>
> *…*
>
> *(iid) the amount of income accruing or arising to an assessee, being a foreign company, from,— (A) the capital gains arising on transactions in securities; or*
>
> *(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII, if such income is credited to the profit and loss account and the income-tax payable thereon in accordance with the provisions of this Act, other than the provisions of this Chapter, is at a rate less than the rate specified in sub-section (1);*
>
> *…*
>
> *(d) after Explanation 3, the following Explanation shall be inserted, namely:—*
>
> *'Explanation 4.—For the purposes of sub-section (2), the expression "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.'.*

As stated by the Finance Minister, the purpose of the above provisions, is "[t]*o rationalise the MAT provisions for FIIs, profits corresponding to their income from capital gains on transactions in securities that are liable to tax at a lower rate shall not be subject to MAT*,".[1] This raises the question: Is the implication of this amendment that MAT leviable Section 115JB, as it stood prior to this amendment, i.e., prior to 01.04.2015, applied to FIIs as well?

[1] "Foreign Investors' MAT woes not over just yet", Business Standard, March 2, 2015 available at http://www.business-standard.com/budget/article/mat-sword-hanging-over-fpis-till-march-end-115030100063_1.html last accessed 29 June 2015.

To understand the implications of this amendment, we have to examine the jurisprudence on this manner of interpretation as laid down by the Supreme Court of India in judgments concerning amendments to the Income Tax Act, 1961.

2. Effect of subsequent amendments on the interpretation of statutes

Section 30 of the Finance Act, 2015, by inserting clause (iid) to Section 115JB exempts the capital gains arising out of securities accruing to foreign companies such as FIIs. We have been given to understand that it is the position of the Revenue that such an amendment is substantive in nature and therefore must be given only prospective interpretation. We were informed that the position of the Revenue on this matter is that the very fact of this amendment suggests that the Parliament's intention was to always tax capital gains of foreign companies through MAT.

In our view, a Five Judge Bench of the Supreme Court of India in *Commissioner of Income Tax v Vatika Township Private Limited*[2] has exhaustively laid down the law on this point and provides the appropriate tests to determine the nature of the 2015 Amendment in question and its implication.

In *Vatika Township*, the Supreme Court was concerned with the interpretation of proviso of Section 113 of the Act which had been inserted by Finance Act, 2002. Section 113 prior to amendment read:

> *"113. Tax in the case of block assessment of search cases.-The total undisclosed income of the block period, determined Under Section 158BC, shall be chargeable to tax at the rate of sixty per cent."*

The proviso, inserted with effect from June 2002 read:

> *"Provided that the tax chargeable under this section shall be increased by a surcharge, if any, levied by any Central Act and applicable in the assessment year relevant to the previous year in which the search is initiated Under Section 132 or the requisition is made Under Section 132A."*

The question that arose for interpretation in this case was whether the surcharge that could be imposed under proviso to Section 113 was applicable only to block assessments carried out subsequent to 2002 or whether it applied to block assessments carried out prior to 2002 as well.

In interpreting the scope of the proviso to Section 113, after analysing various judgments on the point, the Hon'ble Supreme Court set out certain principles to guide it, namely:

a. "Unless a contrary intention appears, a legislation is presumed not to have a retrospective operation."[3]

2 (2015) 1 SCC 1.

[3] *Vatika Township* (n 2) para 31, page 22.

b. "Legislation which modified accrued rights or which obligations or impose new duties or attach a new disability have to be treated as prospective unless the legislative intent is clearly to give the enactment a retrospective effect."[4]

c. "If a legislation confers a benefit on some persons but without inflicting a corresponding detriment on some other person or on the public generally, and where to confer such benefit appears to have been the legislators object, then the presumption would be that such a legislation, giving it a purposive construction, would warrant it to be given a retrospective effect."[5]

Applying these principles, in the context of the proviso to Section 113, the Hon'ble Supreme Court held that since the proviso imposed a burden on the assessee (to pay surcharge as applicable) it would only be prospective in nature and not retrospective.[6]

While amendment in *Vatika Township* imposed a burden on the assessee and was held to be prospective for that reason, could a provision beneficial to assessees under the Income Tax Act, 1961 be held to be retrospective under the above principles?

The normal rule is that the exemption or benefit given in a tax law should be interpreted strictly.[7] However, where there is doubt as to whether an exemption in a given case is clarificatory (i.e. retrospective) or declaratory (i.e. prospective), the principle is that the exemption must be held to be clarificatory and therefore retrospective.

