Committee on Direct Tax Matters

Report on Applicability of Minimum Alternate Tax (MAT) on FIIs / FPIs for the period prior to 01.04.2015

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Report on Applicability of Minimum Alternate Tax (MAT)on FIIs / FPIs for the period prior to 01.04.2015

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TABLE OF ABBREVIATIONS

1. **AAR:** Authority for Advance Rulings
2. **AGM**: Annual General Meeting
3. **CBDT**: Central Board of Direct Taxes
4. **DTAA:** Double Taxation Avoidance Agreement
5. **FII:** Foreign Institutional Investor
6. **FPI**: Foreign Portfolio Investor
7. **IT Act:** the Income Tax Act, 1961
8. **ITAT:** Income Tax Appellate Tribunal
9. **LTCG:** Long Term Capital Gains
10. **MAT:** Minimum Alternate Tax
11. **NAV:** Net Asset Value
12. **PE:** Permanent Establishment
13. **SEBI:** Securities and Exchange Board of India
14. **STCG:** Short Term Capital Gains

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<u>CHAPTER I</u>

BACKGROUND TO THE REPORT

A. Minimum Alternate Tax in India

1.1.1 Minimum Alternate Tax (**"MAT"**) was effectively introduced in India by the Finance Act of 1987, *vide* Section 115J of the Income Tax Act, 1961 (**"IT Act"**), to facilitate the taxation of 'zero tax companies'. It had been observed that many companies, despite showing high profits in their books of accounts and paying substantial dividends, were paying marginal or no tax, by taking advantage of various tax concessions and other incentives, in a manner so as to avoid paying tax[1]. MAT was thus envisaged as levying a minimum tax on such companies by deeming a certain percentage of their book profits, computed under the Companies Act, as taxable income. Section 115J was, however, made inoperative from Assessment Year 1991-92.[2]

1.1.2 The MAT provisions were subsequently reintroduced in 1996 by the Finance Act (No. 2) of 1996, through Section 115JA; and then by the Finance Act of 2000, which replaced Section 115JA with Section 115JB. Section 115JB, which was recently amended by the Finance Act of 2015, provides that in case the tax payable on the total income of a company in respect of any previous year, computed under the Act, is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of such company. The tax payable for the relevant year for such company shall then be 18.5% of its book profit.

1.1.3 A controversy, however, has recently arisen with respect to the applicability of MAT on Foreign Institutional Investors (**"FIIs"**) due to the inconsistent rulings of the Authority for Advance Rulings (**"AAR"**) on the issue. Most pertinently, in 2012, in *Castleton Investment Limited*,[3] the AAR departed from its previous ruling in *The Timken Company*[4] and held that Section 115JB was applicable to foreign companies, even if they have no Permanent Establishment (**"PE"**) or place of business in India. The effect and implication of this ruling was that FIIs could be liable to pay MAT. The Supreme Court admitted a Special Leave Petition filed by Castleton Investment Limited in May

[1]Circular No. 495, dated 22 September, 1987: [1987] 168 ITR (St.) 87.
[2]Circular No. 572 dated 3 August, 1990: [1990] 186 ITR (St.) 89.
[3] [2012] 348 ITR 537 (AAR).
[4] [2010] 326 ITR 193 (AAR). Here, the AAR ruled that since the Applicant in question (Timken) did not have any physical presence in India in the form of an office or branch or a permanent establishment, section 115JB would not apply on the sale of shares of a listed company, on which securities transaction tax has already been paid, and which was accordingly, tax exempt under section 10(38).

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2013,[5] where the company challenged the correctness of the AAR ruling. Based on the AAR ruling in *Castleton*, the income-tax department, from December 2014 finalised assessments and raised MAT demand on various FIIs on capital gains made by them in previous years. These notices raised an alarm amongst FIIs, some of which approached the courts.[6]

B. The 2015 Amendment

1.2.1 In light of the controversy generated, the Finance Minister proposed to rationalize the MAT provisions, *vide* the Finance Act of 2015, by excluding the income of foreign companies earned in relation to capital gains arising on transactions in securities, interest, royalty or fees for technical services etc. from the chargeability of MAT. Thus, clause (iid) was added to such effect to Explanation 1 of Section 115JB. A corresponding clause (fb) was also inserted in Explanation 1 adding the expenditure relatable to the earnings of capital gains from transactions in securities to the net profit of the foreign company, as per their profit and loss account.

1.2.2 However, the 2015 amendments are only intended to apply prospectively from 1st April 2015 (the financial year 2015-16), which is the assessment year 2016-17; and therefore, do not provide clarity on whether MAT provisions apply to foreign companies. This is clear from the Memorandum to the Finance Bill of 2015, which under the heading "Rationalising the provisions of section 115JB" states as follows:[7]

> *"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 (sic) 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.*

[5] Civil Appeal No. 4559 of 2013, Castleton Investment Ltd. v. Director of Income Tax (International Taxation-I), Mumbai., Mumbai. See also, Moneycontrol.com (2013), 'SC to examine MAT applicability to Mauritian cos', 14 May, Available: http://thefirm.moneycontrol.com/story_page.php?autono=871012 (last accessed: 6 June 2015).
[6] At least five Foreign Portfolio Investors have approached the Bombay High Court through a writ petition opposing the tax levy, according to Economic Times (2015), 'FM Arun Jaitley provides some relief to foreign investors from MAT,' 1 May, Available: http://articles.economictimes.indiatimes.com/2015-05-01/news/61723858_1_fm-arun-jaitley-capital-gains-mat-relief (last accessed: 6 June 2015)
[7] [2015] 371 ITR 292, 334-335.

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….These amendments will take effect from 1st April, 2016 and will, accordingly, apply in relation to the assessment year 2016-17 and subsequent assessment years."

1.2.3 Consequently, FIIs/FPIs may still remain liable for MAT for previous years and tax notices and re-assessment notices have been issued to many of them for MAT liability calculated for the period prior to 2015-16. In fact, these assessments have been challenged by FIIs before various forums.

C. The Constitution of the Committee

1.3.1 The controversy on the applicability of MAT to FIIs prompted the Finance Minister to announce the constitution of a committee to look into direct tax matters on 7th May 2015 in the Rajya Sabha. Consequently, a three-member committee was formed on 20th May 2015, comprising Justice (retd.) A.P. Shah as Chairman and Dr Girish Ahuja and Dr Ashok Lahiri as Members as per Office Memorandum, F.No.133/27/2015-TPL.

1.3.2 The Terms of Reference of the Committee are as follows:[8]

"(i) The Committee, to begin with, will examine the matter relating to levy of MAT on FIIs for the period prior to 01.04.2015. The Committee will examine all the related legal provisions, judicial / quasi judicial pronouncements and such other relevant aspects as it may consider appropriate.
(ii) The Committee is requested to give its recommendations on the above issue expeditiously.
(iii) The Committee will examine other issues as may be referred to it in due course.
(iv) The Committee may interact with various stakeholders as it may deem fit.
(v) The Committee may also invite officers from Department of Revenue including CBDT for consultations/discussions as may be necessary.
(vi) The Committee shall set its own procedure for regulating its work.
(vii) Necessary secretarial, logistic and other assistance to the Committee will be provided by the CBDT.

(viii) The Chairman and two Members of the Committee will function on part time basis and will be paid Rs.5000/- each per sitting.

[8] Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, Government of India, "Office Memorandum: Constitution of a Committee on direct tax matters – regarding," F.No.133/27/2015-TPL, 20th May 2015.

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(ix) The term of the Committee will be for one year or such period as may be notified by the Government from time to time.”

D. The Present Report

1.4.1 The Committee met for the first time on 25th May 2015, and decided to call for responses from stakeholders by 22nd June 2015. In all, it received 22 written responses. Subsequently, the committee invited stakeholders, experts and the CBDT to depose before it between 29th June 2015 and 13th July 2015 in the Conference Room of Law Commission of India. Persons appearing before the Committee included representatives from industry organisations and associations, such as FICCI, CII, PHD Chamber of Commerce and Industry, ASSOCHAM, AMCHAM, ICAI, EBG, Indian Merchants' Chamber and Vidhi Centre for Legal Policy; from CA Firms, such as KPMG, Deloitte, Ernst & Young and PwC; officials from the Central Board of Direct Taxes (**"CBDT"**); and leading eminent Advocates, being Mr. Arvind Datar, Mr. S. Ganesh, Mr. Porus Kaka, Mr. Dinesh Kanabar, Mr. Padam Khincha, Mr. K.K. Chaithanya, Mr. Ajay Vohra, Mr. Pranav Sayta, Mr. Mukesh Butani. Mr. Sohrab E. Dastur, also an eminent Advocate, could not personally appear before the Committee. However, Mr. Dastur filed a detailed written submission.

1.4.2 The Committee would like to place on record its special appreciation for Ms. Sumathi Chandrashekaran and Ms. Vrinda Bhandari, who were appointed as Researchers/Consultants to the Committee and whose assistance was vital and require special mention. The Committee would also like to thank Mr. Ananda Raman S, who acted as Secretary to the Committee and facilitated the hearings very ably.

1.4.3 Thereafter, upon extensive deliberations, discussions and in-depth study, the Committee has given shape to the Report, which was submitted to the Ministry of Finance on 24 July 2015.

1.4.4 Thereafter, the CBDT sought certain clarifications as to the impact of the Committee's Report on foreign companies with a permanent establishment (PE) or place of business in India. In connection with the same, a meeting was held on 20th August 2015 in the Finance Minister's chambers at the Finance Ministry, New Delhi. The meeting was attended by the three members of the Committee, the Finance Minister, the Revenue Secretary, the chairperson of the CBDT and other officials. At the meeting, the Committee clarified that its Report was restricted to the applicability of MAT on FIIs/FPIs, which had no PE or place of busineess in India; and that the Report did not express any opinion with regard to foreign companies with a PE or place of business in India.

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1.4.5 Pursuant to the meeting, the Committee again met and during their discussion, agreed that the Committee’s views and position were clearly mentioned in their Report. Nevertheless, in order to avoid any ambiguity on the issue, the Committee decided to make slight modifications to the Report to make its position amply clear. Accordingly, this amended Report is being submitted to the Finance Ministry on 25 August 2015.

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CHAPTER II

LEGISLATIVE HISTORY OF MAT IN INDIA

A. Section 80VVA, IT Act

2.1.1 MAT was first introduced in India *vide* Section 80VVA of the IT Act through the Finance Act of 1983. The United States of America was the first to introduce such a tax as an 'Alternate Minimum Tax' - through the Tax Reforms Act of 1969 to tax high-income individuals who used tax preferences (exemptions, charities and foreign tax credits) to reduce or eliminate their liability under regular income tax.

2.1.2 As explained above, the origins of MAT lay in an attempt to effectively levy a minimum tax on zero tax companies. As the Finance Minister explained in his Budget speech of 1983, given the prevalence of zero tax companies which were highly profitable and paying high dividends, it seemed "reasonable" that these "*profitable and prosperous companies should contribute at least a small portion of their profits to the national exchequer at a time when others and less better off sections of society are bearing a burden*."[9]

2.1.3 Section 80VVA thus placed a restriction on certain deductions in the case of companies, or in other words, placed a ceiling on allowances and required companies to pay a minimum tax on at least 30% of their profits. The allowances that were unabsorbed in a particular year, due to the restriction, could be carried forward and absorbed in a later year, if there were sufficient profits. The rationale for introducing Section 80VVA can be best gauged from Circular No. 372 dated 8th December 1983 issued by the CBDT, dealing with amendments to the IT Act which stated:

> "***Provision for levy of a minimum tax on companies making profits - Section 80VVA***
> *50.1 Under the existing provisions of the Income-tax Act, certain tax concessions are allowed in the computation of taxable profits. Various concessions are also allowed under Chapter VIA in computing the total income.*
> *50.2 With a view to securing that the aggregate deduction in respect of tax concessions admissible under the Income-tax Act does not result in reducing the total income of companies to nil or a negligible part of the income before the grant of these tax concessions, the Finance Act has*

[9]Budget Speech of the Finance Minister for 1983-84 – Part B, [1983]140 ITR 25, 29 (St), 1983-84.

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inserted a new Chapter VIB, containing section 80VVA, for placing a restriction on certain deductions in the case of companies…..”[10]

2.1.4 Section 80VVA was omitted by the Finance Act, 1987 (from the assessment year 1988-89), which instead introduced section 115J in a modified form.

B. Section 115J, IT Act

2.2.1 Section 115J, as introduced in 1987, levied a minimum tax on the "book profit" of certain companies and was similar to the provision as it exists today. This provision was introduced to address the practices followed by certain companies to avoid the payment of income tax, even though they had the "ability to pay". These companies, which were otherwise making substantial profits and declaring high dividends, were taking advantage of various tax concessions and other incentives in a manner as to avoid paying tax. Section 115J was thus introduced as a "measure of equity".[11]

2.2.2 The then Finance Minister, in his budget speech in 1987-88, said:[12]

> "*80. It is only fair and proper that the prosperous should pay at least some tax. The phenomenon of so-called "zero tax" highly profitable companies deserves attention. In 1983, a new section 80VVA was inserted in the Act so that all profitable companies pay some tax. This does not seem to have helped and is being withdrawn. I now propose to introduce a provision whereby every company will have to pay a minimum corporate tax on the profits declared by it in its own accounts. Under this new provision, a company will pay tax on at least 30% of its book profit. In other words, a domestic widely held company will pay tax of at least 15% of its book profit. This measure will yield a revenue gain of approximately Rs. 75 crores.*"

2.2.3 This legislative intent for introducing Section 115J was reiterated by the Supreme Court in *M/s Surana Steels Pvt Ltd v DCIT*.[13]

[10]Central Board of Direct Taxes, "Finance Act 1983: Amendments to the Income Tax Act", Circular No. 372, 146 ITR (St) 9, 8th December 1983, <http://www.incometaxindia.gov.in/pages/communications/circulars.aspx>.
[11] Circular No. 495, dated 22 September 1987: [1987] 168 ITR (St.) 87.
[12]Budget Speech of Prime Minister and Minister of Finance for 1987-88 – Part B, [1987] 165 ITR (St.) 13, 14.
[13](1999) 4 SCC 306.

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2.2.4 Section 115J, as drafted in 1987, introduced a two-step process. *First,* the assessing authority had to calculate the income of the company. *Second*, the book profit had to be determined. If the income of the assessee company was less than 30% of its book profit, the total income chargeable to tax would be 30% of the book profit. The Explanation to Section 115J(1) explained the calculation of "book profits", which were essentially the net profits shown by the company in its profit and loss account prepared under Part II and Part III of Schedule VI to the Companies Act, 1956. For the purpose of income tax, these book profits were then subject to certain adjustments, in the form of reductions and increases, in accordance with provisions of Section 115J.

2.2.5 Section 115J was amended thrice in 1989, introducing certain exclusions and exemptions,[14] correcting the reference to the accounting year for the purpose of calculating book profits,[15] and making certain changes to the calculation of book profits.[16]

2.2.6 In 1990, the government rationalised the tax structure, and widened the taxable income base. As a result, it was felt that there was no longer any need for section 115J to remain, and it was made inoperative from assessment year 1991-92.[17]

C. Section 115JA, IT Act

2.3.1 The principle of levying tax on zero-tax companies was re-introduced in the form of section 115JA in 1996, because it was found that:[18]

> *"In recent times, the number of zero-tax companies and companies paying marginal tax has grown. Studies have shown that inspite of the fact companies have earned substantial book profits and have paid handsome dividends, no tax has been paid by them to the exchequer*."

---

[14] Circular No. 559, dated 4 May 1990: [1990] l84 ITR St 106: The Direct Tax Laws (Amendment) Act, 1989, which amended section 115J to exclude certain types of profits (export profits, tourism-related profits earned in foreign exchange) and income of certain types of companies (engaged in electricity generation and distribution)

[15] Circular No. 550, dated 1 January 1990: [1990] 183 ITR St 129: The Finance Act, 1989, made it mandatory for all companies to prepare their profit and loss account for the previous year ending 31st March to determine book profits for the purpose of section 115K, even if the company had a different accounting year for the purpose of the Companies Act, 1956. This was done to address certain cases where a large number of companies interpreted the section to mean that if they were following one accounting year for the purpose of the Companies Act, which was different from the accounting year under the Income Tax Act, then section 115J would not apply to them. The Finance Act, 1989, also made other changes to the calculation of book profits, to counter certain tax avoidance practices being followed by companies (pertaining to book profits being reduced by the amount withdrawn from reserves or provisions)

[16] The Direct Tax Laws (Second Amendment) Act, 1989.

[17] Circular No. 572, dated 3 August 1990: [1990] 186 ITR (St) 89.

