

# Supreme Court provides clarity on prospective versus retrospective operation of tax amendments

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## In brief

In a recent decision, the Supreme Court of India (SC) held that the proviso to section 113 of the Income-tax Act, 1961 (the Act) levying a surcharge on undisclosed income had a prospective effect as Parliament specifically chose to make the proviso effective from June 1, 2002. Imposing a retrospective levy on the taxpayer would have caused undue hardship.

In this ruling, the SC has also elaborated general principles concerning interpretation of amendments with retrospective effect, relying on a host of Indian and foreign judgments.

## In detail

### Facts

- Search and seizure operations were carried out on the taxpayer,<sup>1</sup> M/s Vatika Township Private Limited, under section 132 of the Act, and accordingly, a notice under section 158BC of the Act was issued, requiring the taxpayer to furnish its return of income for the block period April 1, 1989 to February 10, 2000. The block assessment was completed by the Tax Officer (TO) at a total undisclosed income of INR 8,518,819 with a levy of tax thereon, but no surcharge.
- Based on the insertion of section 113 of the Act by the Finance Act, 1995 and

the circular<sup>2</sup> of the Central Board of Direct Taxes (CBDT), the Commissioner of Income Tax (CIT) was of the opinion that a surcharge should have been levied under section 113. Therefore, a notice under section 263 of the Act was issued to the taxpayer and, in consequence, the TO was directed to levy surcharge at 10%.

- On appeal by the taxpayer, the Income-tax Appellate Tribunal (Tribunal) allowed the appeal, stating that the proviso to section 113 was not declaratory or clarificatory, and therefore was prospective in nature.
- The High Court (HC) dismissed the revenue's appeal and held that the

proviso to section 113, inserted by the Finance Act, 2002, was prospective in nature and therefore, could not be made applicable in the instant case of block assessment from April 1, 1989 to February 10, 2000.

- The revenue then filed an appeal before the SC. The matter was referred to a five-member bench.

### Issues before the SC

Whether the surcharge levied by way of insertion of the proviso to section 113 of the Act, by the Finance Act, 2002 was to operate prospectively or was clarificatory and curative in nature, to be applied retrospectively?

### Taxpayer's contentions

- Chapter XIV-B was a self-contained chapter as it laid down a special procedure

<sup>1</sup> CIT v. Vatika Township Private Limited [TS-573-SC-2014]

<sup>2</sup> No. 717 dated August 14, 1995

for assessment of undisclosed income, containing a charging section (158BA), a computation section (158BB), a procedural section for block assessment (158BC), a limitation provision for the completion of block assessments (158BE), and provisions for the imposition of interest and penalty (158BFA).

- The scheme of assessment under Chapter XIV-B was different from the scheme of assessment under section 4 of the Act, as Chapter XIV-B dealt with the assessment of 'undisclosed income' and section 4 of the Act dealt with the assessment of 'total income'.
- The 'block period' mentioned in Chapter XIV-B was different from the assessment of income of the 'previous year' under section 4 of the Act. Even the rate of tax of 60% at which the undisclosed income is assessed, specified in section 158BA(2) of the Act read with section 113, was different from the rate of tax specified for normal income under the relevant provisions of the Finance Act.
- In a nutshell, the charging section for block assessments under Chapter XIV-B was section 158BA and not section 4. Therefore, levy of surcharge prior to June 2002 was not an option before the TO.

**Revenue's contentions (similar to those as placed before the Division Bench in the case of Suresh N. Gupta<sup>3</sup> holding that the insertion of proviso to section 113 had a retrospective effect)**

- Section 4 dealt with tax on total income. Therefore, the procedure contained in

section 4 of the Act was applicable to a block assessment, as it was an assessment on the total income of the previous years that fell within the block period. Furthermore, as the concepts of 'previous years' as well as 'total income' were retained in Chapter XIV-B, section 158BB had to be read with section 4, implying that section 4 remained the charging section.

- The provisions of the relevant Finance Act had to be read into the block assessment scheme under Chapter XIV-B. Therefore, even without the insertion of proviso to section 113 by the Finance Act 2002, Finance Act 2001 (which levied surcharge on companies) was applicable to the block assessment and therefore, surcharge was leviable.
- The proviso to section 113 inserted by the Finance Act 2002 was clarificatory and curative in nature, having a retrospective effect, as before the insertion of the proviso to section 113, there was ambiguity as to whether the surcharge was to be applied.

**SC's ruling**

**On whether the scheme of Chapter XIV-B of the Act is a complete machinery in itself (Para 27):**

- Section 4 of the Act was a charging section made applicable to the 'total income of the previous year'. As per section 5 read with section 2(45) of the Act, total income included all income received, or deemed to be received, in any 'previous year'. Furthermore, as per section 3 read with section 2(34) of the Act, 'previous year means the financial year immediately preceding the assessment year'.

- Chapter XIV-B of the Act was not relatable to any previous year, but was for a block period of 6 years or 10 years, as the case may be. Chapter XIV-B of the Act stipulated all aspects of a block assessment, beginning from the charging section to the completion of the assessment. Even the rate of tax was prescribed under section 113 of the Act. Therefore, Chapter XIV-B of the Act was a complete machinery in itself.
- Notwithstanding the provisions of section 4 of the Act, the legislature had introduced a separate charging section, section 158BA(2) of the Act, *vide* the Finance Act, 1995 to assess the undisclosed income. This move of the legislature had to be assigned some value; otherwise, there is no necessity to make a separate provision in the form of section 158BA(2).

