SURANA & SURANA NATIONAL JUDGMENT WRITING COMPETITION ON CORPORATE LAW, 2016

KARNATAKA HIGH COURT

Hassleton Investment Limited, Singapore vs Director of Income Tax (International Taxation), Bangalore & Anr.

Author: X

IN THE HIGH COURT OF KARNATAKA

KALABURAGI BENCH

DATED THIS THE 14th DAY OF FEBRUARY, 2016

PRESENT:

THE HON'BLE MR. JUSTICE X

AND

THE HON'BLE MR. JUSTICE Y

Writ Petition (Civil) No. 100000 of 2015

BETWEEN:

HASSLETON INVESTMENT LIMITED, …PETITIONER

AND

1. THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX), NEW DELHI

2. DIRECTOR OF INCOME TAX (INTERNATIONAL TAXATION), BANGALORE

….RESPONDENTS

JUDGMENT (X, J.):

This Writ Petition 100000 of 2015 is filed by the petitioner under Article 226 of the Constitution of India praying to issue a writ of certiorari quashing the ruling of the Authority of Advance Rulings (respondent no.1) and to prevent the Income tax department from any recovery proceedings.

1. It would be necessary to recount some salient facts in order to appreciate the contentions urged.

2. The petitioner, Hassleton Investment Limited (HIL), is a Singaporean investment company having presence in various emerging securities markets including India. In India, it invests through FII route and is registered with Security and Exchange Board of India (SEBI) as a Foreign Institutional Investor (FII) as per SEBI Regulations, 1995. Despite of expertise on the securities markets of its investment destination, generally HIL appoint an investment advisor in every country in which it makes investment. Consequently, HIL appointed Securities Investment Private Ltd. (SAIL), a company registered in Bangalore under the Companies Act, 1956 to act as key advisor to petitioner in India. HIL is the biggest client of SAIL and significantly depends upon it. However, HIL has its own expert team to advise on investments in India, and SAIL too has various other clients.

3. In January 2015, HIL disposed off its major investments made in Indian listed securities held by it for couple of years since markets were rallying bullish and made significant capital gains which ran into several thousand crores. Petitioner strongly believed that since all the securities were LTCG, they are exempt under section 10(38) and are not liable for any tax. However, in order to be certain of the tax position, petitioner filed an application before the Authority for Advanced Ruling (respondent no.1).

4. Respondent no.1 in its ruling decided that since petitioner has an Agency pe/ Place of business in India through SAIL, it shall have to pay Minimum Alternate Tax (MAT) on the gains it has made under Section 115JB of the Income Tax Act, 1996. HIL argued before respondent no.1 that SAIL does not constitute its place of business in India. HIL also argued before respondent no.1 that the definition of 'permanent establishment' under the Double Tax Avoidance Agreement between India and Singapore (hereinafter 'the treaty') should be disregarded in lieu of the concepts of 'business connection' under Section (9)(1)(i) and Section 92-F of the Act as u/S 90(2) the Assessee has the right to elect the more beneficial provision of the Act. HIL, finally, argued that the Amendment to the explanation of Section 11JB(2) vide the Finance Act, 2015 which excludes the capital gains earned by FIIs from the computation of MAT must be construed retrospectively as the same is merely clarificatory. However, all the arguments by HIL were rejected. Therefore, aggrieved by ruling, the petitioner has approached this Court.

5. The petitioner has approached this Court pursuant to the Hon'ble Apex Court's decision *in Columbia Sportswear Company* v. *Director of Income Tax, Bangalore*[1], whereby the Apex Court held that the ruling of AAR should in the first instance be challenged before the High Court under Article 226 instead of directly in the Supreme Court. The respondents have also not challenged the maintainability of the suit, and hence, we may now proceed to decide the case on merits.

6. In light of these facts and the subsequent ruling of AAR, following issues arise for our attention:

1. Whether the petitioner can cherry pick the provisions of Income Tax Act and treaty for the purpose of concept of PE under the Act and capital gains exemption under the treaty?

[1] SPECIAL LEAVE PETITION (C) No. 31543 of 2011

2. Whether 'SAIL' will constitute permanent establishment/ business connection/ place of business of the petitioner?
3. Whether the petitioner is liable to pay Minimum Alternate Tax under Section 115JB?
4. Whether the Amendment to section 115JB(2) vide the finance act, 2015 could be construed retrospectively?