[18] Circular No. 762, dated 18 February 1998: [1998] 230 ITR (St.) 12.

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2.3.2 Accordingly, the Finance Act (No. 2) of 1996 inserted Section 115JA in the IT Act by way of a levy of a minimum tax on companies that had book profits and paid dividends, but did not pay any taxes. Under this provision, substantially similar to the previously abandoned Section 115J, companies whose total income (under the IT Act) was less than 30% of their book profits (under the Companies Act) would have to pay tax on 30% of their book profits. Therefore, 30% of the book profits would be deemed as taxable income. In case the total income was more than 30% of the book profit, tax would be charged on that total income. As with Section 115J, book profits were defined under the Explanation to section 115JA(2), which also detailed the deductions and adjustments to be made for the purpose of calculating book profits.[19]

2.3.3 The Finance Act of 1997, created a tax credit scheme under which the MAT paid could be carried forward or set-off against regular tax payable during the subsequent five-year period, subject to certain conditions.[20]

2.3.4 The Finance Act of 2000, made Section 115JA inoperative with effect from 1st April, 2001 and inserted a new provision, the currently applicable Section 115JB, in its place. As the Explanatory Memorandum for the Finance Bill of 2000 noted, a sunset clause was introduced in respect of Section 115JA because the "*efficacy of the existing provision ha[d] declined in view of the exclusions of various sectors from the operation of MAT and the credit system.*[21] There was also concern that the existing provision had led to legal complications.

D. Section 115JB, IT Act

2.5.1 Section 115JB was thus envisaged by the Explanatory Memorandum for the Finance Act of 2000 as a new provision, which was "simpler in application".[22] Under this version, all companies having book profits under the Companies Act, prepared in accordance with Schedule VI, would be liable to pay MAT at the flat rate of 7.5%,[23] as against the previously existing effective rate of 10.5% of the book profits.[24] Currently, Section 115JB provides

[19] Circular No. 762, dated 18 September 1998: [1998] 230 ITR (St.) 12
[20] Circular No. 763, dated 18 September 1998: [1998] 230 ITR (St.) 54
[21] Circular No. 794, dated 9 August 2000, [2000] 245 ITR (St.) 21.
[22][2000] 242 ITR (St.) 117, 138.
[23] Circular No. 794, dated 9 August 2000: [2000] 245 ITR (St.) 21
[24] The effective rate of 10.5% was calculated by multiplying 30% of the book profits with the prevailing corporate tax rate of 35% (applicable to domestic companies). Here, the "effective rate" refers to the rate for domestic companies. This is because the prevailing rate of tax applicable to foreign companies was 48% (in which case, the effective rate would have been 14.4%, and not 10.5%).

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that MAT shall be levied at 18.5% of the book profits in case the tax as per the normal provisions in the Act is less than 18.5% of the book profits.

2.5.2 Section 115JB, as drafted in 2000, was applicable to all corporate entities, and there was to be no credit for MAT paid. The remaining scheme of Section 115JB, particularly regarding the definition and method of calculation of book profits, was substantially similar to its earlier versions; although it was amended from time to time.[25] The tax credit scheme was later changed by the Finance Act, 2006, under which companies could carry forward and set off the tax paid under MAT for a limited number of years (till 2009, this period was seven years, after which, the Finance Act of 2009 increased it to ten years).[26]

2.5.3 The Finance Act of 2006, increased the flat rate of MAT from 7.5% to 10%, and made other changes to "book profits" under the Explanation to Section 115JB(2). One of these changes was to ensure that income by way of long-term capital gains of a company (otherwise excluded from total income) would be taken into account for computing book profits under section 115JB and for tax payment under that section.[27]

2.5.4 The MAT rates over the last seven years have been increasing, as can be gleaned from the table below:

Table 2.1: Increase in the MAT rate from the Assessment Year 2009-10 to 2015-16

Assessment Year	MAT Rate
2009-10	10%
2010-11	15%
2011-12	18%
2012-13	18.5%
2013-14	18.5%
2014-15	18.5%
2015-16	18.5%

2.5.5 The scheme of Section 115JB, reproduced below, can be broadly divided into two parts – *first*, sub-section (1) which is the charging section and requires MAT to be payable on book profits of the company (assessee). *Second*, sub-section (2) requires every assessee-company to prepare its profit and loss account for the relevant year in accordance with Part II of Schedule VI of the Companies Act of 1956, with Explanation 1 defining "book profits". The

[25] See Circular No. 8/2002, dated 21 August 2002: [2002] 258 ITR (St.) 131; Circular No. 1, dated 27 March 2009: [2009] 310 ITR (St.) 42; and Circular No. 5, dated 3 June 2010: [2010] 324 ITR (St.) 293

[26] Circular No. 5, dated 3 June 2010: [2010] 324 ITR (St.) 293

[27] Circular No. 14, dated 28 December 2006: [2007] 288 ITR (St.) 9

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first proviso stipulates that while preparing accounts, the same accounting policies and standards will be adopted, as are used for preparing accounts laid before a company at its Annual General Meeting (**"AGM"**) under Section 210 of the Companies Act, 1956.

2.5.6 Section 115JB, as it currently stands after the 2015 amendment, reads as follows:

> ***Special provision for payment of tax by certain companies.***
> ***115JB.*** *(1) Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2012, is less than eighteen and one-half per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of eighteen and one-half per cent.*
> *(2) Every assessee,—*
> *(a) being a company, other than a company referred to in clause (b), shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI to the Companies Act, 1956 (1 of 1956); or*
> *(b) being a company, to which the proviso to sub-section (2) of section 211 of the Companies Act, 1956 (1 of 1956) is applicable, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of the Act governing such company:*
>
> ***Provided*** *that while preparing the annual accounts including profit and loss account,—*
> *(i) the accounting policies;*
> *(ii) the accounting standards adopted for preparing such accounts including profit and loss account;*
> *(iii) the method and rates adopted for calculating the depreciation,*
> *shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act, 1956 (1 of 1956) :*
>
> ***Provided further*** *that where the company has adopted or adopts the financial year under the Companies Act, 1956 (1 of 1956), which is different from the previous year under this Act,—*

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(i) the accounting policies;
(ii) the accounting standards adopted for preparing such accounts including profit and loss account;
(iii) the method and rates adopted for calculating the depreciation,
shall correspond to the accounting policies, accounting standards and the method and rates for calculating the depreciation which have been adopted for preparing such accounts including profit and loss account for such financial year or part of such financial year falling within the relevant previous year.

Explanation [1].—For the purposes of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (2), as increased by—

(a) *the amount of income-tax paid or payable, and the provision therefor; or*
(b) *the amounts carried to any reserves, by whatever name called, other than a reserve specified under section 33AC; or*
(c) *the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or*
(d) *the amount by way of provision for losses of subsidiary companies; or*
(e) *the amount or amounts of dividends paid or proposed ; or*
(f) *the amount or amounts of expenditure relatable to any income to which section 10 (other than the provisions contained in clause (38) thereof) or section 11 or section 12 apply; or*
(fa) the amount or amounts of expenditure relatable to income, being share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86; or
(fb) the amount or amounts of expenditure relatable to 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 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); or
(fc) the amount representing notional loss on transfer of a capital asset, being share of a special purpose vehicle, to a business trust in exchange of units allotted by the trust referred to in clause (xvii) of section 47 or the amount representing notional loss resulting from any change in carrying amount of said units or the amount of loss on transfer of units referred to in clause (xvii) of section 47; or
(g) *the amount of depreciation,*

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(h) *the amount of deferred tax and the provision therefor,*

(i) *the amount or amounts set aside as provision for diminution in the value of any asset,*

(j) *the amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset,*

(k) the amount of gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be;

if any amount referred to in clauses (a) to (i) is debited to the profit and loss account or if any amount referred to in clause (j) is not credited to the profit and loss account, and as reduced by,—

(i) the amount withdrawn from any reserve or provision (excluding a reserve created before the 1st day of April, 1997 otherwise than by way of a debit to the profit and loss account), if any such amount is credited to the profit and loss account:

***Provided** that where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below the second proviso to section 115JA, as the case may be; or*

(ii) the amount of income to which any of the provisions of section 10 (other than the provisions contained in clause (38) thereof)or section 11 or section 12 apply, if any such amount is credited to the profit and loss account; or

(iia) the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets); or

(iib) the amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (iia); or

(iic) the amount of income, being the share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any, such amount is credited to the profit and loss account; or

(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

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(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); or

(iie) the amount representing,—

(A) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47; or

(B) notional gain resulting from any change in carrying amount of said units; or

(C) gain on transfer of units referred to in clause (xvii) of section 47, if any, credited to the profit and loss account; or

(iif) the amount of loss on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be; or";

(iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account.

Explanation.—For the purposes of this clause,—

(a) the loss shall not include depreciation;

(b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil; or

(iv) to (vi) [***]

(vii) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

Explanation.—For the purposes of this clause, "net worth" shall have the meaning assigned to it in clause (ga) of sub-section (1) of section 3 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986); or

(viii) the amount of deferred tax, if any such amount is credited to the profit and loss account.

Explanation 2.—For the purposes of clause (a) of Explanation 1, the amount of income-tax shall include—

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(i) any tax on distributed profits under section 115-O or on distributed income under section 115R;
(ii) any interest charged under this Act;
(iii) surcharge, if any, as levied by the Central Acts from time to time;
(iv) Education Cess on income-tax, if any, as levied by the Central Acts from time to time; and
(v) Secondary and Higher Education Cess on income-tax, if any, as levied by the Central Acts from time to time.

Explanation 3.—For the removal of doubts, it is hereby clarified that for the purposes of this section, the assessee, being a company to which the proviso to sub-section (2) of section 211 of the Companies Act, 1956 (1 of 1956) is applicable, has, for an assessment year commencing on or before the 1st day of April, 2012, an option to prepare its profit and loss account for the relevant previous year either in accordance with the provisions of Part II and Part III of Schedule VIto the Companies Act, 1956 or in accordance with the provisions of the Act governing such company.

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.

(3) Nothing contained in sub-section (1) shall affect the determination of the amounts in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of sub-section (2) of section 32 or sub-section (3) of section 32A or clause (ii) of sub-section (1) of section 72 or section 73 or section 74 or sub-section (3) of section 74A.

(4) Every company to which this section applies, shall furnish a report in the prescribed form from an accountant as defined in the Explanation below sub-section (2) of section 288, certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income filed under sub-section (1) of section 139 or along with the return of income furnished in response to a notice under clause (i) of sub-section (1) of section 142.

(5) Save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company, mentioned in this section.

(5A) The provisions of this section shall not apply to any income accruing or arising to a company from life insurance business referred to in section 115B.

(6) The provisions of this section shall not apply to the income accrued or arising on or after the 1st day of April, 2005 from any business carried

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on, or services rendered, by an entrepreneur or a Developer, in a Unit or Special Economic Zone, as the case may be:

***Provided** that the provisions of this sub-section shall cease to have effect in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2012."*

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CHAPTER III

LEGAL REGIME GOVERNING FIIS AND FPIS IN INDIA

A. FIIs in India

3.1.1 With the launch of economic reforms in 1991, the policy of self-reliance and import substitution was replaced a policy of external openness and of trying to harness foreign investment – both direct and of the portfolio variety – to augment growth through higher investments. Following the Report of the High Powered Committee on Balance of Payments, from September 14, 1992, with suitable restrictions, FIIs or Foreign Institutional Investors, and Overseas Corporate Bodies were permitted to invest in financial instruments. The policy framework for permitting such investments was provided in the Government of India's Press Note dated September 14, 1992. FIIs seeking to invest in India are required to be registered with the Securities and Exchange Board of India (SEBI) and conform to SEBI Guidelines. For attracting portfolio inflows, FIIs were granted a concessional flat tax rate of 20% on dividend and interest income, 10% tax rate on long-term capital gains and a 30% tax rate on short-term capital gains

3.1.2 FIIs were first allowed to invest in all the securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India and in the schemes floated by domestic mutual funds. But, the holding of a single FII and of all FIIs, Non-resident Indians (NRIs) and OCBs in any company were subject to the limit of 5 per cent and 24 per cent of the company's total issued capital, respectively. Furthermore, funds invested by FIIs had to have at least 50 participants with no one holding more than 5 per cent to ensure a broad base and preventing such investment acting as a camouflage for individual investment in the nature of FDI and requiring Government approval.

3.1.3 Initially the idea of allowing FIIs was that they were broad-based, diversified funds, leaving out individual foreign investors and foreign companies. The years since 1992 have seen a gradual liberalisation of the policy towards portfolio investments by foreign entities, including the FIIs.[28] FIIs were allowed to open subaccounts for foreign corporates, foreign individuals, broad based funds or portfolios established or incorporated outside India, after due registration with SEBI, and make investments on their behalf. Qualified Financial Investors (QFIs) were also allowed to come in. The liberalisation has involved the streamlining of SEBI registration procedures, allowing FIIs to

[28] OCB investments through the portfolio route have been banned since November, 2001.

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invest in debt securities and relaxation of ceilings on FII investment, together with implementation of Know Your Client (KYC) guidelines. To harmonize the various available routes for foreign portfolio investment in India, namely FIIs, QFIs and sub-accounts of FIIs, SEBI, by a notification dated January 7, 2014, introduced a new class of foreign investors known as the Foreign Portfolio Investors ("FPIs"). This class includes FIIs, QFIs and subaccounts of FIIs.

3.1.4 Foreign portfolio investment has increased over time and become an important source of augmenting investment in the economy (Table 2). [29]

Table 3.1: FII/FPI Investments from 1992-93 to 2015-16 (in rupees crore)

Financial Year	Equity	Debt	Total
1992-93	13	0	13
1993-94	5,127	0	5,127
1994-95	4,796	0	4,796
1995-96	6.942	0	6,942
1996-97	8,546	29	8,575
1997-98	5,267	691	5,958
1998-99	-717	-867	-1,584
1999-00	9,670	453	10,122
2000-01	10,207	-273	9,933
2001-02	8,072	690	8,763
2002-03	2,527	162	2,689
2003-04	39,960	5,805	45,765
2004-05	44,123	1,759	45,881
2005-06	48,801	-7,344	41,467
2006-07	25,236	5,605	30,840
2007-08	53,404	12,775	66,179
2008-09	-4,77,606	1,895	-45,811
2009-10	1,10,221	32,438	1,42,658
2010-11	1,10,221	36,317	1,46,438
2011-12	43,738	49,988	93,726
2012-13	14,033	28,334	1,68,367
2013-14	79,609	-28,060	51,649
2014-15	1,11,333	1,66,127	2,77,461
2015-16 (till 12.7.15)	5,776	-2,250	3,526
Total	**8,25,199**	**3,04,284**	**11,29,480**

Source: "FPI/FII Investment Details: Financial Year", https://www.fpi.nsdl.co.in/web/Reports/Yearwise.aspx?RptType=5.

3.1.5 FIIs or FPIs are foreign entities who typically invest directly in Indian equity and debt securities from overseas after meeting the Securities

[29] Many stakeholders have submitted that there has been a recent reduction of investment by FPIs, possibly on account of the levy of MAT and the resultant uncertainty.

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and Exchange Board of India's (**"SEBI"**) eligibility criteria and registering under the SEBI (Foreign Portfolio Investors) Regulations, 2014, which repealed SEBI's (Foreign Institutional Investor) Regulations, 1995.

3.1.6 Since FIIs do not have any physical presence in India – either by way of an office or fixed place, whether rented or owned, or by way of employees or dependent agents – they open cash and custody accounts with their bankers and custodians in India. To do this, FIIs engage the services of Indian stockbrokers (independent agents), who transact on the Indian bourses, and issue instructions to them directly from overseas. Notably therefore, FIIs take their investment/disinvestment, remittance and withdrawal decisions from outside India and arrange for trade instructions to its global custodian, who then issues the same instructions to the local custodian in India – an independent broker – in whose accounts the funds for the settlement of trades are debited and credited.

B. FIIs/FPIs and SEBI Regulations

3.2.1 Regulation 2(g) of the SEBI (FPI) Regulations, 2014 defines an FII as institutions registered under the SEBI (FII) Regulations, 1995, where they have been defined as an institution established or incorporated outside India that proposes to make investment in Indian securities. Regulation 2(h) defines an FPI as a person satisfying the eligibility criteria under Regulation 4 and registered under Chapter II of the Regulations, deemed as an intermediary.[30]

3.2.2 The 2014 Regulations were introduced to rationalise foreign investments in India, whether by FPIs or qualified foreign investors and to put in place a framework for registration and other procedures. They were accompanied by SEBI's Operational Guidelines for Designated Depository Participants, Circular CIR/IMD/FIIC/02/2014 dated 8th January 2014[31] to put in place a scheme for Designated Depository Participants to grant registrations to FPIs on behalf of SEBI and carry out other allied activities.