In *Govt of India v Indian Tobacco Association*[8] the Hon'ble Supreme Court of India has held to this effect.

In the *Indian Tobacco Association* case, the Supreme Court was concerned with an exemption notification dated 01.04.1997 under the Customs Act, 1962 which was amended with effect from 27.11.1997 to include more ports from which a 2% incentive was given for exports undertaken from that port. Some of the exporters sought the extension of this benefit from 01.04.1997 as well contending that the amendment to the notification was merely clarificatory, and it had always been the intention to grant the exemption to certain ports. Going into the intention of the legislature, the fact that the intent seemed more to be to correct an omission and clarify it, the Hon'ble Supreme Court in *Indian Tobacco Association*, held that the amendment to the notification had to be given retrospective effect.

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[4] *Vatika Township* (n 2) para 32, page 23.

[5] *Vatika Township* (n 2) para 33, page 24.

[6] *Vatika Township* (n 2) para 37, page 25.

[7] See *State of UP v Mahindra & Mahindra Ltd* (2011) 42 VST 365 (SC).

[8] (2005) 7 SCC 396.

It may be noted here that in the *Indian Tobacco Association* case, the fact that the notification was issued with prospective effect did not deter the Supreme Court from holding that it should be given retrospective effect since it was clarificatory and sought to provide a benefit to the assessee in question. This principle has been followed and applied in the case of *Vatika Township* as well.

To sum up the principles of interpretation as laid down in *Vatika Township*:

1. No amendment is retrospective unless the Parliament clearly intends it to be so.
2. Even an amendment made with ostensibly prospective effect may either be clarificatory (in which case it is deemed to have retrospective effect) or amendatory (in which case, it is deemed to have only prospective effect).
3. In determining whether an amendment is clarificatory or amendatory, it has to be examined whether such an amendment seeks to confer a benefit to the assessee or impose a burden.
4. Where such an amendment imposes a burden on the assessee, it must be deemed to be prospective and where it confers a benefit, it must be deemed to be retrospective.

Of course, in a situation where Parliament has made it clear that the amendment is conferring a benefit for the first time, that was not otherwise available in the past, but only with prospective effect then there is no question of extending it retrospectively. (See *Gem Granites v Commissioner of Income Tax, TN* (2005) 1 SCC 289)

In the context of the present case, the purpose of introducing clause (iid) in Explanation 1 to Section 115JB has been described by the Memorandum Explaining the Provisions of the Finance Bill, 2015 as follows:

> "Further, vide Finance Act (No.2), 2014 it was provided that any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 would be capital asset. Consequently, the income arising to a Foreign Institutional Investor from transactions in securities would always be in the nature of capital gains. It is, therefore, proposed to amend the provisions of section 115JB so as to provide that income from transactions in securities (other than short term capital gains arising on transactions on which securities transaction tax is not chargeable) arising to a Foreign Institutional Investor, shall be excluded from the chargeability of MAT and the profit corresponding to such income shall be reduced from the book profit. The expenditures, if any, debited to the profit loss account, corresponding to such income (which is being proposed to be excluded from the MAT liability) are also proposed to be added back to the book profit for the purpose of computation of MAT."[9]

The memorandum also states that the amendment is intended to be prospective and applicable to assessment year 2016-17 onwards.

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[9] Memorandum Explaining the Provisions of the Finance Bill, 2015 available at http://indiabudget.nic.in/ub2015-16/memo/mem1.pdf last accessed 19 July 2015.

It is obvious that this is a benefit which is being conferred on the assessee. However, it is not categorically clear that the benefit to FIIs is being introduced for the first time for the purposes of the MAT. While the term "rationalising" as used in the Memorandum and also in the Budget speech suggests that there was confusion over the interpretation of Section 115JB. In one sense, it could be contended that Parliament here is settling the debate over the applicability of MAT to FIIs.

In assessing whether the said amendment is clarificatory, it is also necessary to see if, on a plain construction of the clauses of Section 115JB as it stood prior to this amendment could have possibly included capital gains from the sale of shares.

As we have pointed out in the main submissions, this will involve examining whether an FII is said to have a "place of business" in India for the purposes of Section 491 of the Companies Act, 1956. The next Chapter will therefore analyse this particular phrase.