7. In regard to the **FIRST ISSUE**, the learned counsel for the petitioner submitted that the concept of 'business connection' u/S 9(1)(i) and 'PE' u/S 92-F of the Income Tax Act, 1961 (hereinafter, 'the Act') are inapplicable to it, and hence, are more beneficial as compared to the analogous provision of 'PE' under the treaty. Therefore, the petitioner should be permitted to choose the provisions u/S 9(1)(i) and u/S 92-F of the Act and revert to the treaty to claim the tax exemption on capital gains under Article 13 of the treaty as the language of Section (90)(2) does not contemplate any restriction over simultaneously choosing the more beneficial provisions of the Act and the treaty.

To further support the contention, the petitioner placed reliance on the decision of Delhi High Court in *British Airways Plc.* v. *Dy. CIT*,[2] where the Court observed that:

"*Section 90(2) of the Income Tax Act gives an option to an assessed to choose whichever provision is more beneficial to it whether of the agreement or the Act and he can seek application at the same time of the provisions of both the agreement and the Act."*

8. On the other hand, the learned Departmental Representative forcefully submitted that for the assessment of the same set of income arising in the same assessment year, the Assessee is prohibited from partly taking the advantage under Act and going back for the selective treaty benefit. To strengthen the submission, the Departmental representative relied on the decision in the case *of Dresdner Bank Ag.* v. *Addl. CIT*[3] and *DCIT* v. *Patni Computer Systems Ltd.*[4],

[2] (2001) 73 TTJ Del 519.

[3] 105 TTJ 149 (Mumbai).

according to both of which the Assessee cannot split the income into different segments to avail the benefit partly under the Act and partly under the treaty.

9. After having considered the rival contentions, we inclined to view that the petitioner through its conduct has subjected itself to the liability in India; it cannot resort back to the treaty for the purpose of Article 13. To substantiate the reasoning on this observation, it is noteworthy to examine the conduct of the petitioner at two occasions. *Firstly*, after disposing off its investment, the petitioner claimed the tax exemption on capital gains u/S 10(38) of the Act. *Secondly*, it also urged before AAR to disregard the concept of 'PE' under the treaty in lieu of the concepts of 'PE' and 'business connection' under the Act.

10. It is surprising that the learned counsel for the department has not invited our attention to a very significant aspect that Section 10(38) of the Act and Article 13(4) of the treaty cannot be used simultaneously, and the Assessee has to choose either among both. However, we trust that this facet cannot be overlooked while dealing with the issue at the hand. To substantiate further, we feel it highly pertinent to observe the relation between Section 10(38) of the Act and Article 13(4) of the treaty.

11. Article 13(4)[5] provides that the capital gains derived in transaction on securities by a resident of a Singapore State shall be taxable only in Singapore. In short, Article 13(4), per se, is not in itself an exemption provision; it provides that the capital gains of Singaporean entity are taxable only in Singapore, although, Singapore tax statute ultimately exempts capital gains. Here, when the petitioner claimed the tax exemption for its long-term capital gains u/S 10(38), there is an explicit inference that it has subjected itself to the taxation liability in India forgoing the option to be taxed in Singapore as per Article 13(4). Therefore, when the 'taxability' of the gains has been accepted in India by availing the exemption under

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[4] 109 TTJ 742 (Pune).

[5] *See*, India-Singapore DTAA as amended by *CBDT Notification No. GSR 610(E), dated 8th August 1994 as amended by Notification No.SO 1022(E), dated 18th July 2005.*

the Act, the path of liability cannot be changed by resorting back to the benefit under Article 13(4).

Therefore, the petitioner cannot revert to the treaty for the purpose of Article 13.

11. It has been unanimously agreed by us that Article 13(4) is inapplicable to the petitioner on the other premise as dealt above. Therefore, we refrain from adjudicating on whether the Assessee can split the assessment of its income partly under the provisions of Act, i.e., 'PE' u/S 92-F and 'business connection' u/S 9(1) and partly under Article 13(4) of the treaty for capital gains exemption as the question becomes irrelevant for the present case. We also feel diffident to decide on this aspect as there are contradictory views by different forums, and hence, the Apex Court more suitably should consider the aspect.