3.2.3 Regulation 5 of the SEBI (FPI) Regulations of 2014 introduces three categories of FPIs. Category I FPIs include Government and Government related investors such as Central Banks, Governmental agencies, sovereign wealth funds and international or multilateral organisations or agencies. Category II includes: -

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[30]Regulation 2(h) of the 2014 regulations deems an FII or a qualified foreign investor with a valid certificate of registration as an FPI for a period of three years for which fees have been paid as per the SEBI Regulations of 1995.

[31] http://www.sebi.gov.in/cms/sebi_data/attachdocs/1389173830887.pdf

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(i) Appropriately regulated broad based funds such as Mutual Funds, Investment trusts, Insurance/ Reinsurance Companies;
(ii) Appropriately regulated entities such as Banks, Asset Management Companies, investment/portfolio managers etc.;
(iii) Broad based funds that are not appropriately regulated, but whose investment manager is regulated;
(iv) University Funds and Pension Funds; and
(v) University related endowments already registered with the SEBI as FIIs/ sub-account

3.2.4 Category III FPIs include all other FPIs that are not eligible under the above two Categories, such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

3.2.5 Chapter V of the Regulations further stipulates the general obligations and responsibilities of an FPI. These include certain general obligations such as the need to obtain a PAN number or submitting certain information etc. (Regulation 23), the appointment of a custodian of securities (Regulation 26), appointment of designated bank (Regulation 27), appointment of compliance officer (Regulation 28), investment advice in publicly accessible media (Regulation 29), and maintenance and preservations of proper books of accounts, records and documents (Regulations 30 and 31).

3.2.6 These are similar to Chapter IV of the 1995 Regulations (relevant for the assessment years under consideration in this Report), which prescribed the general obligations and responsibilities of FIIs. Those included the appointment of a domestic custodian (Regulation 16), the appointment of a designated bank (Regulation 17), investment advice in publicly accessible media (Regulation 17A), maintenance and preservation of proper books of accounts, records etc. (Regulations 18 and 19), the appointment of a compliance officer (Regulation 19A) and information to the Board or RBI as required (Regulation 20).

C. FIIs/FPIs and the IT Act

3.3.1 Before proceeding to explain the taxation regime, as applicable to FIIs/FPIs, it is useful to provide a snapshot of this regime in a tabular form (Table 3).

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Table 3.2: Snapshot summary of taxability of FIIs/FPIs under Section 115AD of the IT Act

Source of Income of FIIs/FPIs	Taxability under the IT Act	Relevant Provisions of the IT Act
Dividend Income	Exempt	Section 115AD r/w Section 10(34)
Interest	• 5% concessional rate for government and specified corporate debt securities -coupon bonds • 20% for other interest income	• Section 115AD r/w Section 194LD • Section 115AD
Long Term Capital Gains ("**LTCG**")	• Exempt where LTCG arises from transfer of securities subject to securities transaction tax (listed equity shares) • 10% on other LTCG	• Section 10(38) • Section 115AD
Short Term Capital Gains ("**STCG**")	• 15% where STCG arises from transfer of securities subject to securities transaction tax (listed equity shares) • 30% on other STCG	• Section 115AD r/w Section 111A • Section 115AD

(i) <u>Section 115AD of the IT Act</u>

3.3.2 Section 115AD of the Act provides for a special regime to specifically deal with the tax on income of FIIs from securities or capital gains arising from their transfer. The section was brought in *vide* the Finance Act of 1993 (when FIIs were first permitted to invest in India) with the intention of granting preferential tax treatment to foreign investors to encourage investment and has been consistently applied to FIIs over the last 23 years. Section 115AD can thus be said to be a complete code in itself as far as FIIs/FPIs are concerned.

3.3.3 The genesis of Section 115AD lies in the old Government Guidelines issued through a Press Note dated 14th September 1992, which laid down a specific scheme to permit FIIs registered with SEBI to invest in the Indian capital markets at concessional tax rates.[32] Its legislative basis,

[32] Press Note dated 4th September 1992; [1992] 197 ITR (St.) 173. Under these Old Government Guidelines, FIIs investing under the scheme would benefit from a concessional flat tax rate of 20% on dividend and interest income, 10% tax rate on long term capital gains and a 30% tax rate on short term capital gains.

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however, is best explained by Circular No. 657 the Memorandum to the Finance Act, 1993:[33]

"*38. While presenting the Budget for 1992-93, the Finance Minister had stated that ways would be considered of allowing reputable foreign investors to invest in the country's capital markets. In pursuance of this announcement, guidelines had been issued through a Press Note, dated 14th September, 1992 for such investment by Foreign Institutional Investors. Income from such investment was to be taxed at concessional rates. Accordingly, a new section 115AD has been inserted in the Income Tax Act relating to tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer*." [*Emphasis supplied*]

3.3.4 In *Universities Superannuation Scheme,*[34] the AAR ruled that Section 115AD is a self-contained code for determining the tax on incomes of FIIs. Thus, it was held that FIIs cannot opt out of the provisions of Section 115AD in favour of general provisions for computing capital gains. Thus, the assessee was not entitled to the benefit of indexation available to other assessees whose income is taxed under Sections 45 and 48 of the Act as capital gains. The idea of the special provisions of Section 115AD overriding the general provisions of the IT Act have also been followed in *Platinum Asset Management Ltd and Ors v Assessee*,[35] which held that if a particular item of income was covered under Section 115AD, it would be governed by the prescription of that section alone. Similarly, in *LG Asian Plus Ltd*,[36] the Delhi Bench of the Income Tax Appellate Tribunal (**"ITAT"**) held that the tax on the income from the transfer of securities by an FPI should be charged on the income arising from the transfer of such securities alone.

3.3.5 Section 115AD also assumes relevance in the context of tax credit, set offs and carry forward provisions, which will be discussed in further detail in Chapter V.

3.3.6 However, while Section 115AD prescribes a 15% tax rate for short-term capital gains and exempts tax for long-term capital gains in cases of FIIs/FPIs investing in listed equity shares, Section 115JB of the IT Act imposes

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[33] Circular No. 657, "Finance Act, 1993", (1993) 114 CTR (St) 1, 30th August 1993, <http://www.incometaxindia.gov.in/pages/communications/circulars.aspx>. This has been expressly referred to by the ITAT, Mumbai 'L' Bench in *Advantage Advisors Inc. v Deputy Director of Income Tax (International Taxation)*, [2010] 6 ITR 235.

[34][2005] 275 ITR 434 (AAR). Also, see *Royal Bank of Canada, In Re.*, [2010] 323 ITR 380 (AAR)

[35]ITA No. 7317/M/2008, ITAT, Mumbai Bench. Also see 61 SOT 119.

[36]46 SOT 159 ITAT, Delhi Bench.

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a higher tax rate of 18.5%. In practice, this means that the MAT credit can never be effectively utilised and the benefits of the special concessional tax regime under Section 115AD lose relevance.

3.3.7 Sub-clause (iid) of sub-section (2) of Section 115JB, introduced *vide* the 2015 amendment, seeks to allay this problem; although, only as long as the tax rate under Section 115AD "is at a rate less than" the applicable MAT rate.

(ii) <u>Section 2(14) of the IT Act</u>

3.3.8 Pertinently, for the applicability of Section 115AD (and long-term and short-term capital gains tax rates), the gains from investment in Indian securities by FIIs/FPIs have always been treated as "capital gains". Although such an interpretation has been accepted by the Revenue over the years, this position has been confirmed by the 2014 amendment to Section 2(14) of the Act. The Finance Act of 2014 amended the definition of "capital asset" in Section 2(14) of the Act and inserted sub-clause (b) to include any securities held by an FII, which has invested in such securities in accordance with the SEBI Regulations. Accordingly, the gains arising to the FIIs/FPIs from the disposal of such capital assets are required to be considered "capital gains" and subject to the tax regime under Section 115AD of the IT Act.

D. FIIs and the Companies Act

3.4.1 While "company" under Section 2(17)(ii) of the IT Act includes a foreign company "unless the context otherwise requires", Section 2(10) read with Section 3 of the Companies Act, 1956 defines a "company" as one which has been formed and registered under the Act of 1956 or an existing company, as defined in clause (2) of Section 3. Part XI of the Companies Act, 1956, Sections 591 to 602, deal specifically with foreign companies, [37] namely companies incorporated outside India which establish a place of business within India; or have already established a place of business within India and continue to have an established place of business within India. This difference in the treatment of foreign companies under both the laws has led to the recent controversy of the applicability of Section 115JB of the IT Act to foreign companies and will be dealt with in the Chapter V of this Report.

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[37] It is pertinent to note that although the Companies Act, 1956 does not define the term "foreign companies", Section 2(42) of the Companies Act, 2013 defines a "foreign company" as any company or body corporate incorporated outside India, which has a place of business in India and conducts any business activity in India in any other manner.

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(i) Section 591 read with Section 594 of the Companies Act, 1956

3.4.2 Section 591 read with Section 594 of the Companies Act dealing with "companies incorporated outside India" obligates every foreign company with a "place of business"[38] within India to prepare its balance sheet and profit and loss account in accordance with the provisions of the Act, as if it were an Indian company. Evidently therefore, the Companies Act intended to completely exclude companies incorporated outside India with no place of business in India – such as FIIs/FPIs – from its purview and impose no requirement of preparing accounts. Notably, the new Companies Act 2013 incorporates the same scheme under Section 2(42) (on the definition of "foreign company") read with Sections 381 (on accounts of foreign company) read with the Companies (Registration of Foreign Companies) Rules 2014. Under this, foreign companies are defined as companies with a place of business and conducting business activity in India and are required to make out a balance sheet and profit and loss account in the prescribed format.

(ii) Section 210 read with Section 166 of the Companies Act, 1956

3.4.3 For the purpose of this section, it is pertinent to note that Section 115JB(2) of the IT Act is the computation provision requiring every company to prepare its profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI to the Companies Act, 1956. The first proviso stipulates that the accounting policies, standards etc. prepared by the company have to be the same, as have been adopted for the purpose of preparing such accounts and laid before the company at its AGM under Section 210 of the Companies Act, 1956. Notably, Section 210 (on annual accounts and balance sheet) read with Section 166 (on AGMs) of the Companies Act requires every "company" as defined under the Companies Act to lay its balance sheet and profit and loss account at every AGM held annually. This thus excludes foreign companies.

E. FIIs/FPIs and Double Taxation Avoidance Agreements

3.5.1 Section 90(2) of the IT Act provides a non-resident assessee with the option of being governed by the provisions of the IT Act or the applicable tax treaty, whichever is more beneficial. Many treaties, such as the Indo-Mauritius Double Taxation Avoidance Agreement (**"DTAA"**), exempt assessees from any capital gains tax, which the FIIs/FPIs are entitled to avail. This becomes relevant in the context of the present controversy insofar as it has been argued that levying MAT on capital gains earned by an FII/FPI, even when it is exempt from such tax under the applicable tax treaty, denies the assessee treaty benefits and is incorrect.

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[38] Section 602(c) of the Companies Act, 1956 defines "place of business" as including a share transfer or a share registration office.

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3.5.2 In most DTAAs, capital gains are taxable in India or in both countries. However, in countries such as Mauritius, Singapore, Netherlands, Korea and Cyprus, capital gains are taxed in the country of residence. These countries do not have any capital gains tax; therefore, effectively, capital gains may be zero for a company residing in one of these countries covered under a DTAA. If the nature of income is business income, then such income will be taxable in India only if the FIIs have a permanent establishment (**"PE"**) in India.

3.5.3 It is also important to consider FIIs/FPIs from non-exempt jurisdictions such as the United States and the United Kingdom, where the tax treaty does not prescribe any tax rate for capital gains and does not contain any MAT provisions. In such cases, questions arise on the applicability of the provisions of the entire IT Act (including Section 115JB) or only those specifically relating to capital gains (such as Section 115AD) as mentioned in the treaty.

3.5.4 The inter-relation between Section 115JB and Section 90 in the context of DTAAs and non-exempt jurisdictions will be discussed in Chapter V later.

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CHAPTER IV

ANALYSIS OF THE RELEVANT JUDICIAL DECISIONS

4.1 Before analysing the relevant rulings of the AAR on the applicability of MAT to foreign companies, it is important to refer to Section 245S of the IT Act, which states that the orders of the AAR are only binding on the applicant in respect of the transaction in relation to which the ruling is sought and on the jurisdictional Commissioner of the applicant. AAR rulings are thus not intended to lay down the law on the matter and are, in fact, not even binding on the Commissioner in respect of another taxpayer within their jurisdiction. The Supreme Court, in *Columbia Sportswear v Director of Income Tax, Bangalore*,[39] clarified that the advance ruling of the Authority is only binding on the particular transaction before it, although it can have persuasive value in respect of other parties. However, it stated that this did not mean that a principle of law laid down in particular case would not be followed in the future.

A. AAR and ITAT Rulings on MAT

(i) *P. No. 14*, [1998] 234 ITR 335 (AAR)

4.2.1 This was the first case to discuss the issue of MAT and held that MAT was applicable to a foreign company, incorporated in the Netherlands, *having* a presence, through its project office, in India.

4.2.2 In the present case, while the management and control of the company were maintained in the Netherlands, the applicant had to maintain its accounts in relation to its projects in India in accordance with Parts II and III of Schedule VI of the Companies Act, 1956. It was also filing annual returns of income based on the statements of assets and liabilities and revenue and expenses for its Indian projects. The applicant sought to determine whether, as a foreign company, the profits attributable to its PE in India were liable to be taxed under Section 115JA of the IT Act.

4.2.3 In effect, the question before the AAR was whether Section 115JA would apply to any "company" under Section 2(17) of the Act, including a foreign company.

4.2.4 Expounding on the rationale for introducing MAT as being to tax "zero tax companies", the AAR ruled that the MAT provisions were applicable to all companies defined under Section 2(17) of the IT Act, including foreign

[39] [2012] 34 ITR 161 (SC).

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companies. It observed that the applicability of Section 115JA did not depend on whether a company was an Indian or foreign company or whether it been given depreciation allowance or made dividend payments. In fact, it was not even held necessary for every provision for the calculation of book profits *vide* Explanation to Section 115JA to apply, since some of the provisions may not be applicable even to Indian companies. The provisions needed to be applied only to the extent applicable and there was no reason to presume that Parliament did not intend Section 115JA to apply to foreign assessees.

4.2.5 The argument that a foreign company did not have to show its entire book profits for taxation in India and had to show only the profits of only the Indian part of its business was also rejected. A foreign company with an established place of business in India was required to prepare accounts in accordance with provisions of Section 594 read with Section 209 of Companies Act. This, then, attracted the charge under Section 115JA. Further, no "special difficulty" was perceived in determining the book profit of the foreign company in its Indian business, as required by the India-Netherlands DTAA.

4.2.6 In relation to Article 7 of the DTAA, the AAR held that it would only limit the quantum of taxable income of the assessee, who still remained liable to pay tax on its business profits attributable to its PE in India. Thus, the DTAA did not prevent a foreign company from falling outside the purview of Section 115JA.

(ii) *Niko Resources Ltd.* [1998] 234 ITR 828 (AAR)

4.2.7 The applicant was a foreign company incorporated in Canada, engaged in the business of exploration and development of oil and gas fields. It had entered into a production-sharing contract with the government. It was claiming entitlement to the special deduction benefits under Section 42 of the IT Act[40] before calculating book profits as per Section 115JA; and that Section 42 had an overriding effect on the more general Section 115JA, which anyway did not apply to it.

4.2.8 The AAR held that Section 42 of the IT Act cannot override Section 115JA, which was a self-contained code that would apply notwithstanding any other provision in the Act.[41] Section 115JA was designed to introduce a legal fiction to tax on assessee's total income, and not their business income. Section 115A stood on a different footing from Section 293A

[40]Section 42 provides for special provision for deductions in the case of business for prospecting, etc., for mineral oil.

[41] The AAR further noted that deduction under Section 42 is allowable only when business income is computed under the head "profits and gains from business or profession".

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of the IT Act[42] altogether and its scope and effect could not be cut down by Section 293A. Thus, no allowance or deduction was permissible under any other section of the Act.

4.2.9 The AAR further observed that Section 115JA did not contain a machinery for the computation of business income or total income of an assessee and only provided a "rough and ready formula". It also relied on the non-obstante clause in Section 115JA to reach its conclusion.

(iii) *Dresdner Bank AG v ACIT*, [2006] 108 ITD 375 (Mumbai)

4.2.10 The assessee-appellant was a non-resident banking company incorporated in Germany and operating in India through its branch office in Mumbai. The Indian branch had provided an inter-unit loan to other PEs and its head office. Subsequently, its interest in respect of such funds was assessed by the Department.

