Undermining Judiciary thro' retrospective amendments – Rule of Babus prevailing over Rule of Law – Mar 19, 2012

Undermining Judiciary thro' retrospective amendments – Rule of Babus prevailing over Rule of Law?

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THIS Budget has become notoriously famous for its retrospective amendments……. the historical decision of the Hon'ble Apex Court in the Vodafone case has now been rendered ineffective, through retrospective amendments to Sections 2 and 9, dating back to 1 st April, 1962…..

Is this the first time that the Government has gone for retrospective amendments in direct taxes? Of course, not…….. In the Finance Act, 2010, there were as many as 16 retrospective tax amendments, aimed at overcoming judicial pronouncements. In what could be seen as a major disturbing trend in terms of tax administration, over the last five years, the Government has undertaken about 150 odd retrospective amendments to direct taxes.

While, in the initial years, the amendments were aimed at overcoming the judicial pronouncements of the Apex Court, the trend now seems to scuttle the decisions of the High Courts. The amendment to Section 9(1)(vi), for instance, is aimed at scuttling the unfavourable decisions of the Delhi High Court in the EricssonAB case and Dynamic Vertical Software India Pvt Ltd case, wherein, it had been held that payments for import of shrink wrapped software cannot be treated as „royalty' taxable in the hands of the non-resident. Of course, in terms of the taxability of payments for import of packaged/shrink wrapped software, there have been conflicting decisions from the High Courts (including the decision of the Karnataka High Court in the Samsung and certain unreported decisions). With the matter already before the Supreme Court, shouldn't the Government have had the patience to wait for the Apex Court to pronounce its decision in this matter?

The Government would seem to go to any extent to undermine certain judicial pronouncements. Take the case of taxability of off-shore supplies by non-residents. The Apex Court had, in Ishikawajma Harima Heavy Industries case (2007-TIOL-03-SC-IT) had held that, for the non-resident to be taxable in India in terms of the fees paid for technical services, under Section 9(1)(vii), the technical services should have been rendered and utilized in India. Many High Courts had delivered similar decisions, based on this decision. The Government, upset with this development, came out with a retrospective amendment to Section 9(1) by the insertion of a badly worded Explanation, in the Finance Act, 2007 with effect from June 1, 1976, which read as under:

" Explanation.— For the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-section (1),

such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India."

That this badly worded Explanation was not enough to unsettle the Apex Court's decision in the Ishikawajma Heavy Industries case (2007-TIOL-03-SC-IT) became clear when the Bombay High Court, in the Clifford Chance case (2008-TIOL-650-HC-MUM-IT) and the Karnataka High Court, in the Jindal Thermal Power case (2009-TIOL-302-HC-KAR-IT) , held that, the law laid down by the Apex Court was still good law even after the 2007 amendment. Not one to give

up, the Government came out with another retrospective amendment in the Finance Act, 2010, by inserting the following Explanation, in place of the Explanation inserted by the Finance Act, 2007:

[Explanation.- For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

This then, is a case of re-retrospective amendment, overcoming the effects arising out of a badly drafted law with an equally badly drafted amendment. That the Government would not hesitate going in for another re-retrospective amendment, if the earlier retrospective amendment is struck down by the Courts, should perhaps, come as warning signal for tax payers and other stakeholders who might want to contest the latest round of retrospective amendments.

One popular and unconvincing argument that the Government gives is that, these explanations are inserted in order to „remove the doubts". Doubts, in whose mind, one wonders. Clearly, the taxpayer and the Judiciary would seem to have no doubts about these provisions. And look at this irony.. the law related to the taxation of payments towards software imports is being retrospectively amended from 1976…. How can somebody justify that the Legislature, in its wisdom, had thought of taxing software payments to non-residents in 1976 when computers were largely unknown in those days…..

Take the case of the retrospective amendments aimed at overcoming the Vodafone decision…. That these retrospective amendments take effect from April 1, 1962, when the concept of tax havens was unknown, is rather unfortunate. One essential test of a retrospective law is that, the law should have and be seen to have the same validity as on the date from which it is retrospectively applicable. This test would completely fail in the case of these retrospective amendments.

The policy of the current day tax administration seems to be, sadly, one of "Heads I Win… Tails you lose" and this view is getting reinforced thro' the recent retrospective amendments. The tax part546yer, who has run his business and taken investment and business decisions based on the existing law for several years, is made to pay a heavy price even after spending considerable time, effort and money in pursuing litigation, even up to the High Courts and the Supreme Court. If the Government has been lax in terms of

unclear statutory provisions and Rules, who is to be blamed… the Babus who draft the laws and the rules or the tax payers who depend on the statutory provisions for running their businesses?

Nothing prevents the Government from changing the law on a prospective basis, if it feels strongly that the legislative intent has not been well appreciated by the Judiciary. But, to unsettle the law by putting the clock back by 50 years in unheard of, in any legal system, in any part of the world, as far my limited knowledge of international taxation goes.

At this rate, India would not need Courts and Tribunals to decide on tax matters. The Government would do well to take away the provisions related to appellate remedies. This

would, at least, save the tax payers from spending effort and money on litigation. If this trend goes on, there would be no point in the Courts trying to interpret the law, as any decision which is not to the liking of the Government, could easily get retrospectively amended.

Before concluding…….

One fails to understand the so called „legislative intent' getting reinforced thro' these retrospective amendments? All that one can see is the reinforcement of the „executive will' rather than the „legislative will', in as much as, it seems that the „Rule of the Babus' is prevailing over the „Rule of Law'.

The most undesirable outcome of a retrospective amendment is that, it would affect all the concluded transactions which have attained finality. In the instant case, not only would Vodafone get affected. A lot of other concluded transactions would also get affected, which seems rather unfair.

Irrespective of anything else…. to go back and change the law even while the review petition is pending before the Apex Court, looks completely unjust and unfair. By no means am I getting into the merits of the Vodafone case and whether the facts contained in this case would promote to advance the case of „tax avoidance'. But, once the Supreme Court had decided that this is a case of tax avoidance rather than tax evasion, all of us including the Government should respect it. I, for one, would have heartily welcomed a prospective amendment to the law and had indeed expressed this view, in my earlier piece in TIOL.

Talking specifically of the Vodafone decision… it would seem, in hindsight, that if Government had marshalled the facts in a more effective manner, the decision could, perhaps, have been different. This feeling comes when one goes thro' the arguments advanced in this land mark case. Retrospective amendments then, are an easy way out, for the Department and its officers.

The Apex Court could, perhaps, still uphold the constitutional validity of these retrospective amendments. But, as a nation, we would do well to remember and recollect what the great Nani Palkhivala has repeated said "What is legal is not necessarily ethical, just and fair".

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