12. To determine the applicability of MAT, it is important to determine as the **SECOND ISSUE** as to whether SAIL constituted business connection/ permanent establishment of the petitioner.

13. The petitioner has decided to be governed by the concept of 'business connection' u/S 9(1)(i) which is akin to the concept of agency PE in the treaty. Since the petitioner was not relying upon any other provision of the treaty except Article 13 which he has not been allowed to resort to, there is no question of cherry picking, and hence, we permit the petitioner to be governed by the concept of 'business connection' in lieu of 'permanent establishment'.

14. It is submitted by the petitioner that the definition of 'business connection' under the Act is for the purpose of ascertaining the income deemed to accrue in India.[6] However, the definition of business connection is limited and definite for the purpose of business which is carried out in India and does not extend to investment activities, as were being carried out by the Petitioner. To support the contention, the counsel for the petitioner has placed reliance on

[6] The Anglo-French Textile Company v. CIT, AIR 1954 SC 198.

the Hon'ble Apex Court's decisions In *CIT v. Toshoku Ltd., Guntur,* [7] and *CIT v. R. D. Aggarwal & Co*.,[8] whereby it was observed that:

"If no operations of business are carried out in the taxable territories, it follows that the income accruing or arising abroad through or from any business connection in India cannot be deemed to accrue or arise in India."

Therefore, the petitioner argued that since the petitioner is engaged into the activities of 'holding the investment' and not 'business', it cannot have business connection in India.

14. Arguing further in the similar line, the learned counsel submitted that the term 'business' as used in the fiscal statute must be interpreted legally in regard to nature of the activity.[9] The investment activities are usually not included in the term 'business'. To reinforce the contention, the learned counsel strenuously invited our attention to the Apex Court's decision in *Bengal and Assam Investors Ltd.* v. *CIT*[10], where the Hon'ble Court observed that there is nothing like a business of 'holding of investments'. The reliance has also been placed on the Apex Court's decision in *CIT* v. *Distributors (Baroda)*[11], where the Apex Court took the similar stance and held that an investment holding company, in the strict sense, does not carry out business unless the assets are purchased have been held as stock-in-trade.

The learned counsel precisely drew our attention to the fact that the petitioner has held the investment for a considerably long period instead of merely showing interest in price appreciation or earning profit so that the invested money could be used for some meaningful purpose before disposing it off in January 2015, and hence, its activities were in nature of 'investment holding' and not 'trade in investment' or 'business'.

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[7]CIT v. Toshoku Ltd., 1981 SCR (1) 587.

[8]CIT v. R.D.Aggarwal & Co., 1965 SCR (1) 660.

[9] Addl. Commissioner v. Ram Nath & Co., 1983 141 ITR 897 Delhi.

[10] Bengal & Assam Investors Ltd v. CIT, (1967) 66 ITR 473 (SC).

[11] 83 ITR 377 (SC).

15. Lastly and crucially, the learned counsel for the petitioner brought to the notice of this Court that as per Amendment to the definition of 'capital assets' u/S 2(14) vide Finance Act, 2014,

"*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 is capital asset.*"

Hence, any income derived out of the securities held by the petitioner shall be considered as 'capital gains' and not 'business income' or 'profit'. Now since, both the concept of 'business connection' under the Act and the 'PE' under the treaty is concerned with the taxability of 'business profit' and not 'capital gains', both the concepts are inapplicable to the petitioner.

16. On the other hand, the respondent interestingly resorted to the '*doctrine of updating construction'*. This concept would tend to mean that a provision has to be read in the light of latest developments and not go by a strict interpretation.[12] It was argued by the learned counsel that, in the present scenario, the FIIs earn mammoth without paying any substantial tax or paying no tax which leads to the imbalance of liability by overburdening few classes with the incidence of taxation. In the present case also the petitioner has earned humongous capital gains by disposing the securities when the market was rallying unprecedentedly bullish on the advice of SAIL. Thus, having regard to the nature of its conduct, the income derived should be treated as 'business profit' attributable to the presence of SAIL in India.

17. After hearing both the parties with undivided attention on this issue, we would agree with the learned counsel for the petitioner. Undoubtedly, both the concepts of 'business connection' as well as 'PE' are for the purpose of charging 'business profit' and not 'capital gains'.