4.2.11 Before the Tribunal, the assessee clarified that it was not seeking the benefit of the treaty and was instead disputing the taxability of interest income earned by the branch. The assessee also questioned the applicability of Section 115JA of the IT Act, given that it was a foreign company and argued legislative omission in failing to specifically clarify that Section 115JA excluded foreign companies.

4.2.12 The Mumbai Bench of the ITAT rejected the assessee's contentions based on its reliance on *P. No. 14 of 1997* to hold that Section 115JA "in principle" applied to foreign companies as well. It further dismissed the arguments regarding legislative intent on the basis that it could not supply the *casus omissus*, as claimed by the assessee, especially since the language was clear. Such an omission could be remedied only by legislative action, and not judicial interpretation.

(iv) *The Timken Company*, [2010] 326 ITR 193 (AAR)

4.2.13 The applicant was a company incorporated in USA and engaged in the business of manufacture of bearings, alloys, etc. It was initially a joint venture between Timken USA with TISCO and later bought the shareholding from TISCO, subsequent to which the company undertook a maiden public issue in 1991. In 1992, it started commercial production. Subsequently, Timken USA acquired equity shares of the company from TISCO under Indian law. Timken India was listed on the Bombay Stock Exchange. The Applicant wanted

[42] Section 293A of the IT Act deals with the power to make exemption, etc., in relation to participation in the business of prospecting for, extraction, etc., of mineral oils.

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to transfer its holdings in Timken India (which had been held for more than 12 months) through the BSE to Timken Mauritius as part of its global re-structuring. Notably, it did not have a place of business or PE in India.

4.2.14 It therefore sought an advance ruling from the AAR on four questions. *First,* whether the provisions of Section 115JB were applicable only to domestic Indian companies? *Second,* If not, whether Section 115JB was applicable only to such foreign companies that had a physical business presence in India? *Third*, given that the applicant was a foreign company without any physical presence or PE (in terms of the DTAA) in India, whether Section 115JB was applicable on its sale of shares of a listed company, Timken India Ltd, which had suffered securities transaction tax and was accordingly, tax exempt under Section 10(38)? *Finally*, if Section 115JB was applicable, whether the payments made by it on the sale of shares would suffer any withholding tax under Section 195 of the Act, and if so, how much?

4.2.15 The applicant attempted to rely on the context in which the word "company" was used in Section 115JB, in light of the opening paragraph in Section 2 ("unless the context otherwise so requires") to argue that the reference to "company" in Section 115JB was only to an Indian company, notwithstanding that company included foreign company under Section 2(17). It took support from various CBDT circulars, extracts of speeches by the Finance Minister, Notes on Clauses and Memorandums attached to the Finance Bill. Conversely, the Department sought to rely on the definition of "company" under the IT Act as including foreign company and the wordings of Section 115JB being applicable to "any company". Other arguments were made regarding the requirement/difficulty of computation of book profits under Section 115JB(2), the different adjustments and deductions made in pursuance of the same, and the requirement for a foreign company to hold an AGM.

4.2.16 This three judge bench of the AAR distinguished its previous ruling in *P. No. 14 of 1997* and clearly held that MAT provisions would not be applicable on a foreign company that *had no* physical presence, in the form of an office or branch, or a PE in India. Thus, the provisions of Section 115JB of the Act were not applicable on the sale of shares of a listed company, Timken India Limited, by the applicant, which has suffered securities transaction tax and was thus, tax exempt under Section 10(38).

4.2.17 The AAR distinguished *P. No. 14 of 1997* in the following words:

> "*In the above-referred case the applicant was doing business and had a PE in India. Its income was being assessed under the head "income from business and profession". It was required to maintain accounts under section 44AA of the IT Act and prepare accounts under section 594 of*

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the Companies Act, 1956. However, under section 591 of the Companies Act, only such foreign companies, who have established a place of business within India, are required to make out a balance sheet and P&L Account as required under section 594 of the Companies Act. In the case referred supra, as it had a place of business by way of a PE in India, it was required to comply with Section 594 as if it was a company within the meaning of Companies Act, 1956. In order therefore to comply with the requirement under section 115JA(2) to prepare P&L Account in accordance with the provisions of Part II and III of Schedule VI of the companies Act, 1956, it is essential that the foreign company should have a place of business within India. Therefore, while giving ruling in the case referred supra, there was no reason to look into the applicability of section 594 read with section 591. In the present case as the applicant does not have an established place of business in India, its preparation of P&L Account in accordance with the provisions of Part II & III of Schedule VI of the Companies Act cannot be complied. This is the sine-qua non to comply with the provision under section 115JA."

4.2.18 In reaching its decision, the AAR adopted a contextual interpretation of Section 115JB of "company" as excluding foreign company, based on the history of MAT provisions and the unworkability of Section 115JB(2) if it were to apply to foreign companies. Holding that the law had to be read harmoniously as part of one larger scheme, it was clear that any other meaning would take away force and life from the true intent of the makers of the Act. The AAR thus reasoned as follows:

"*The annual accounts, including the P&L Account, can not be prepared as per the first proviso to section 115JB(2) in respect of the world income and laid before the company at its AGM in accordance with the provision of Section 210 of the Companies Act. The speech of Finance Minister and the memorandum explaining the provision also become out of sync if the meaning of "company" appearing in section 115JB is adopted as 'foreign company"…..*

*……It has also not drawn its attention to the fact that as the applicant did not have a place of business in India it was not required to prepare its accounts under section 594 read with section 591 of the Companies Act, 1956. That being so the applicant could not have prepared its accounts in accordance with the provisions of Part II and III of Schedule VI of the companies Act, 1956. We therefore do not find any force in the contentions raised by the departmen*t."

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(v) *Praxair Pacific Limited,* [2010] 326 ITR 276 (AAR)

4.2.19 The Applicant was a company incorporated in Mauritius with a wholly owned subsidiary in India, Praxair India P. Ltd (99.99% holding). The applicant also held 74% of the equity shares in Jindal Praxair Oxygen P. Ltd. The applicant proposed to transfer its 74% share holding in Jindal Praxair Oxygen P. Ltd. to its wholly owned subsidiary, Praxair India P. Ltd. Notably, it did not have any PE or place of business in India.

4.2.20 On the basis of this proposed transfer, the applicant sought to determine, *inter alia*, whether the equity shares of Jindal Praxair would be considered as "capital asset", whose transfer to Praxair India would be liable to tax in view of the exemption from capital gains and subject to the conditions under Section 47(iv) of the IT Act. It also sought to determine whether it would be liable to tax under Section 115JB of the Act and raised certain issues with respect to the Indo-Mauritius DTAA.

4.2.21 The Applicant argued that the transfer of shares to the holding company was not eligible to tax by virtue of Section 47(iv) read with Section 45 of the Act and that provisions of Section 115JB were not applicable to foreign company, relying on the notes on clauses of the Finance Bill, 2002. It made further submissions with respect to the gains arising out of transfer not being liable to tax in India under Article 13 of the India-Mauritius DTAA. The Department had left the questions raised to be answered on merits.

4.2.22 The AAR decided to address a larger question based on the facts on whether Section 115JB would apply to a foreign company, which had no place of business or PE in India. The AAR referred to its previous ruling in *Timken* to hold that Section 115JB was not attracted to the applicant. It premised its holding on the conclusions in *Timken* with respect to the fact that Section 115JB was "not designed to be applicable" to a foreign company without any presence or PE in India based on reading Sections 591 and 594 of the Companies Act, 1956 and the fact that annual accounts could not be prepared in accordance with the first proviso to Section 115JB(2). This was supported by the fact that in the present case, where given the solitary transaction, the purport of maintenance of accounts did not appeal to any logic. It also held that the transfer of shares was not liable to tax in India in view of the India-Mauritius DTAA.

4.2.23 It is relevant to note that the AAR rulings in both *Timken* and *Praxair* attained finality, and no appeal against the ruling was preferred. It appears that the Department accepted the rulings. A different view was, however, taken by the AAR in *ZD, In re* and *Castleton*, which are both discussed below.

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(vi) ***ZD*, [2012] 348 ITR 351 (AAR)**

4.2.24 The Applicant, 'ZD', was a company registered under the laws of Panama, having no presence in India. It held shares in two Indian public limited companies, which it proposed to transfer through recognised stock exchanges. According to the Applicant, its shares were long-term capital assets, and the capital gains arising out of their sale, on which securities transaction tax would be paid, would be exempt under section 10(38) of the IT Act. Since, the proviso to section 10(38) would be attracted, the Applicant sought a ruling as to whether the tax computed under Section 115JB would be applicable. It emphasised that it was not seeking a ruling on the question whether the transaction would be exempt from taxation under section 10(38), but was seeking a ruling only on the applicability of Section 115JB to the proposed transaction.

4.2.25 The applicant argued that Section 115JB had no application to foreign companies without any presence in India. However, the Revenue countered this by arguing that if Section 115JB were confined to resident Indian companies, then Section 10(38) of the IT Act would also be confined to resident companies.

4.2.26 The AAR ruled in favour of the Revenue holding that Section 115JB was "the overriding charging provision" on the payment of tax by an assessee, being a company. In paragraph 29 of its order, the AAR noted:

> "*That company normally, is a company of whatsoever hue, or in the alternative, a company as defined in the Income-tax Act. There is no warrant for borrowing the definition of a company from section 3 of the companies Act, 1956. Merely because sub-section (2) of section115JB refers to the Companies Act, it does not mean that the definition from therein has to be borrowed. There may be practical difficulties for foreign companies to prepare an account in terms of Schedule VI of the Companies Act, but that is no reason to whittle down the scope of section 115JB of the Act. The difficulties are for the legislature to consider and remove and not for this Authority. In fact, the difficulties in respect of some of them are now sought to be removed by the amendment made by the Finance Act, 2012*."

4.2.27 It thus held that the liability to be taxed did not depend on the obligation to prepare an account in terms of the Companies Act, 1956 and that Section 115JB made no distinction between a resident and a non-resident company and only the definition of a "company" in Section 2(17) of the IT Act, as including a foreign company, would apply. In fact, it ruled that there was no lack of clarity in Section 115JB to warrant an interpretative exercise, by referring to extraneous material to understand its meaning (as had been done in *Timken*).

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4.2.28 The AAR's interpretation was bolstered by reading the term "company" in Sections 10(38) and 115JB together. The proviso to Section 10(38) states that income by way of long-term capital gain shall be taken into account in computing the book profit and income-tax payable under Section 115JB. However, section 115JB overrides Section 10(38), even though it is to some extent interlinked. A company's total income has to be computed based on its book profit, as prescribed in Section 115JB. The AAR opined that if by an interpretative process one were to conclude that Section 115JB was confined to resident companies, the logical corollary would be that Section 10(38) would also operate only in respect of a resident company. There was held to be no need to warrant such a restrictive interpretation of the Act.

4.2.29 It is pertinent to note that in paragraph 37 of the ruling, the AAR stated that the applicant had insisted that it did not "seek or want" a ruling on all the aspects arising out of the questions posed for ruling, including the applicability of Section 10(38) of the Act. The AAR noted that since it would have to interpret Section 10(38) with Section 115JB together to answer the question of taxability of the relevant transaction, "*it would be proper to decline a Ruling on the questions raised*." This assumes importance in light of the fact that the very same judge relied on this ruling while deciding *Castleton Investments Ltd* a few days later. To this we now turn.

(vii) *Castleton Investment Ltd,* [2012] 348 ITR 537 (AAR)

4.2.30 The applicant was a company incorporated in, and a tax resident of, Mauritius, and was part of the Glaxo Smithkline group (GSK group). The applicant had held shares in GSK Pharma Ltd (GSKPL), a listed Indian company and a member of the GSK group, since 1993 as investment. This holding was shown as non-current assets in the books of accounts of the applicant and not as stock in trade. Thus, the applicant submitted (as was accepted) that the shares were a capital asset of the company.

4.2.31 Pertinently, the applicant had no office, employees or agents in India and hence, no PE in India. Further, being a foreign company, it was admittedly not obliged to maintain books of accounts in India, as prescribed by the Companies Act, 1956. For the present report, it is also important to note that the applicant was not an FII and thus, the provisions of Section 115AD were not relevant.

4.2.32 As part of the re-organisation of the GSK group, GSK and the applicant (the Mauritius company) proposed to transfer GSKPL shares (of the Indian company) to GSK Pte, a Singapore company and part of the same group. This would be off the market and not through a recognised stock

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exchange, so as to avoid attracting securities transaction tax. It thus sought an advance ruling on the taxability of the proposed transaction of sale of shares of GSKPL, the Indian company, to GSK Pte. Singapore and whether Section 115JB would be applicable to it.

4.2.33 Notably, the Revenue did not join issue on the question of applicability of Section 115JB, although the AAR brushed that aside in paragraph 37 of the order by simply stating:

> "*The Revenue presumably in the light of an earlier Ruling by this Authority has not specifically disputed the claim of the applicant. But, when the question of construction of a statute is involved, it cannot depend on the stand of the parties. The statute has to be construed by this Authority*."

4.2.34 On the relevant question of the applicability of Section 115JB, this single judge bench ruling of the AAR held that MAT would be "equally" applicable to foreign companies even without their physical or taxable presence in India. In reaching its conclusion, the AAR found it "difficult to agree" with the *Timken* approach and instead relied upon *P. No. 14 of 1997.* In reaching its conclusion, the AAR completely relied on its prior ruling in *ZD*, decided by the same judge just a few days prior to *Castleton*.

4.2.35 It adopted a strictly literal approach to Section 115JB, holding that the charging provision in sub-section (1) would also extend to foreign companies, since the IT Act did not distinguish between Indian and foreign companies, unlike the Companies Act, 1956. More importantly, even though Section 115JB constitutes an integral code, it held that computation mechanism in Section 115JB(2) had to be read independently of the charging provision in Section 115(1) by stating in paragraph 38:

> "*Sub-section (2) of section 115JB which is sought to be shoved in to deprive sub-section (1) of its width actually reaffirms the independent operation of sub-section (1). It exhorts every company, for the purpose of sub-section (1) to prepare its profit and loss account as provided for therein. The operation of sub-section (1) does not depend on the applicability of sub-section (2). It is on the applicability of sub-section (1) that the obligation under sub-section (2) arises. It is a fallacy to think that unless sub-section (2) is independently attracted, sub-section (1) also cannot be operated. Sub-section (2) gets attracted when sub-section (1) operates proprio vigorie. It is for the purpose of the section that the account has to be prepared as detailed therein. The liability to tax under sub-section (1) does not depend on the accounting. It arises from chargeability to tax under the Act*."

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4.2.36 Finally, the AAR emphasised the overriding nature of Section 115JB (referred to in *ZD* above) to reason that confining its scope to domestic companies alone may be "*doing violence to the special scheme of taxation adopted for taxing certain companies*", especially since no compelling reasons existed.

4.2.37 Before concluding this sub-section, it is important to take note of the fact that no appeal was filed against the decisions in *Timken* and *Praxair*, which thus attained finality. Conversely, in 2013, Castleton filed a Special Leave Petition before the Supreme Court, challenging the AAR ruling, which was admitted in May 2013.[43] The case is still pending. Meanwhile, as discussed, the requirement of MAT for FIIs was removed prospectively *vide* the 2015 amendment, while tax recovery notices for MAT against FIIs for previous years continued.

B. Judicial Decisions on the applicability of MAT to banking, electricity, non-life insurance companies

4.3.1 A different set of decisions need to be examined in light of the original enactment of Section 115JB, which did not require electricity, banking and non-life insurance companies to prepare accounts in accordance with the special requirements of other Acts prior to the Amendment of 2012. In that context, Section 115JB was held to be inapplicable to such companies. This subsequently led to the Finance Act of 2012, which inserted Explanation 3 to sub-section (2) to include such companies within the ambit of MAT by clarifying that book profits could be computed on the basis of accounts prepared under the governing acts of such companies. Further, sub-section (5A) was also inserted with retrospective effect (from AY 2001-02) to provide that MAT would not be applicable to life insurance companies. The decisions here deal with the pre-2012 amendment situation.

(i) *Maharashtra State Electricity Board v. JCIT,* [2002] 82 ITD 422 (Mum)

4.3.2 The question before the Mumbai Bench of the ITAT was whether the appellant, a statutory corporation constituted under Section 5 of the Electricity (Supply) Act, 1948, could be construed to be a company for the purpose of Section 115JA of the IT Act and the applicability of Section 115JA of the Act.

[43] SLP (C) No. 28370/2012, which was converted in Civil Appeal (No.) 4559/2013.