II. INTERPRETATION OF THE TERM "PLACE OF BUSINESS" IN SECTION 591 OF THE COMPANIES ACT, 1956

1. "Place of Business" under Section 591 of the Companies Act, 1956

The term "place of business" has been given judicial interpretation in a long line of cases by Courts in the United Kingdom. In fact the provisions of the Companies Act, 1956 relating to "companies incorporated outside India" are almost identical to those of Part X of the Companies Act, 1948 passed by the UK Parliament. Specifically, Section 406 of the Companies Act, 1948 is almost identical to Section 591 of the Companies Act, 1956. Section 406 reads:

> "406. The next eight following sections shall apply to all of SS. '407 to overseas companies, that is 'to say, companies incorporated outside Great Britain which, after the commencement of this Act, establish a place of business within Great Britain, and companies incorporated outside Great Britain which have, before the commencement of this Act, established a place of business within Great Britain and continue to have an established place of business within Great Britain 'at the commencement of this Act. "

The term "place of business" occurs in almost identical context and therefore judgments of UK courts may be relied upon for the purposes of interpreting the scope of Section 591 of the Companies Act, 1956 as well.

In *Deverall v Grant Advertising*[10], the Court of Appeal noted that physical presence was one of the factors to be taken into account while determining whether or not a company has "established a place of business". While the Court here was not concerned directly with Section 406 of the UK Companies Act, this particular interpretation has been relied upon in several subsequent cases as well where Section 406 was being interpreted.

In the case of *South India Shipping Corporation vs. Export-Import Bank of Korea*[11] the Court of Appeal in the UK was held that the defendant had a place of business for the purpose of the proviso to s.412 of the English Companies Act of 1948. The Court arrived at this conclusion even though its branch office in London did not conclude any banking transactions but merely conducted activities incidental to its banking business, such as the collection and dissemination of information, maintenance of public relations with other banking and financial institutions in the United Kingdom, as well as conduct of other liaison activities. The Court was of the view that it was not absolutely necessary that the main or even a substantial part of business of the company be carried out from the place of business in order to fall within the purview of Section 406 of the UK

[10] [1955] Ch. 111.

[11] [1985] 2 All ER 219.

Companies Act.[12]

In *Re Oriel Ltd*[13], the UK Court of Appeal was interpreting the term "established a place of business" as it occurred in Section 106 of the UK Companies Act, 1948 which was also concerned with the application of provisions of the UK Companies Act, 1948 to foreign companies. In this case, the Court of Appeal distinguished the concepts of "carrying on business" and "establishing a place of business". The Court gave the example of a foreign company which sends agents over to meet clients in a hotel lounge may be carrying on business there but does not establish the hotel lounge as a place of business.[14] The Court elaborated on the meaning of the term as follows:

> "Speaking for myself, I think also that when the word "established" is used adjectively, as it is in section 106, it connotes not only the setting up of a place of business at a specific location, but a degree of permanence or recognisability as being a location of the company's business. If, for instance, agents of an overseas company conduct business from time to time by meeting clients or potential customers in the public rooms of an hotel in London, they have, no doubt, "carried on business" in England, but I would for my part find it very difficult to persuade myself that the hotel lounge was "an established place of business." The concept, as it seems to me, is of some more or less permanent location, not necessarily owned or even leased by the company, but at least associated with the company and from which habitually or with some degree of regularity business is conducted."[15]

In *Cleveland Museum of Art* v. *Capricorn Art International SA*[16] the Commercial Court of the Queen's Bench Division held that in order to make a finding that an overseas company had established a place of business in England, it was necessary to show that it had "some more or less permanent location associated with the company" and from which "habitually, or with some degree of regularity, business was conducted". In the given case, the company in question had used the London premises for storing works of art and also for the viewing of works of art stored there and that these were carried out to such an extent that the company had clearly established a place of business on the premises.

It may be noted that the judgment of the UK Courts on the scope of "place of business" for the purposes of the Companies Act, 1956 has been relied upon by the High Court of Delhi in the case of Dabur (Nepal) Pvt Ltd v M/s Woodworth Trade Links Pvt Limited[17] where the Hon'ble Delhi High Court was pleased to hold that the petitioner in that case, despite being registered in a foreign

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[12] *South India Shipping* (n 11), 293.

[13] [1986] 1 WLR 180.

[14] *Oriel* (n 13), 214.

[15] *Oriel* (n 13), 184.

[16] [1990] 2 Lloyd's Rep. 166.