**On general principles of retrospectivity (Para 30):**

- Legislation differed as to its meaning and implications according to the intent of the lawmaker. Legislation may physically consist of words printed on paper. However, it was conceptually more than an ordinary text. It was not like a series of statements found in a work of fiction/non-fiction, or in any Court judgement. A technique was required to draft a piece of legislation and to interpret it.
- One of the established rules of interpretation was that unless explicitly stated, a piece of legislation is presumed not to be intended to have a retrospective operation<sup>4</sup> The idea behind

<sup>3</sup> CIT v. Suresh N Gupta [2008] 4 SCC 362 (SC)

<sup>4</sup> Govinddas v. Income Tax Officer [1976] 1 SCC 906 and CIT Bombay v. Scindia Steam Navigation Company Limited [1962] 1 SCR 788

such a rule was that a current law should govern current activities. The principle of *lex prospicit non respicit*, which means that 'The Law looks forward and not backward' was upheld.

- Retrospective legislation was contrary to the general principle that 'legislation introduced for the first time need not change the character of past transactions carried out upon the faith of the then existing law.'<sup>5</sup> The obvious basis of the principle against retrospectivity was the principle of 'fairness', which must be the basis of every legal rule<sup>6</sup>.
- Legislations which modified accrued rights or imposed disabilities were to be treated as prospective in nature unless they were accounting for an obvious omission, or explaining a former legislation.
- The doctrine of fairness was a relevant factor when construing a statute that conferred a benefit without inflicting a corresponding detriment. Accordingly, it had to be given a retrospective operation<sup>7</sup>.
- In the instant case, the proviso added to section 113 was not beneficial to the taxpayer. On the contrary, the provision was onerous to the taxpayer. Therefore, under the normal rule of presumption, the proviso did not have a retrospective effect.

*On whether the proviso to section 113 of the Act could be treated as declaratory/statutory/curative in nature having a retrospective effect (Para 38):*

- A declaratory Act may be defined as an Act to remove doubts existing as to the common law or meaning or effect of any statute. Such Acts were generally held to be retrospective.
- In the absence of clear words indicating that the amending Act was declaratory, retrospective effect could not be resorted to, particularly when the pre-amended provisions were clear and unambiguous<sup>8</sup>.
- The TOs were indeterminate about the date of the levy of surcharge, considering the varying rates of surcharge from Finance Act 1995 to Finance Act 2003 with reference to:
  - a) the rates provided in the Finance Act of the year in which the search was initiated, or
  - b) the year in which the search was concluded, or
  - c) the year in which block assessment procedures were initiated, or
  - d) the year in which the block assessment order was passed.
- The court rephrased the conceptualisation of tax<sup>9</sup> so as to include a computation provision to attract the charging section. Applying this analogy, the Court held that in the absence of a particular date to levy the surcharge *vis-a-vis* the varying rates to be applied,

the proviso to section 113 of the Act was not clarificatory.

- Any ambiguity in the tax laws must be resolved against the imposition of tax and in the favour of the taxpayer<sup>10</sup>. Accordingly, lack of clarity regarding the rate of surcharge and the date of levy would not automatically lead to levy of surcharge on the undisclosed income under the existing provisions of the Act, thereby making the insertion of the proviso to section 113 retrospective.
- The 'Notes on Clauses' appended to the Finance Bill, 2002 clearly stated that the amendment would take effect from June 1, 2002 and could only be meant to have prospective effect. Furthermore, the SC also held that there were certain other amendments in the Finance Bill 2002 specifically making them applicable retrospectively, e.g., section 92F (as the amendment was clarificatory). Thus, the decision taken by the legislature to insert the proviso from June 1, 2002 was a conscious one.
- This was further reinforced by the Circular<sup>11</sup> of the Central Board of Direct Taxes and the proviso to section 2(3) of the Finance Act, 2003, which specified that the provisions of section 113 of the Act shall be increased by a surcharge in the case of block assessment, and would be prospective in nature, i.e., with effect from June 1, 2002.
- The charge in respect of the surcharge that was created by the Finance Act 2003 for the first time was clearly a

<sup>5</sup> Phillips v. Eyre [1870] LR 6 QB 1

<sup>6</sup> L'Office Cherifien des Phosphates v. Yamashita-Shinnihon Steamship Company Limited [1994] 1 AC 486

<sup>7</sup> Government of India & Ors v. Indian Tobacco Association [2005] 7 SCC 396 and Vijay v. State of Maharashtra & Ors [2006] 6 SCC 286

<sup>8</sup> As explained by Justice G.P. Singh Principles of Statutory Interpretation, 13th Edition 2012 published by LexisNexis Butterworths Wadhwa, Nagpur

<sup>9</sup> CIT v. B C Srinivasa Setty [1981] 128 ITR 294 (SC)

<sup>10</sup> Billings v. US – 232 U.S. 261, at p.265, 34 S.Ct. 421 [1914]

<sup>11</sup> Circular no. 8 of 2002 dated August 27, 2002

substantive provision, and hence had been construed as having prospective effect. There was no intent of the Parliament to suggest otherwise, or any material which purported it to be clarificatory.

- Any amendment to a taxing statute is intended to remove any hardship caused to taxpayers, and not to the tax department.
- Based on the above, the conclusion of the Division Bench in Suresh N. Gupta<sup>3</sup> treating the proviso as clarificatory and giving it retrospective effect, was held to be incorrect and was overruled.

### ***The takeaway***

In determining whether a provision is applicable prospectively or retrospectively, attention would be required to be paid to the language of the amending statute, the legislature's intent, the memorandum to the relevant Finance Act, and the hardship the amendment would cause to the taxpayer. This is an extremely welcome judgment for taxpayers, which clarifies retrospective applicability of a taxing statute.

### ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact:

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