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4.3.3 The ITAT relied on Section 80 of the Electricity (Supply) Act, 1948 read with Section 2(17) of the IT Act (defining "company" as including an Indian company) read with Section 2(26) of the IT Act (defining "Indian company" as one established by or under a Central, State or Provincial Act) to deem the appellant a "company" for the IT Act. However, it termed the definition of "company" under Section 2 as "*nomen generalissimum*" (term of the most general meaning), whose meaning in the context of Section 115JA was to be gathered from the connection in which it is used and subject matter applied.

4.3.4 Based on this, the ITAT concluded that although Section 115JA used the word "company" and began with a non-obstante clause, it was situated within a section titled "Deemed income relating to certain companies". Based on the history and context of the introduction of MAT through the Finance (No. 2) Act, 1996, it was thus obvious that Section 115JA was a deeming provision intended to curb the mischief of zero tax companies and that:

> "*It is a trite law that deeming provision should be narrowly watched, jealously regarded and never to be pressed beyond its true limits. It is applicable to a company. The assessee is not a company. It is not required to distribute any dividend. As such it does not come within the mischief of this section.*"

4.3.5 Thus, the ITAT ruled that the appellant corporation could not be construed as a company for the purpose of charging MAT and was outside the scope of Section 115JA of the IT Act.

(ii) *Kerala State Electricity Board v. Deputy, CIT,* [2010] 329 ITR 91 (Ker)

4.3.6 The case concerned the appeals filed by the Kerala State Electricity Board, a statutory corporation constituted under the Electricity (Supply) Act, 1948 against the orders of the ITAT, which confirmed the invocation of the legal fiction under Section 115JB to enable the Revenue to arrive at a fictitious conclusion regarding the total income of the assessee and the tax applicable therein. The question before the High Court was whether Section 115JB was applicable to the appellant, an Indian company under Section 2(26)(ia) of the IT Act and whether Section 43B of the Act could be legally invoked.

4.3.7 Noting that a contextual meaning should be given to the word "company" in Section 115JB of the Act, the High Court held that Section 115JB would not apply to a body corporate such as a State Electricity Board in light of the first proviso to sub-section (2) of Section 115JB and the requirements under the Companies Act, 1956.

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4.3.8 The High Court took note of the history, scope and ambit of Sections 115J, 115JA and 115JB of the Act to state that Section 115JB stipulated that the accounting policies and standards etc. had to be uniform for the purpose of the IT Act and the information statutorily required to be placed before an AGM under Section 210 read with Section 166 of the Companies Act, 1956. On page 101, the Court observed that:

> *"…However, the appellant though is by definition a Company under the Income Tax Act and deemed to be a Company for the purpose of Income Tax Act, (by virtue of the declaration under Section 80 of the Electricity Supply Act) it is not a Company for the purpose of Companies Act. Therefore, the appellant is not obliged to either to convene an annual general meeting or place its profit and loss account in such general meeting. As a matter of fact, a general meeting contemplated under Section 166 of the Companies Act is not possible in the case of the appellant as there are no share holders for the appellant Board. On the other hand, under Section 69 of the Electricity Supply Act, the appellant is obliged to keep proper accounts…..*"

4.3.9 The High Court after examining in detail the scheme underlying the provisions of Section 115J, 115JA and 115JB observed at page 100 that, "*the scheme of section 115JB is similar to section 115J and section 115JA*." Thereafter, it noted the differences in the scheme of Section 115JB, which however, are irrelevant for the consideration of the present report. At page 105, the Court ultimately observed:

> "*If that is the background in which section 115JA in introduced into the Income-tax Act, section 115JB, which is substantially similar to section 115JA, in our opinion, cannot have a different purpose and need not be interpreted in a manner different from the understanding of the Central Board of Direct Taxes of section 115JA.*" [This was stated with reference to Circular No. 762, dated 18th February 1998, [1998] 230 ITR (St.) 12]

4.3.10 It thus concluded that Section 115JB was not applicable against the Appellant, being a statutory corporation under the Electricity (Supply) Act.

(iii) *<u>Krung Thai Bank PCL v JDIT-International Taxation</u>*, <u>[2010] 133 TTJ 435 (Mumbai)</u>

4.3.11 In the present case, the assessee was a foreign bank operating in India through a branch office and filed a nil return. In 2007, the Assessing Officer re-opened the assessment against it on the ground that despite showing a profit of Rs. 78.32 lakh in the Profit and Loss account, it declared "nil income" and did not compute "book profits" under Section 115JB. The assessee

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challenged the reopening on the ground that Section 115JB did not apply to banking companies, including the assessee.

4.3.12 The ITAT agreed with the assessee's contentions that Section 115JB of the Act "*can only come into play when the assessee is required to prepare its profit and loss account in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act*." It held that the starting point of computation of MAT under Section 115JB is the result shown by such a profit and loss account. Nevertheless, in the case of banking companies, the provisions of Schedule VI of the Companies Act were not applicable in light of the exemption set out under proviso to Section 211(2) of the Companies Act, 1956. In fact, banking companies are required to prepare their final accounts in accordance with the provisions of the Banking Regulation Act (and not the Companies Act, 1956).

4.3.13 Consequently, relying on its previous decision in *Maharashtra State Electricity Board v JCIT*[44] cited above, the ITAT concluded that Section 115JB could not be applied to a banking company, including the assessee and hence, the initiation of re-assessment proceedings was bad in law.

(iv) *Bank of Tokyo-Mitsubishi UFJ Ltd v. ADIT,* ITA Nos. 5364/Del/2010 and ITA Nos. 5104/Del/2011 decided on 19th September 2014

4.3.14 The assessee was a foreign bank, incorporated in Japan and a resident of Japan within the meaning of Article 4 of the Indo-Japan DTAA. It was engaged in banking operations in India during the relevant assessment year of 2007-08, and its branches constituted a PE in India. Admittedly, the assessee had not prepared its profit and loss account as per Parts II & III of Schedule VI to the Companies Act.

4.3.15 While filing its return of income, although computing its book profits as per Section 115JB of the Act, the assessee gave a note that the provisions of Section 115JB were not applicable. It claimed that the profits of its PE, namely its Indian branches, had to be computed in accordance with Article 7 of the DTAA and not as per Section 115JB of the Act because the (beneficial provisions of the) Treaty overrode the IT Act.

4.3.16 The Assessing Officer and the Dispute Resolution Panel relied on the assessee having a PE in India to hold Section 115JB to be applicable. The assessee sought to rely on the decisions in *Maharashtra State Electricity Board* (supra), *Kerala State Electricity Board* (supra), *Krung Thai Bank PCL* supra), which held that since the assessee-company was not preparing its accounts as

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[44] [2002] 82 ITD 422 (Mum).

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per Part II of Schedule VI of the Act, and were not laid before an AGM, Section 115JB was inapplicable.

4.3.17 In appeal, the Delhi Bench of the ITAT very clearly held in paragraph 76.1 of the order that the "*intention of Legislation [was] very clear that the MAT provisions are applicable only to domestic companies and not to foreign companies.*" It premised its ruling on the fact that the while introducing the new MAT provisions for the first time in the Finance Bill of 2006, the Finance Minister had observed that the companies engaged in the power and infrastructure sector would remain exempt from the MAT levy. It then cited the amendments brought in by Clause 49 of the Finance Bill of 2002,[45] which amended Section 115JB, noting that:

> "*Clause 49 seeks to amend section 115JB of the Income-tax Act relating to special provision for payment of tax by certain companies.*
> *The existing provisions of the said section provide for levy of a minimum tax on domestic companies of an amount equal to seven and one-half per cent of the book profit, if the tax payable on the total income chargeable to tax as per the provisions of the Income Tax Act, 1961, is less than seven and one-half per cent of the book profit.*
> *Sub-clause (a) seeks to provide that where the tax payable on the total income chargeable to tax is less than seven and one-half per cent…*
> *….this amendment will take effect retrospectively from 1st April 2001, and will, accordingly apply, in relation to the assessment years 2991-2002 and subsequent years.*"

4.3.18 The ITAT held that coordinate benches of the AAR had consistently held that Section 115JB was not applicable to banking companies. Further, it accepted the assessee's contention that the 2012 amendment to the Finance Act, which had inserted *Explanation 3* on computing book profits on the basis of accounts prepared under the governing Act of a company, was not retrospective. Given the substantial change Explanation 3 brought in the taxability of companies governed by special laws, it would not apply to the assessment year of 2007-08. Even otherwise, it concluded that in view of Section 90(2) of the Act, the assessee's claim for the lower impost of tax would have to be accepted given that Section 115JB had no overriding effect over Section 90 of the Act (and hence Article 7(3) of the DTAA).

4.3.19 In any event, apart from the above decisions, it is useful to refer to the 2002 Supreme Court decision in *Apollo Tyres v CIT*,[46]concerning the computation of tax on the basis of book profits and total income under Section

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[45][2002] 254 ITR (St) 118.
[46](2002) 9 SCC 1.

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115J of the Act. Although considered in a different context (under Section 115J), the decision of the three-judge bench brings out the inseparable link between the IT Act and the Companies Act and the assessee company's obligations under both. In paragraph 7 of the judgment, it observes that:

> "*For the said purpose, Section 115-J makes the income reflected in the companies books of accounts as the deemed income for the purpose of assessing the tax. If we examine the said provision in the above background, we notice that the use of the words "in accordance with the provisions of Part II and III of Schedule VI to the Companies Act" was made for the limited purpose of empowering the assessing authority to rely upon the authentic statement of accounts of the company. While so looking into the accounts of the company, an assessing officer under the IT Act has to accept the authenticity of the accounts with reference to the provisions of the Companies Act which obligates the company to maintain its account in a manner provided by the Companies Act and the same to be scrutinised and certified by statutory auditors and will have to be approved by the company in its General Meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and satisfy that the accounts of the company are maintained in accordance with the requirements of the Companies Act. In spite of all these procedures contemplated under the provisions of the Companies Act, we find it difficult to accept the argument of the Revenue that it is still open to the assessing officer to re-scrutinize this account and satisfy himself that these accounts have been maintained in accordance with the provisions of the Companies Act. In our opinion, reliance placed by the Revenue on Sub-section (1A) of Section 115-J of the IT Act in support of the above contention is misplaced. Sub-section (1A) of Section 115-J does not empower the assessing officer to embark upon a fresh inquiry in regard to the entries made in the books of account of the company. The said sub-section, as a matter of fact, mandates the company to maintain its account in accordance with the requirements of the Companies Act which mandate, according to us, is bodily lifted from the Companies Act into the IT Act for the limited purpose of making the said account so maintained as a basis for computing the company's income for levy of income-tax. Beyond that, we do not think that the said sub-section empowers the authority under the Income-tax Act to probe into the accounts accepted by the authorities under the Companies Act.*" [*Emphasis supplied*]

4.3.20 This decision is thus relevant to bring out the point that the obligation to pay tax under Section 115J (and Section 115JB today) does not exist *de hors* the provisions of the Companies Act. In fact, the tax liability of the

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assessee arises under the IT Act because it maintains books of accounts under the regulatory provisions of the Companies Act.

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CHAPTER V

THE APPLICABILITY OF SECTION 115JB TO FIIS/FPIS: AN ANALYSIS

A. Legislative History of the MAT Provisions in the IT Act

5.1.1 A quick perusal of the previous chapter reveals the evident inconsistency in the judgments and rulings of the ITAT and the AAR on the applicability of MAT provisions (whether Sections 115J, 115JA or 115JB) to foreign companies, including FIIs/FPIs. While the Delhi Bench of the ITAT in *Bank of Toyko-Mitsubishi UFJ* Ltd[47] was clear that MAT provisions do not apply to foreign companies *per se,* the AAR in *Timken*[48] and *Praxair Pacific Ltd.*[49] held that MAT provisions only apply to foreign companies with a place of business or PE in India. Conversely, two years later, the AAR in *Castleton*[50]and *ZD*[51] took the opposite view to rule that MAT provisions applied to all companies, including foreign companies, regardless of whether they had established a place of business/PE in India, or the applicability of provisions of the Companies Act, 1956.

5.1.2 In view of such inconsistent rulings, there is an even greater need to put matters in perspective by considering the various circulars, Explanatory Memoranda, Finance Acts and Notes on Clauses.

(i) Principles of statutory interpretation

5.1.3 Before proceeding, it is important to take note that the legislative history of a fiscal statute is a valid interpretive aid for construing an enacted provision, especially for ascertaining the evil sought to be remedied.[52] Similarly, circulars and directions issued by the CBDT may be utilised to interpret the provisions of the IT Act. It is well settled that circulars issued by the CBDT are not only binding on the income tax authorities under Section 119 of the IT Act, but are also in the nature of *contemporanea expositio*, furnishing legitimate aids in the construction of the provisions.[53]

5.1.4 Similarly, in order to analyze the legislative intent, or in ascertaining the object/purpose behind a particular provision, a speech made by a Minister or by a member of the legislature moving a bill can be taken into

[47] ITA Nos. 5364/Del/2010 and ITA Nos. 5104/Del/2011 decided on 19th September 2014.
[48] [2010] 326 ITR 193 (AAR).
[49] [2010] 326 ITR 276 (AAR).
[50] [2012] 348 ITR 537 (AAR).
[51] [2012] 348 ITR 351 (AAR).
[52] S.C. Prashar v. Vasantsen Dwarkadas, [1963] 49 ITR 1 (SC).
[53] K.P. Varghese v. ITO, [1981] 131 ITR 597 (SC).

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consideration in case there is ambiguity.[54] In addition, the Notes on Clauses of the Finance Bill, and the Memorandum explaining its provisions may be relied upon in ascertaining the legislative intent in case of interpretive doubts or difficulties.[55] It has been held by the Supreme Court in the case of *K.P. Varghese v. ITO*[56] that the speech made by the mover of the Bill can certainly be referred to for the purpose of ascertaining the mischief sought to be remedied by the legislation and the object and purpose for which the legislation was enacted. This has been reiterated in the case of *Kerala State Industrial Development Corpn. Ltd. v. CIT*[57] and *R&B Falcon (A) Pty. Ltd. v. CIT*.[58] The Supreme Court has also held that due consideration should be given to the legislative history, background and context while interpreting a statute in *Imperial Chit Fund (P) Ltd v. ITO*.[59]

5.1.5 In *Sole Trustee, Lok Shikshana Trust v. CIT,*[60] the Supreme Court observed: -

> "*It is true that it is dangerous and may be misleading to gather the meaning of the words used in an enactment merely from what was said by any speaker in the course of a debate in Parliament on the subject. Such a speech cannot be used to defeat or detract from a meaning which clearly emerges from a consideration of the enacting words actually used. But, in the case before us, the real meaning and purpose of the words used cannot be understood at all satisfactorily without referring to the past history of legislation on the subject and the speech of the mover of the amendment who was, undoubtedly, in the best position to explain what defect in the law the amendment had sought to remove. It was not just the speech of any member in Parliament. It was the considered statement of the Finance Minister who was proposing the amendment for a particular reason which he clearly indicated. If the reason given by him only elucidates what is also deducible from the words used in the amended provision, we do not see why we should refuse to take it into consideration as an aid to a correct interpretation. It harmonises with and clarifies the real intent of the words used. Must we, in such circumstances, ignore it?*"

[54] Kerala SIDC v. CIT, [2003] 259 ITR 51 (SC).
[55] Rangaswamy (M) v. CWT, 221 ITR 39 .
[56] [1981] 131 ITR 597 (SC).
[57] [2003] 259 ITR 51 (SC).
[58] [2008] 301 ITR 309 (SC).
[59] (1996) 8 SCC 303.
[60] [1967] 1 SCR 461.

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(ii) Legislative history of Section 115JB

5.1.6 In this context, it would be appropriate to begin with the legislative history of the erstwhile Section 115J, the scheme of which was similar to the present Section 115JB as explained earlier.

5.1.7 The purpose of inserting Section 115J of the Act was explained by the Hon'ble Finance Minister in his speech of 28th February, 1987 while introducing the Budget for 1987-88,[61] as follows :-

> "*It is only fair and proper that the prosperous should pay at least some tax. The phenomenon of so-called "zero-tax" highly profitable companies deserves attention. In 1983, a new Section 80VVA was inserted in the Act so that all profitable companies pay some tax. This does not seem to have helped and is being withdrawn. I now propose to introduce a provision whereby every company will have to pay a "minimum corporate tax" on the profits declared by it in its own accounts. Under this new provision, a company will pay tax on at least 30% of its book profit. In other words, a domestic widely held company will pay tax of at least 15% of its book profit. This measure still yields a revenue gain of approximately Rs.75 crores.*" [*Emphasis supplied*]

5.1.8 The above speech makes reference to only domestic companies.

5.1.9 The scope and ambit of Section 115J was also explained in CBDT Circular No.495 dated 22nd September, 1987.[62] The relevant portion is extracted below:-

> "*New provisions to levy minimum tax on "book profit" of certain companies.*
>
> *36.1 It is an accepted canon of taxation to levy tax on the basis of ability to pay. However, as a result of various tax concessions and incentives certain companies making huge profits and also declaring substantial dividends, have been managing their affairs in such a way as to avoid payment of income-tax.*
>
> *36.2 Accordingly, as a measure of equity, section 115J has been introduced by the Finance Act. By virtue of the new provisions, in the case of a company whose total income as computed under the provisions of the Income-tax Act is less than 30 per cent of the book*

[61] Budget Speech of Prime Minister and Minister of Finance for 1987-88 – Part B, [1987] 165 ITR (St.) 13, 14.