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[12] FRANCIS BENNION, STATUTORY INTERPRETATION 889-890, (5th ed. 2008).

18. The Hon'ble Apex Court's decisions, as have been relied upon the petitioner clearly show that 'holding of investment 'cannot be regarded as 'business. Further, we also accept that after the Amendment to the definition of 'capital assets' vide the Finance Act, 2014, all the securities held by the FIIs as per the SEBI Regulations are capital assets, and hence, the gain earned out of them being capital gains, the concepts of 'business connection' or 'permanent establishment' are inapplicable to such gains. It was extremely erroneous on the part of AAR to completely overlook this aspect of law.

Therefore, SAIL neither constitute business connection nor permanent establishment of the petitioner. Before parting with the issue, we feel it dutiful to clarify that the 'doctrine of updating construction' or any such principle of interpretation giving farfetched interpretation cannot be applied to the taxation statute when the words used in the statute are clear.

19. In regard to the **THIRD ISSUE**, the petitioner submitted that for the MAT to be applicable u/S 115JB, the requirements of computation provision 115JB(2) must be satisfied. Section 115JB(2) requires every company to prepare its financials in accordance with Part II of Schedule VI of the Companies Act, 1956. While doing so Section 210 [on Annual Accounts and Balance Sheet] has to be complied with. Section 210 r/w Section 166 of the Companies Act, 1956 would exclude foreign companies without a place of business, from its purview.[13] Therefore, it was submitted by the petitioner, that it being a non-resident company (i.e., FII) without having place of business in India, it is not required to prepare financials as per Section 594 of the Companies Act, 1956 or Section 381 of the Companies Act, 2013.

20. We find merits in the above contention for the petitioner. It is pertinent to note that the government has clarified that tax provision u/S 115JB shall only be applicable to the Foreign Company having place of business/ permanent establishment in India for the period prior to

[13] CBDT, MINISTRY OF FINANCE, REPORT ON THE APPLICABILITY OF MAT 23 (2015).

1-4-2015[14], and the position has been also been accepted by the Apex Court in *Castleton Investment Ltd.* v. *DIT.*[15] Moreover, the view is also justified in the light of the Apex Court's observation in by the Supreme Court in *Ernakulam, Kerala* v. *Official Liquidator*[16], where it observed that:

"Where the computation of tax against income levied under the Act is impossible to conduct, the charge of tax against such income too would resultantly fail."

Therefore, we agree that MAT cannot be imposed upon the petitioner.

23. As we have decided that MAT is not applicable on the petitioner, it is redundant for us to determine the **FOURTH ISSUE** pertaining to the nature of amendment to Section 115JB(2). However, as the issue involves an important question of law, we would succinctly adjudicate upon the same. In this regard, it is pertinent to observe that amendment excludes the capital gains earned by the FIIs from computation of MAT w.e.f 1-4-2015 is made to the 'explanation' clause of the provision, and hence, merely clarifies the existing state of law. Generally, FIIs do not have place of business in India and their capitals gains were not computed under 115JB even before the Amendment in question. There is no authority on record to show that the capital gains earned by FIIs were chargeable with MAT before the amendment. Therefore, though in hast the amendment is made prospectively applicable, it should be construed retrospectively. It is worth mentioning that the Apex Court in *various decisions*[17] has observed that:

"A statutory amendment that is not expressly made retrospective, but is of an explanatory, declaratory or clarificatory nature should be judicially construed retrospectively."

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[14] Government of India Press Release dated 24 September 2015, Applicability of MAT) on foreign companies having no PE in India.

[15] (2015) 280 CTR (SC) 409;

[16] (1985) 1 SCC 45.

[17] CIT v. Podar Cement, 226 ITR 677 (SC); Brij Mohan v. CIT, 223 ITR 825(SC).

Further, it is equally important to notice that government itself constituted Justice A.P. Shah Committee to scrutinize its stand on amendment. *The committee proposed* to apply the amendment retrospectively which has accepted by the government through the *press release dated 24 September 2015*. Therefore, there is no reason for this Court to take the contrary stand. **Consequently, the amendment in question must be construed retrospectively.**

24. Therefore, in these circumstances, we hold that the income of the petitioner is not liable for any tax including MAT. Appeal is allowed with no order as to costs.