[17] (2012) 175 Comp Cas 338.

country, but having warehouses and godowns in India, would be deemed to be have a "place of business" in India, for the purposes of Section 591 of the Companies Act, 1956.

In another decision, the Hon'ble High Court of Delhi has interpreted the scope of Section 591 of the Companies, 1956 to hold that merely appointing an a constituted attorney would not constitute a "place of business" having been established for the purposes of the Act. In *Tumlare Software Services Pvt. Ltd., India vs. Magic Software Services*[18] it was held that

> "22. As is apparent, the crux of the above provisions of Companies Act is that unless a company has a specified or identifiable place at which it carries on business it cannot be said to have an established place of business that includes office, storehouse, godown or any other kind of such activity that has direct relation with the business and the place. Mere appointment of a constituted attorney by such a company for the purpose of signing the contract does not mean that the said company has an established place of business in that country. Sole requirement for complying with the provisions of Part II of the Companies Act by a foreign company is that such a company must have an "established place of business" at the time of signing the contract. Thus unless a foreign company has an established place of business at the time of signing of the contract the said company cannot be governed by the restriction imposed under Section 599 of the Companies Act."
>
> The expression that the company has 'an established place of business' in a particular country necessarily means that at the time of signing of the contract it has a permanent and specific location in that country from where it habitually and regularly carries on the business."[19]

From the above discussion of case-law, what emerges is that in order to establish a "place of business" two requirements are necessary, though not sufficient for determining for this purpose, namely, permanence and physical presence. In addition to such permanence and physical presence, it also necessary to show that there were activities related to the business being carried out from such permanent and physical premises in India. Such activities may be ancillary and in support of the main business,[20] and whether this would render such premises as "place of business" depends on the facts of each case but unless it is conclusively established that there was a permanent and physical presence of such company in India, it cannot be said to have "established a place of business" in India for the purposes of Section 591 of the Act.

If the Revenue wishes to bring FIIs under the purview of MAT, it will have to show, on the basis of facts, that there was in fact such a place of business established by the FII. In the absence of any specific facts in the public domain, we do not wish to comment on the specifics of each individual show cause notices, but would like to point out that the legality of the show cause notices will be

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[18] ILR (2001) 1 Del 529.

[19] *Tumlare Software* (n 18), 540.

[20] However, it is also pertinent to mention here that auxiliary/incidental activities, do not constitute a Permanent Establishment or 'business connection' for the purposes of cross-border taxation. Article 5.4 of the OECD Model Tax Treaty Convention states that such activities will not constitute a PE in India. This has been upheld by the Supreme Court in the case of *DIT vs. Morgan Stanley (2007) 7 SCC 1*.

adjudged on the position of law we have elaborated on above.

To summarise the position of law therefore, a foreign company is not said to have “established a place of business” in India for the purposes of Section 591 of the Companies Act, 1956 unless it is shown that the foreign company has had a permanent, physical presence in India from which the main business or even an ancillary part of the main business, is being run. It is dependent on the facts of each case whether there is such a place of business, but in the absence of a permanent, physical presence in India, it cannot be said that the FII would be subject to tax on the capital gains irrespective.

III. CONCLUSIONS

To summarise the conclusions of the previous chapters therefore:

a. The introduction of clause (iid) to Explanation 1 of Section 115JB indicating that capital gains on sale of securities made by FIIs is clarificatory in nature and therefore retrospective in its application to FIIs given the fact that it is extending a benefit to the FIIs.

b. Even prior to the introduction of this amendment, a plain reading of Section 115JB, which is applicable to foreign companies covered under the Companies Act, 1956 suggests that it would not be applicable to an FII which has not "established" a place of business in India.

c. Establishing a place of business in India would require such FII to have at least a permanent and physical presence in India from which the business activities of the FII (or activities ancillary to the business activity) are carried out.

d. Whether or not business activities are being carried out from the premises in question is a matter of fact to be decided in each case.

It is our submission therefore that if an FII does not have a permanent, physical presence in India, it cannot be said to have "established a place of business" in India and is therefore outside the purview of Section 591 of the Companies Act, 1956. Being outside the purview of the Companies Act, 1956 such a foreign company would therefore not be liable to pay Minimum Alternate Tax under Section 115JB since it does not maintain its books of accounts in the manner required by the Companies Act, 1956. Consequently, for capital gains made by such FIIs from sale of shares, they would not be liable to pay Minimum Alternate Tax in India.

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