[62] Circular No. 495, dated 22 September, 1987: [1987] 168 ITR (St.) 87.

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profit computed under the section, the total income chargeable to tax will be 30 percent of the book profit as computed." [*Emphasis supplied*]

5.1.10 After setting out how net profit was to be arrived at, this Circular explained that the net profit was to be reduced by –

"*i) amounts withdrawn from reserves if any, such amount is credited to the profit and loss account; … iii) the amount of any brought forward losses or unabsorbed depreciation, whichever is less, as computed under the provisions of section 205(1)(b) of the Companies Act, 1956, for the purposes of declaration of dividend. Section 205 of the Companies Act requires every company desirous of declaring dividend to provide for depreciation for the relevant accounting year. Further, the company is required under section 205 to set off against the profit of the relevant accounting year, the depreciation debited to the profit and loss account of any earlier year(s) or loss whichever is less*."[63] [*Emphasis supplied*]

5.1.11 Section 205 of the Companies Act refers to the declaration and payment of dividends by an Indian company and does not apply to foreign companies. Foreign companies thus do not have to comply with the requirements of Section 205.

5.1.12 As has already been stated, Section 115J was made inoperative from assessment year 1991-1992. However, MAT was re-introduced into the IT Act, in 1996, vide Finance (No.2) Act, 1996, with effect from assessment year 1997-98. MAT was re-introduced at this point, through Section 115JA. While presenting the Finance (No. 2) Bill, 1996 in Parliament, the Hon'ble Finance Minister, as part of his Union Budget Speech, stated:-

"*90*

…

*(ii). I propose to introduce a 'Minimum Alternate Tax' (MAT) on companies. In a case where the total income of the company, as computed under the Income Tax Act after availing of all eligible deductions, is less than 30 per cent of the book profit, the total income of such a company shall be deemed to be 30 per cent of the book profit and shall be chargeable to tax accordingly. The effective rate works out to 12% of book profit calculated under the Companies Act. Companies engaged in the power and infrastructure sectors, will however, be exempted from the levy of MA*T".[64]

[63] *Ibid* at 110-111 (paragraphs 36.1 and 36.2).

[64] Budget Speech of the Minister of Finance for 1996-97 – Part B, [1996] 220 ITR (St.) 105, 107.

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5.1.13 It may be noted that the Hon'ble Finance Minister stated that the effective rate of tax for MAT would be 12%. In the Assessment Year 1997-98, i.e. the first year of application of MAT provisions, the tax rate applicable to a domestic company was 40%. Accordingly, the rate of tax was worked out at 12% of book profits. As 30% of book profit was deemed to be the income (as stated in the above speech), the figure of 12% was arrived at by applying the tax rate on domestic companies to the aforementioned percentage of book profits (i.e. 40% of 30%). In case of a foreign company, in the assessment year 1997-98, the rate of tax was 55%. At that time, the rate of tax applicable to a foreign company would be 16.5% (applying the 55% rate to 30% of book profits) and not 12%.

5.1.14 Similarly, the Explanatory Memorandum to the Finance (No.2) Bill, 1996 states:-[65]

"*Minimum Alternative Tax on companies*

> *In recent times, the number of zero-tax companies and companies paying marginal tax has grown. Studies have shown that in spite of the fact that companies have earned substantial book profits and <u>have paid handsome dividends</u>, no tax has been paid by them to the exchequer.*
>
> *The new proposal provides for those companies to pay tax on 30% of the book profits, whose total income as computed under the Income-tax Act is less than 30% of the book profits as per the books of account prepared in accordance with Parts II & III of Schedule VI to the Companies Act, 1956. "Book Profit" is defined and certain adjustments are provided in the proposed section.*
>
> *The proposed amendment will take effect from 1st April, 1997 and, will accordingly, apply in relation to assessment year 1997-98 and subsequent years. [Clause 37]*" [*Emphasis supplied*]

5.1.15 The Notes on Clauses in respect of the Finance Bill, 1996 state that:-[66]

> "*Clause 37 seeks to insert a new section 115JA of the Income-tax Act containing special provisions relating to certain companies.*

[65] [1996] 220 ITR (St.) 248, 263-264.
[66] [1996] 220 ITR (St.) 216, 233.

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The new section provides that in the case of a company, other than a company engaged in the business of generation or generation and distribution of power or a company fulfilling the conditions laid down in sub-section (4A) of section 80-IA, where the total income as computed under this Act is less than thirty per cent of the book profits, the total income of such assessee shall be deemed to be thirty per cent, of the book profits. Book profit shall mean the net profit as shown in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 as increased or reduced by certain adjustments. It is also proposed to provide that in respect of the relevant previous year, the amounts determined under the provisions of sub-section (2) of section 32 or sub-section (3) of section 32A or clause (ii) of sub-section (1) of section 72 or section 73 or section 74 or sub-section (3) of section 74A, shall be allowed to be carried forward to the subsequent year or years.

This amendment will take effect from 1st April, 1997 and will, accordingly, apply in relation to the assessment year 1997-98 and subsequent years."

5.1.16 In explaining the provisions of Section 115JA, Circular No.762 dated 18th February, 1998[67] stated as follows:-

"46.1 In recent times, the number of zero tax companies and companies paying marginal tax has grown. Studies have shown that in spite of the fact that companies have earned substantial book profits and <u>have paid handsome dividends,</u> no tax has been paid by them to the Exchequer.

46.2 The Finance Act has inserted a new section 115JA of (sic) the Income-tax Act, so as to levy a minimum tax on companies who are having book profits and paying dividends but are not paying any taxes….." [*Emphasis supplied*]

5.1.17 The Finance Act, 2000 rendered Section 115JA inoperative from 1st April, 2001, inserting in its place a new provision, namely, Section 115JB which (with minor amendments in applicable rates etc.) is the presently applicable MAT provision. While introducing the Finance Bill, 2000, the then Hon'ble Finance Minister in his Budget Speech stated[68]: -

[67] [1998] 230 ITR (St.) 12 at 42.
[68] Budget Speech of Minister of Finance for 2000-01 – Part B, [2000] 242 ITR (St.) 18, 29.

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"*156. The various exemptions currently available while calculating Minimum Alternate Tax (MAT) and the credit system has undermined the efficacy of the existing provision and has also led to legal complications. To address these issues, I propose that the Minimum Alternate Tax be now levied at the revised rate of 7.5% of the "book profits" as determined under the Companies Act instead of the existing effective rate of 10.5%. However, this will now be uniformly applied – barring one exception that I will mention later. There will also be no credit for Minimum Alternate Tax paid. This should bring all zero tax companies within the tax-net, which is also the basic purpose of this tax. The new system has the virtue of a lowered rate of tax, a simple method of computation, and an equitable spread.*" [*Emphasis supplied*]

5.1.18 The Memorandum explaining the provisions of the Finance Bill, 2000[69] states:

"*As the number of zero tax companies and companies paying marginal tax had grown, Minimum Alternate Tax was levied from assessment year 1997-98. The efficacy of the existing provision has declined in view of the exclusions of various sectors from the operation of MAT and the credit system. It has also lead to legal complications. It is, therefore, proposed to put a sunset clause in the existing provision, so that, it is not applicable after assessment year 2000-2001.*

In its place, it is proposed to insert a new provision which is simpler in application.

The new provisions provide that all companies having book profits under the Companies Act, prepared in accordance with Part II and Part III of Schedule VI to the Companies Act, shall be liable to pay a minimum alternate tax at a lower rate of 7.5%, as against the existing effective rate of 10.5% of the book profits. These provisions will be applicable to all corporate entities without any exception. However, export profits under section 80HHC, 80HHE and 80HHF are kept out of the purview of this provision during the period of phasing out of deductions available under those provisions. In view of the changes made in the provisions of sections 10A and 10B, those export oriented units and the units in free trade zones, which are set up before 1.4.2000, would be out of the purview of new provisions of MAT.

No credit of MAT under the new provision will be available. However, the credit for the brought forward MAT paid under the existing provisions will

[69] [2000] 242 ITR (St) 117, 138.

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be allowed against the regular tax payable but not against the tax payable under the new provision." *[Emphasis supplied]*

5.1.19 The CBDT Circular No. 794, dated 9th August, 2000,[70] while explaining the provisions of the new Section 115JB of the Act states the following:-

"*43. Minimum Alternate Tax on companies:*

43.1. In recent years, as the number of zero tax companies and companies paying marginal tax had grown, minimum alternate tax was levied under section 115JA of the Income-tax Act from the assessment year 1997-78. The efficacy of the existing provision, however, declined in view of the exclusion of various sectors from the operation of MAT and the credit system. The Act has, therefore, modified the scheme of MAT. The existing section 115JA has been made inoperative with effect from 1st April 2001. In its place, the Act inserts a new provision, section 115JB of the Income-tax Act.

43.2. The new provisions provide that all companies having book profits under the Companies Act, prepared in accordance with Part-II and Part-III of Schedule-VI of the Companies Act, shall be liable to pay a minimum alternate tax at a lower rate of 7.5% as against the existing effective rate of 10.5% of the book profits. These provisions will be applicable to all corporate entities without any exception.

43.3. The new provisions further provide that for purposes of MAT, the company shall follow same accounting policies and standards as are followed for preparing its statutory account.

43.4. The amended provision discontinues the system of allowing credit of MAT in future. However, the taxes paid under the existing provisions of section 115JA shall get the credit.

43.5. The export profits under sections 10A, 10B, 80HHC, 80HHE and 80HHF are kept out of the purview of this provision as these are being phased out. The new provisions also exempt companies registered under section 25 of the Companies Act.

43.6 Certificate from an auditor has also been prescribed with a view to ascertaining the extent of book profits." [Emphasis supplied]

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[70] [2000] 245 ITR (St.) 21.

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5.1.20 The Memorandum to the Finance Bill, 2000 and the CBDT Circular No.794 dated 9th August, 2000, refer to the effective rate of MAT as being 10.5% of Book Profits. This effective MAT rate was determined by multiplying "30% of the Book Profits" (as was provided in the erstwhile section 115JA of the Act) with the corporate tax rate that was prescribed for 'domestic companies' (i.e. 35%). During FY 1999-2000 (relevant to AY 2000-01), the corporate tax rate that was prescribed for 'foreign companies' in India was 48% which, on computation, when applied to 30% of book profits, would have thrown up an effective tax rate of 14.4% of Book Profits and not 10.5% of Book Profits.

5.1.21 Further, the Notes on Clauses explaining the provisions of Finance Bill, 2002,[71] which provided for some amendments to Section 115JB of the Act, read as follows:-

> "*Clause 49 seeks to amend Section 115JB of the Income-tax Act relating to special provision for payment of tax by certain companies. The existing provisions of the said Section provide for levy of a minimum tax on <u>domestic companies</u> of an amount equal to seven and one-half per cent of the book profit, if the tax payable on the total income chargeable to tax as per the provisions of the Income-tax Act, 1961, is less than seven and one-half per cent of the book profit …."[Emphasis supplied]*

5.1.22 Therefore, the notes explaining the provision indicate that Section 115JB was understood to apply to domestic companies.

5.1.23 As explained in Chapter IV, electricity, banking and non-life insurance companies did not originally fall within the purview of Section 115JB by virtue of the fact that the Companies Act permitted them to prepare their profit and loss accounts in accordance with the provisions specified in their regulatory Acts. Explanation 3 had to be inserted to Section 115JB(2) by the Finance Act of 2012 to bring such companies within the ambit of Section 115JB. The Memorandum to the Finance Bill of 2012 read as under:[72]

> "*As per section 115JB, every company is required to prepare its accounts as per Schedule VI of the Companies Act, 1956. However, as per the provisions of the Companies Act, 1956, certain companies, e.g. insurance, banking or electricity company, are allowed to prepare their profit and loss account in accordance with the provisions specified in their regulatory Acts. <u>In order to align the provisions of Income-tax Act with the Companies Act, 1956, it is proposed to amend section 115JB</u> to provide that the companies which are not required under section 211 of*

[71] Notes on Clauses, Finance Bill 2002, [2002] 254 ITR (St) 118, 151.
[72] [2012] 342 ITR (St.) 234, 238-240.

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the Companies Act to prepare their profit and loss account in accordance with the Schedule VI of the Companies Act, 1956, profit and loss account prepared in accordance with the provisions of their regulatory Acts shall be taken as a basis for computing the book profit under section 115JB." [*Emphasis supplied*]

5.1.24 This made it clear that the obligation under Section 115JB exists because of the regulatory requirements of the Companies Act and not independent of it. Thus, the Legislature could only have intended for MAT to apply to companies governed by the regulatory requirement of the Companies Act, 1956, else it would have clarified the manner of computation of book profits for FIIs/FPIs as well (as it did for electricity, banking and non-life insurance companies).

5.1.25 Thus, in conclusion, it is necessary to take into account the following three factors. *First*, the Budget speech of the Finance Minister in 1987 makes an express reference to "domestic companies". Notably, even after foreign companies were permitted to enter India, the Notes on Clauses on the Finance Amendment Act of 2002 speak about the MAT provisions being applied to domestic companies. *Second*, the rates discussed were always meant to be aligned to domestic companies. *Third*, the 2012 amendment inserting *Explanation 3* in light of decisions such as *Krung Thai Bank* and *Kerala State Electricity Board* (which had held MAT to be inapplicable in view of the Companies Act) reveals the government's intent to align Section 115JB(2) with the Companies Act and that the obligation under Section 115JB(2) does not exist *de hors* the Companies Act.

5.1.26 Having considered the legislative history of Section 115JB, it is important to analyse it in the context of the legislative scheme of the entire IT Act, by interpreting the term "company" in Section 115JB read with Section 2(17).

B. Contextual interpretation of the term "company" as appearing in Section 115JB

5.2.1 The need to go into the contextual interpretation of the term "company" as appearing in Section 115JB has been necessitated by the decisions of the AAR in *ZD*[73] and *Castleton*[74]. Both these decisions go on to hold that the provision of MAT applies to all assessees that are companies. While holding so, the AAR was of the view that since company is defined under

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[73] [2012] 348 ITR 351 (AAR).
[74] [2012] 348 ITR 537 (AAR).

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the IT Act, therefore there is no need to borrow the definition of company from Section 3 of the Companies Act, 1956.

5.2.2 The AAR thus held that the charging provision contained in Sub-Section (1) of Section 115JB of the IT Act would also extend to a foreign company since the definition of 'Company' under the Act makes no distinction between domestic and foreign companies. Therefore, the mechanism for computation given under Sub-Section (2) should be read independent of the charging provision and the applicability must not be limited to only domestic companies.

5.2.3 The term 'Company' is defined under Section 2(17) of the IT Act, which covers domestic as well as foreign company. Section 2 of the IT Act begins with the phrase, "*In this Act, unless the context otherwise requires*". The words "*unless the context otherwise requires*" provides flexibility to the definition clause inasmuch as the language of the definition clause should govern the definition of the term only if the context permits the same. As soon as the context limits or otherwise requires an alternate meaning to such a term, then Section 2 cannot be given a strict application.

5.2.4 In *Knightsbridge Estates Trust Ltd. vs. Byrne*,[75] the House of Lords held that where the context makes the definition given in the interpretation clause inapplicable, a defined word when used in the body of the statute may have to be given a meaning which is different from what is contained in the interpretation clause. In *CIT vs. B.C. Srinivasa Shetty*,[76]the Supreme Court held that "...*the definitions in s. 2 are subject to an overall restrictive clause that is expressed in the opening words of the section: "unless the context otherwise requires". We must, therefore, inquire whether contextually s. 45, in which the expression "capital asset" is used excludes goodwill...*". To the same effect are the decisions in *Vanguard Fire and General Insurance Co. Ltd., Madras vs. Fraser and Ross*[77] and *State of Madhya Pradesh vs. Saith Skelton (P) Ltd.*[78]

[75][1940]2 All ER 401 (HL).
[76][1981] 128 ITR 294 (SC) – The Court in that case held that 'goodwill' cannot be described as an asset within the meaning of Section 45 and hence, any capital gain arising on the transfer of such goodwill cannot be subject to income tax under the head "capital gains".
[77]AIR 1960 SC 1971 – Where the Court, using the principle of interpretation held that the word "Insurer" not only applies to a person who is carrying on the business of insurance but would also include someone who has closed his insurance business.
[78]AIR 1972 SC 1507 – The Court held that the definition of the word "Court" in the Arbitration Act, 1940, meant not only the Court which could entertain the suit on the subject matter of arbitration but also applied to a Court which appointed the arbitrator.

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5.2.5 In our view, the MAT provision becomes unworkable if the decision of the AAR in *Castleton*[79] is to be accepted. On a careful analysis, the Committee finds that the very structure of Section 115JB makes it non-applicable to FIIs/FPIs. The provisions of Section 115JB clearly suggest that the context of Section 115JB requires that the word "company" be restricted to include only companies covered by the regulatory regime of the Companies Act, 1956. The Committee's view finds support from the following aspects.

5.2.6 The first proviso to Sub-Section (2) of Section 155JB requires the book profits to be calculated in the same way for preparing the profit and loss accounts to be laid before the AGM of the Company. However, in the case of an FII/FPI, there is no legal obligation to prepare a profit and loss account as per Section 210 of the Companies Act to be laid before the AGM.

5.2.7 If Section 115JB is held applicable to FIIs/FPIs, then, as a necessary corollary, every FII/FPI would be required to compile its global accounts (which are adopted by shareholders in the annual general meeting) in accordance with Part II of Schedule VI of the Companies Act, which is not discernible from the legislative intent. The inclusion of such foreign income in the 'book profit' would also be contrary to the principle of '*territorial nexus*' which has been laid down by the Supreme Court as the basic principle for chargeability of income tax.[80]

5.2.8 Another important facet which bears mention is that Section 115JB was amended to provide that in case of companies which are not required under Section 211 of the Companies Act to prepare their profit and loss account as per Schedule VI of the Companies Act, in that case the profit and loss account prepared in accordance with the respective regulatory Acts shall be taken as a basis for computing the book profit under Section 115JB (e.g. insurance, electricity or banking companies). It is evident, therefore, that the intention of the Legislature was not to cover all kinds of companies, as has been the view taken in *Castleton.*[81] Otherwise, the Legislature would have brought about an amendment for FIIs/FPIs also to clarify the manner in which their book profits are required to be calculated.

5.2.9 In this regard, it is important to refer to the decision of the Kerala High Court in *Kerala State Electricity Board vs. CIT*[82]where it was held that Section 115JB of the Act stipulates that the accounting policies, accounting standards etc. shall be uniform for the purpose of income tax as well as the

[79][2012] 348 ITR 537 (AAR).
[80]As per *GVK Industries vs. ITO,* [2011] 332 ITR 30 (SC) and *Ishikawajima-Harima Heavy Industries Company Limited vs. Director of Income Tax, Mumbai*, [2006]288 ITR 408 (SC).
[81][2012] 348 ITR 537 (AAR).
[82][2010] 329 ITR 91 (Ker.).

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information statutorily required to be placed before the Annual General Meeting. The Court also held that where the computation provision could not be applied in a particular case, it is indicative of the fact that the charging section also would not apply. The High Court thus held that Section 115JB of the Act would not apply to a body corporate such as a State Electricity Board.

5.2.10 The ITAT applied these principles to an Electricity Corporation – *Maharashtra State Electricity Board vs. JCIT*[83], a foreign bank in *Krung Thai Bank PCL vs. JDIT*[84]and statutory corporations in *Union Bank of India vs. ACIT*[85]and *Dena Bank vs. DCIT.*[86]

5.2.11 The above decisions clearly go on to show that the word Company in Section 115JB would not have the same meaning as in Section 2(17) of the IT Act but would have a narrower scope so as not to include every company as defined under the IT Act. It therefore becomes evident that Section 115JB does not include an FII/FPI.

C. "Place of business" under Section 591 to 594 of the Companies Act, 1956 and its applicability to FIIs/FPIs

5.3.1 There are several obligations cast upon FPIs under the SEBI (FPI) Regulations, 2014. The view of the Revenue authorities seems to be that under these Regulations, the resulting operations of FPIs create an 'established place of business within India' for the FPIs and therefore Sections 591 to 594 of the Companies Act, 1956 and Section 115BJ of the Income Tax Act would be applicable to FPIs.

5.3.2 However, in the opinion of this Committee, the view of the Revenue appears to be incorrect. Upon a reading of the SEBI Regulations (both the 1995 Regulations as also the 2014 Regulations), it can be seen that the books of accounts required to be maintained by the FPIs are different from books of accounts specified under Schedule VI of the Companies Act. Schedule VI prescribes the instructions for preparation of balance sheets and statements of profit and loss account whereas the SEBI Regulations merely prescribe the information to be maintained by the FPIs with respect to the trade that they carry in India. In addition, the SEBI Regulations do not mandate the maintenance of books of accounts for an FPI under Schedule VI of the Companies Act.

[83] 82 ITD 422.
[84] 133 TTJ 435.
[85] 2012 49 SOT 32.
[86] ITA No. 3676/M/2012, ITA No. 4113/M/2012 and CO/138/M/2013 Order dated 09th April, 2014.

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5.3.3 It is important to mention that the 2014 FPI Regulations do not mandate the appointment of a compliance officer to be in India. In fact, the compliance officer appointed by an FPI is usually situated outside India.

5.3.4 We now turn to Sections 591 to 594 of the Companies Act. Section 591 makes Sections 592 to 602 applicable to all foreign companies which have an established place of business within India. Section 594 provides that the foreign company shall, in every calendar year, make out a balance sheet and profit and loss account as per the Companies Act, a copy of which is to be delivered to the ROC. The term "*place of business*" is defined in Section 602 of the Companies Act to include a share transfer or a share registration office. The expression "*Place of business*" has been interpreted by various judicial decisions, not just by Indian Courts but also by English Courts.

5.3.5 In *Deverall vs. Grant Advertising Inc.*[87], it was held that the word "*establish*" indicates more than an occasional connection. A company will be establishing a place of business in India, if it has a specified or identifiable place at which it carries on business, such as an office, storehouse, godown or other premises, having some concrete connection between the locality and its business.

5.3.6 In *Lord Advocate vs. Huron and Erie Loan and Saving Co.*[88], it was held that if a foreign company has an agent within the UK but has no office there, then it does not establish a place of business within UK. In *Rakusens Ltd. vs. Baser Ambalaj Plastik Sanayi Ticaret*[89], the agent of an overseas company authorised to find customers on behalf of the company and to forward orders placed by the customers was held to be as not amounting to an established place of business.

5.3.7 The Court of Appeal in the case of *In Re, Oriel Ltd.*[90] held that the company must have some degree of continuity and recognisability with respect to its business before it can be treated to have an established place of business. The test would be satisfied if there is a location which is readily identifiable with the Company by the members of the public from which it could be deduced that some substantial business activity was being carried on.

5.3.8 It is important to have a look at the decision of the Delhi High Court in *Tumlare Software Services (P) Ltd. vs. Magic Software Services*[91]

[87](1955) 25 Comp. Cas. 37.
[88]1911 Scottish Cases 612.
[89]AS (2002) 1 BCLC 104 (CA).
[90][1985] 3 All ER 216.
[91][2001] 34 SCL 232.

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where the Court, while deciding whether a foreign company had established a place of business in India in terms of Section 591, held that mere appointment of a constituted attorney by a foreign company for the purposes of signing a contract did not result in establishing a place of business of the foreign company. The following observations of the Court are pertinent:

> *"As is apparent, the crux of the above provisions of Companies Act is that unless a company has a specified of 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 mean 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." [Emphasis supplied]*

5.3.9 It clearly emerges from the above decisions that there is a difference between "*carrying of business*" and having an "*established place of business*" in India since the latter requires some degree of performance which is not so in the case of the former.

5.3.10 FPIs do not normally have an office or employees of their own in India and they carry on their decision making activities outside India. The purchase and sale of securities in India can only be carried out by a SEBI registered stock broker. The local custodian only provides settlement services to FPIs and do not make any investment decisions on behalf of the FPIs. The appointment of stock brokers and domestic custodians in India are made in terms of the SEBI Regulations. Therefore, the dealings of FPIs in India are through independent agents like stock brokers and custodians and thus they do not have any physical presence in the country.

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D. Non-applicability of the charging provision in light of the computational failure under Section 115JB(2) of the IT Act.

5.4.1 The provisions of Section 115JB of the IT Act constitute an integrated code. The charging provision contained in Sub-Section (1) of Section 115JB cannot be read in isolation of the computation mechanism given under Sub-Section (2). Therefore, where the computation of a tax against such income levied under the Act is impossible to conduct, the charge of tax against such income too would resultantly fail. This is a well established principle under tax jurisprudence as seen from the decision of the Supreme Court in *CIT, Ernakulam, Kerala vs. Official Liquidator, Palai Central Bank Ltd. (In Liquidation)*[92]which held that:

> *"When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section there is no scheme of computation for quantifying it."*

5.4.2 In this regard, the Supreme Court has also laid down in *CIT vs. B.C. Srinivasa Shetty*[93]that*:*

> *"The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus the charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise one would be driven to conclude that while a certain income seems to fall within the charging section there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion. It must be borne in mind that the legislative intent is presumed to run uniformly through the entire conspectus of provisions pertaining to each head of income. No doubt there is a qualitative difference between the charging provision and a computation provision. And ordinarily the operation of the charging provision cannot be affected by the construction of a particular computation provision. But the question here is whether it is possible to apply the computation provision at all if a certain interpretation is pressed on the charging provision. That pertains to the fundamental integrality of the statutory scheme provided for each head."*

[92](1985) 1 SCC 45.
[93][1981] 128 ITR 294 (SC).

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5.4.3 The Revenue submitted before us that Section 115JB merely gives a general standard for preparation of accounts. Therefore, the same should be followed irrespective of whether the company is governed by the Companies Act or not. However, this view of the Revenue seems quite untenable to us for several reasons. *Firstly*, if the argument of the Revenue is to be accepted, then why would the reference to Section 210 be necessary which spells out the need to lay the accounts before the annual general meeting. As already discussed above, there is no requirement for an FII/FPI which has not established a place of business in India to lay its accounts before its AGM in terms of the Companies Act. *Secondly*, if the Revenue's view is accepted, then Electricity companies should have been maintaining accounts under both the Acts. There would not have been any need to bring in a specific amendment in 2012 to make the Electricity companies liable under Section 115JB. *Thirdly*, there is no guidance under Section 115JB as to which portion of the income of a foreign company, having no established place of business in India, is to be taken into consideration for the purpose of Section 115JB. There is also no guidance on how such foreign companies segregate their domestic accounts from the global accounts for the purposes of such computation, so as to ensure that the global profits are not offered for taxation in India.

E. Interplay between Section 115JB and Section 10(38) of the IT Act

5.5.1 The next submission of the Revenue, which also appears untenable to us, is regarding the interplay between Sections 10(38) and 115JB. The Revenue submitted that, as per *Castleton*[94], Section 10(38) is applicable to both domestic as well as foreign companies. It is further stated that by way of the amendment in 2006, the first Proviso has been added to Section 10(38) to provide that the income by way of long term capital gains of a company, though exempt under Section 10(38), shall be taken into account in computing the book profit and income tax payable under Section 115JB. Therefore, the argument of the Revenue is that since the term 'company' is mentioned in both Sections 10(38) and 115JB, then by necessary implication, Section 115JB must also be applicable to domestic as well as foreign companies, as is the case with Section 10(38).

5.5.2 This argument, in our view, is completely wrong. The proviso to Section 10(38) only means that long-term capital gain has to be added in computing book profits under Section 115JB(2). However, in order to attract the proviso to Section 10(38), the company must be covered under Section 115JB in the first place. We have seen form the discussion above that Section 115JB does not apply to FIIs/FPIs. Therefore, even the proviso of Section 10(38),

[94][2012] 348 ITR 537 (AAR).

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which makes a reference to Section 115JB would also not be applicable to FIIs/FPIs.

5.5.3 Therefore, we find that the ratio in *Castleton*[95] that even foreign companies having no 'place of business' or 'permanent establishment' are also covered by Section 115JB, is not the correct position of law. We therefore are of the view that MAT provisions cannot be applicable to FIIs/FPIs.

F. Section 115AD of the IT Act – A self-contained code for FIIs/FPIs

5.6.1 Part C of Chapter III dealt with the separate scheme introduced for FIIs/FPIs, taxing their income arising from Indian securities at a concessional rate under Section 115AD of the Act, introduced in 1993 when, FIIs were permitted to enter the Indian market. Table 3 therein explained how income earned by FIIs/FPIs from their Indian securities is treated as "capital gains", instead of "business profits", and is taxed according to the nature of gains. However, if Section 115JB were to apply to foreign companies, FIIs/FPIs would be liable to tax at 18.5% of their book profits, thus effectively losing their concessional tax basis, specifically provided in Section 115AD of the IT Act. This would have the following consequences for FIIs/FPIs:

a) *First*, long-term capital gains realised on the sale of Indian equities on the floor of a recognised Indian stock exchange, on which Securities Transaction Tax has been paid, would be taxed at 18.5% instead of 0% under Section 10(38) of the IT Act.

b) *Second,* long-term capital gains realised on the sale of Indian equities, off market, and Indian debt securities, on which no Securities Transaction Tax was paid, would be taxed at 18.5% instead of 10% under Section 115AD.

c) *Third*, short-term capital gains realised on the sale of Indian equities on the floor of a recognised Indian stock exchange, on which Securities Transaction Tax has been paid, would be taxed at 18.5% instead of 15% under Section 115AD read with Section 111A of the IT Act.

d) *Fourth*, interest income on certain rupee-denominated bonds and government securities covered under Section 194LD read with Section 115A would become taxable in the hands of the FII/FPI at 18.5% instead of 5% as per Section 194LD.

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[95] [2012] 348 ITR 537 (AAR).

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5.6.2 The above four points clearly indicate that applying the MAT provisions under Section 115JB would render the separate scheme under Section 115AD otiose. Such an interpretation is further bolstered by the fact that the set off provisions and MAT credit, which can currently be carried forward for up to ten years immediately succeeding the assessment year in which MAT was paid, become redundant since FIIs/FPIs will never be able to avail of its benefits. Under MAT, the tax credit earned by an assessee company is the difference between the amount payable under MAT and regular tax (under the normal computation of total income of the company). It can be availed in the year regular tax becomes payable, which in the present case would always be lower than 18.5% prescribed by Section 115JB.

5.6.3 It is thus clear that the Legislature could not have intended one part of the IT Act to render another part irrelevant and otiose. Given that the provisions of a statute have to be read harmoniously, we do not believe that Section 115JB would apply to FIIs/FPIs and they would instead, continue to be governed under the separate code under Section 115AD.

G. Interpretation of Section 115JB in light of the 2015 amendment

5.7.1 Subsequent to the 2015 amendment inserting clause (iid) and (fb) to Explanation 1 of Section 115JB(2), a possible interpretation that may be advanced by the Revenue is that the prospective nature of the amendment implies that prior to Assessment Year 2016-17, FIIs/FPIs are liable to pay MAT. Thus, it could be argued that all capital gains arising out of transactions in securities prior to 1st April 2016 could be credited to an FII/FPI's profit and loss account and taxed at 18.5%.

5.7.2 We, however, reject such an interpretation outright because it is based on the false premise that the insertion of an exclusion implies that in its absence, tax was payable in the past on what has now been excluded. Such an argument is not tethered to the text and context of the introduction of MAT and Section 115JB, as already discussed above.

5.7.3 It is pertinent to refer to the judgment of the Supreme Court in *CIT v. Madurai Mills*,[96] where the three-judge bench had to interpret the impact of an exemption provision under Section 12B of the Income Tax Act of 1922, which was earlier present but had not been re-introduced. Rejecting the Revenue's argument that the exclusion of the exemption provision when capital gains tax was re-introduced in 1956 would mean that the distribution of capital assets on the liquidation of a company would attract capital gains tax liability, the Court observed in pages 51-52:

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[96] [1973] 89 ITR 45 (SC).

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> "*This contention, in our opinion, is not well founded. It appears to us that the cases of the distribution of capital assets on dissolution of a firm or other association of persons or liquidation of a company were mentioned in the third proviso under the earlier Act, as a matter of clarification to allay fears even though the language of Sub-section (1) of Section 12B was not intended to apply to such cases. Provisos, as mentioned on page 221 of Craies on Statute Laws, Sixth Edition, are often inserted to allay fears. A proviso is inserted to guard against the particular case of which a particular person is apprehensive, although the enactment was never intended to apply to his case or to any other similar case at all.*
>
> *….. If the language of Sub-section (1) of Section 12B of the Act is clear and does not warrant the inference that distribution of assets on liquidation of a company constitutes sale, transfer or exchange the said transaction of distribution of assets would not, in our opinion, change its character and acquire the attributes of sale, transfer or exchange because of the omission of a clarification in the first proviso to Sub-section (1) of Section 12B of the Act, even though such a clarification was there in the third proviso of the section inserted by the earlier Act (Act 22 of 1947). It is well settled that considerations stemming from legislative history must not be allowed to override the plain words of a statute (see Maxwell on the Interpretation of Statutes, Twelfth Edition, page 65). A proviso cannot be construed as enlarging the scope of an enactment when it can be fairly and properly construed without attributing to it that effect…..*" [*Emphasis supplied*]

5.7.4 To extend this reasoning to the issue at hand, it can only be successfully argued that the prospective nature of the 2015 amendment indicates the liability of FIIs/FPIs to MAT if FIIs/FPIs were liable to pay MAT in the first place. As has been elaborated above, FIIs/FPIs are not governed by the regulatory regime of the Companies Act, thus taking such entities outside the ambit of Section 115JB of the IT Act. Thus, the 2015 amendment was not actually required to exempt them from MAT liability and can only be said to be clarificatory in nature.

5.7.5 Thus, merely because the Legislature grants an exemption out of anxiety or caution, it should not be presumed that, but for such specific exemption, the charge would otherwise have been attracted.[97] This is because the beliefs or assumptions of those who draft laws cannot actually make law.[98]

[97] See *Cadell Weaving Mills Ltd v CIT*, [2001] 249 ITR 265 (Bom) affirmed in *CIT v Sandu Brothers*, [2005] 273 ITR 1 (SC) for a similar principle.
[98] *ITO v Mani Ram*, [1969] 72 ITR 203 (SC), at 211.

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5.7.6 To conclude, merely because clauses (iid) and (fb) have been introduced in Explanation 1 to Section 115JB(2) by the Finance Act of 2015 with effect from 1st April 2016 does not mean that FIIs/FPIs can be said to be covered by the MAT provision in Section 115JB. Nevertheless, at this stage we would like to point out that various concerns have been raised about the efficacy, correctness and workability of the 2015 amendment and the fear of it leading to more litigation, both during the written submissions and the hearings. Although this issue is not part of our Terms of Reference, we recommend that the government may consider the concerns raised in respect of the amendment brought out by the Finance Act of 2015.

H. Interpretation of Section 115JB in light of Section 90 of the IT Act and the existing DTAAs

5.8.1 Although this Report is limited to the consideration of the applicability of Section 115JB to FIIs/FPIs, regardless of the applicability of any treaty, it is important to consider DTAAs, under which many foreign companies are exempt from tax or are taxed at a reduced rate.

5.8.2 India has entered into nearly 90 DTAAs with other countries and by virtue of Section 90(2), the DTAA provisions will override the provisions of the IT Act (including Section 115JB) if they contain more beneficial provisions for the assessee-company.[99] In such cases, FIIs/FPIs will clearly not be taxable under Section 115JB. The intent of the *non-obstante* clause of Section 115JB cannot be interpreted to override a specific treaty obligation and due meaning needs to be given to Article 51(c) of the Constitution.[100]

5.8.3 At this stage, it is relevant to briefly point out certain other problems in including FIIs/FPIs within the purview of MAT. For instance, various items of income under a DTAA cannot be taxed in India at all, although they constitute a part of the "book profit" of the FII/FPI. Alternately, certain items can be taxed in India – such as income attributable to a foreign company's PE in India – but these are entirely different and lower than the company's global "book profit" under its profit and loss accounts. Section 115JB(2) does not provide for any mechanism for splitting up the amounts from the book profit shown by the FII/FPI in its profit and loss account and segregating it from its global profits.

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[99] In fact, a reading of Section 90(2A) with Chapter XA of the IT Act also makes it clear that the DTAA clearly overrides Section 115JB of the IT Act, given that it contains an express exclusion for the provisions within Chapter XA.

[100] Article 51(c) of the Constitution states that the "*State shall endeavor to foster respect for international law and treaty obligations in the dealings of organised peoples with one another; and encourage settlement of international disputes by arbitration*."

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5.8.4 Thus, it is clear that where a DTAA exemption is available, the MAT provisions would not be applicable, regardless of the interpretation given to Section 115JB; and the interpretation as rendered in *Castleton*,[101] based on the *non obstante* clause contained in Section 115JB, is incorrect.

I. Tax certainty as a desirable goal

5.9.1 Apart from the legal arguments elaborated above, it is also significant to consider certain other commercial and policy arguments, particularly the importance of tax certainty to foreign investors.

5.9.2 Most FIIs/FPIs are well-regulated investment funds or pooling vehicles, being "collective investment vehicles", that pool investments from different investors to access diverse Indian securities in a cost-effective manner. Notably, many FIIs are open-ended investment funds, which permit their investors to enter and exit daily, based on the Net Asset Value (**"NAV"**) of the investment fund. Thus, investors in an FII keep changing on a daily basis. This makes the need for tax certainty even more important, inasmuch as the NAVs are directly affected by tax liabilities and the burden of an unanticipated tax liability relating to previous years has to be borne by the investors participating presently. The fear of an unanticipated tax liability, even without it actually being imposed, may be a sufficient trigger for investors to exit such open-ended investment funds based on a possible erosion in the NAV of the fund. Many such arguments were brought to the notice of the Committee.

5.9.3 It is in this context, therefore, that the sudden change in the interpretation of Section 115JB to apply to FIIs/FPIs has to be viewed. In the 19 years since MAT was introduced in the IT Act (in 1996), it had never been levied on FIIs/FPIs.[102]Instead, the beneficial tax scheme under Section 115AD was always applied to FIIs/FPIs. As mentioned earlier, the Department accepted the *Timken*[103] ruling and did not file an appeal. Even after the 2012 ruling in *Castleton*,[104] which significantly did not deal with an FII/FPI, no notices were issued by the Revenue authorities in the financial year 2012-13 and 2013-14. At no point of time did the Registrar of Companies under the Companies Act, 1956 call upon FIIs/FPIs to file their global accounts the RoC; evidencing that despite the *Castleton* ruling, FIIs/FPIs were not intended to be liable under the MAT provision. The situation, however, changed in August 2014, when

[101] [2012] ITR 537 (AAR).
[102]In a few stray cases, discussed in Chapter IV, MAT provisions were made applicable to foreign companies, but *only* where these foreign companies had a place of business or permanent establishment in India by way of a branch or project office.
[103][2010]326 ITR 193 (AAR).
[104][2012] 348 ITR 537 (AAR).

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notices began being issued to FIIs/FPIs calling upon them to pay MAT. A change in this settled position so late in the day is unfortunately perceived as a retrospective amendment to the law.

5.9.4 While we acknowledge that the Department has been constrained to issue MAT notices to FIIs/FPIs as a consequence of the *Castleton* ruling, the Committee believe the ruling to be completely wrong. Ultimately, we take notice of the fact that while this is not an actual case of retrospective levy of tax on FIIs/FPIs, the *Castleton* ruling and subsequent Department action has raised significant concerns in the foreign investment community.

J. Comparative international practices

5.10.1 So far, the Committee has resisted examining or commenting upon international practices regarding MAT, or "alternative minimum tax" or "minimum tax", since it does not directly affect our interpretation of Section 115JB. Nevertheless, we find it fit to consider the same at the end of our analysis to provide a better context to our recommendations.

5.10.2 In this regard, it is instructive to note that none of the other BRICS countries, namely Brazil, Russia, China and South Africa, levy MAT. Some of the OECD, such as Austria, Belgium, Hungary, Republic of Korea, Luxembourg, Slovak Republic/Slovakia and USA, levy MAT, but do not levy the same on foreign companies / persons unless they have a physical presence in such countries. For example, in the United States of America, MAT is applicable to domestic as well as foreign companies. However, foreign companies are taxed only on their "Effectively Connected Income". All income from sources within the USA connected with the conduct of that trade business is considered to be "Effectively Connected Income". However, if the business activity in the USA is restricted to trading in stocks, securities, or commodities (including hedging transactions) through a resident broker or other agent, then a foreign person is not considered to be engaged in a trade or business in the USA. Hence, such income of the foreign person is not taxable in the USA.

5.10.3 India thus seems to be an outlier in its tax treatment of FIIs/FPIs. Significantly, the position has changed after the recent amendment brought in by the Finance Act of 2015 (as discussed above).

5.10.4 Having analysed various aspects surrounding the applicability of MAT provisions to FIIs/FPIs, including an interpretation of Section 115JB of the Act, we now turn to our recommendations in the next chapter.

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CHAPTER VI

RECOMMENDATIONS OF THE COMMITTEE

A. Summary of the Findings

6.1 Legislative History of the MAT Provisions in the IT Act

In order to interpret an existing provision of a fiscal statute, the legislative history, circulars and directions issued by the CBDT can be used as legitimate aids in the construction of such a provision. Having examined the various circulars and directions issued by the CBDT, including Circular Nos. 495, 762, and 794; and the legislative history, including the Finance Acts of 1987, 2002, and 2012, it can be concluded that the Legislature could only have intended for MAT to apply to companies governed by the regulatory requirement of the Companies Act, 1956. This is further bolstered by the fact that the Legislature expressly failed to specify any method for the computation of book profits for FIIs/FPIs, as it specifically did for electricity, banking and non-life insurance companies by way of the 2012 amendment. This makes it clear that the obligation under Section 115JB exists because of the regulatory requirements of the Companies Act and not independent of it.

6.2 Contextual interpretation of the term "company" in Section 115JB

6.2.1 The term "company" as defined under Section 2(17) of the IT Act includes foreign companies. Nevertheless, Section 2 begins with the phrase, "*In this Act, unless the context otherwise requires….*".

6.2.2 If Section 115JB is held applicable to FIIs/FPIs, they would be required to compile their global accounts in accordance with the Companies Act. However, such an obligation is absent in the legislative intent, as is evident from the insertion of Explanation 3 by the 2012 amendment, which failed to provide any computation mechanism for foreign companies' book profits. Rather, the consideration of such foreign income in the company's "book profits" would be contrary to the principle of *territorial nexus*, which is the basic principle for chargeability of income tax. Evidently therefore, the legislative intent was not to cover all kinds of companies, but to limit the definition based on context. We find that "company" has a narrower scope under Section 115JB than Section 2(17), IT Act, and is limited to entities required to file accounts in accordance with Sections 591 to 594 of the Companies Act, 1956. Thus, Section 115JB clearly does not cover an FII/FPI, and any other interpretation would render the computation mechanism in the Section unworkable.

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6.2.3 The Committee is not expressing any view on whether a foreign company having a PE/place of place of business in India is covered by Section 115JB. This issue is squarely covered by the decisions of the AAR in *The Timken Company*[105]and *Praxair Pacific Ltd.*[106]

6.3 Whether FIIs/FPIs ordinarily have an established "place of business" in India under Section 591 to 594 of the Companies Act, 1956

The expression "place of business" has been judicially interpreted to mean a permanent and specific location in that country from where a company habitually and regularly carries on its business. The Committee has come to a finding based upon established precedent that having an "established place of business" is different from merely carrying on a business in India. FIIs/FPIs normally do not have their own office or employees in India and carry out their decision-making activities outside India. All their dealings are through independent agents in India. Additionally, the SEBI Regulations do not mandate their maintenance of books of accounts under Schedule VI of the Companies Act. Thus, FIIs/FPIs are, ordinarily, not covered under Sections 591 to 594 of the Companies Act, 1956.

6.4 Non-applicability of the charging provision in light of the computational failure under Section 115JB(2) of the IT Act

Section 115JB of the IT Act is an integrated code and the charging provision contained in sub-section (1) cannot be read in isolation of the computation mechanism under sub-section (2). Thus, where the computation of a tax against such income is impossible to calculate, the charge of tax against must also resultantly fail. The Committee disagrees with the Revenue's argument that Section 115JB merely prescribes a general standard for preparation of accounts, which should be followed regardless of the company being governed by the Companies Act. Due to the computational failure in light of Section 591 read with Section 594, Companies Act and the absence of guidance on the segregation of domestic and global accounts, a foreign company having no established place of business or PE in India (i.e. an FII/FPI) cannot be taxed under Section 115JB.

6.5 Interplay between Section 115JB and Section 10(38) of the IT Act

The Revenue argued that Section 10(38) is applicable to both domestic as also foreign companies and since "company" was used in both Sections 10(38) and 115JB, then, by necessary implication, Section 115JB

[105] [2010] 326 ITR 193 (AAR).
[106] [2010] 326 ITR 276 (AAR).

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must also be applicable to foreign companies. This is a completely incorrect argument in our view. In order to attract the proviso to Section 10(38), the company must be covered under Section 115JB in the first place. As evidenced from the discussion in the Report, Section 115JB is not applicable to FIIs/FPIs. Therefore, even the proviso of Section 10(38), which makes a reference to Section 115JB, cannot be applicable to FIIs/FPIs.

6.6 Section 115AD of the IT Act – A self-contained code for FIIs/FPIs

Section 115AD of the IT Act, introduced in 1993 (when FIIs entered the Indian market) provides for a separate scheme for taxing the income of FIIs/FPIs, arising from Indian securities at a concessional rate. A perusal of this scheme clearly indicates that applying the MAT provisions under Section 115JB would render this separate scheme under Section 115AD otiose inasmuch as FIIs/FPIs will be taxed at a higher rate under Section 115JB and will not be able to avail of the benefits of the set off provisions and MAT credit. This indicates that Section 115AD, not Section 115JB, would apply to FIIs/FPIs.

6.7 Interpreting Section 115JB in light of the 2015 amendment

As discussed elaborately in the Report, FIIs/FPIs are not governed by the regulatory regime of the Companies Act, and thus Section 115JB is inapplicable to them. The 2015 amendment was only clarificatory in nature, and was not actually required to exempt them from MAT liability. Therefore, its prospective nature cannot be used to apply a different interpretation pre-2015.

6.8 Interpreting Section 115JB in light of Section 90 and the DTAAs

Section 90(2) of the IT Act provides that the DTAA provisions will override the provisions of the IT Act (including Section 115JB) if they contain more beneficial provisions for the assessee-company. Thus, regardless of the interpretation given to Section 115JB, it will not be applicable where a beneficial DTAA exemption is available. *Castleton's* interpretation to the contrary, based on the *non-obstante* clause in Section 115JB, is incorrect.

6.9 Tax certainty as a desirable goal

6.9.1 FIIs are mostly open-ended investment funds, which permit their investors to enter and exist daily, based on the NAV of the fund. Unanticipated tax liability (or the fear thereof) relating to previous years, which would have to be borne by the current investors, may be a sufficient trigger for the investors to exit. The sudden change in the interpretation of the applicability of Section 115JB to FIIs/FPIs thus contextualises the need for tax certainty. In the 19 years

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since MAT was introduced (in 1996), it had never been levied on FIIs/FPIs, which were instead governed by the beneficial tax scheme under Section 115AD. Significantly, the Department also accepted the *Timken* ruling and did not file an appeal. Even after the 2012 ruling in *Castleton*, the Registrar of Companies, under the Companies Act, never called upon FIIs/FPIs to file their global accounts, evidencing that FIIs/FPIs were not intended to be taxed under the MAT provision.

6.9.2 A change in this settled position in August 2014 is extremely late in the day. While this may be a consequence of the *Castleton* ruling, the Committee believes the ruling to be completely wrong.

6.10 Comparative international practices

None of the other BRICS countries, namely Brazil, Russia, China and South Africa, levy MAT. Some of the OECD countries, such as Austria, Belgium, Hungary, Republic of Korea, Luxembourg, Slovak Republic/Slovakia and USA, levy MAT, but do not levy the same on foreign companies / persons unless they have a physical presence in such countries. India is therefore perceived as an exception in terms of its tax treatment of FIIs/FPIs. The position however has significantly changed after the recent amendment brought in by the Finance Act of 2015, which is discussed in detail in the Report.

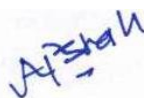
B. <u>Recommendations</u>

6.11 In view of the findings and upon a considered deliberation, we would like to make the following recommendations to the Government:

(i) To bring an amendment to Section 115JB of the Income Tax Act, 1961 clarifying the complete inapplicability of the MAT provisions to FIIs/FPIs; or

(ii) CBDT may issue a circular clarifying the complete inapplicability of the MAT provisions to FIIs/FPIs.

[Dr.Girish Ahuja]
Member



[Justice (Retd.) Ajit Prakash Shah]
Chairman

[Dr. Ashok Lahiri]
Member

New Delhi ***August 25th, 2015***

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