

# *Hazards of retrospective amendments in tax planning*

FE NEWSLINE

Chandigarh, Monday, August 13, 2001

Tax practitioners need to update themselves on how a statutory provision has been interpreted by different courts of law on different occasions; in order to conceive and advice novel and acceptable tax-planning techniques. This is where the Supreme court decisions are very important—as if the final word on any question of law, unless the following Finance bill(budget) proposes amendments to nullify these rulings which are not in favour of the revenue. This act of the Parliament has the strength of upsetting the tax-planning applectart, more so in cases where the amendments are made with retrospective effect.

## **Meaning of retrospective amendment :**

When the date of commencement of an amendment is the date on which it is inserted in the statute book it is known as a prospective amendment. When amendments are made operative from a date prior to the date the amendment is inserted in the statute, it is known as a retrospective amendment.

## **Powers of the legislature :**

It is a well-settled judicial position that the legislature, in exercise of its legislative powers, can enact laws that are retrospective in their operation. Courts have upheld the powers of the legislature in enacting amendments retrospectively. Reference can be drawn to the Supreme Court decisions in the case of Rai Ramanakrishna vs State of Bihar (1963 50 ITR 171) and D Cawasji vs State of Mysore (1984 150 ITR 648).

## **Judicial thought :**

It is a settled proposition that there is no legal disability in the powers of the legislature in enacting laws that are retrospective in operation, it is perhaps appropriate to review the judicial thought on some aspects.

In the case of Rai Ramanakrishna vs State of Bihar (1963 50 ITR 171) as apex court held that if a law passed by the legislature is struck down by the courts as being invalid on account of one infirmity or another, it is competent for the legislature to cure the said infirmity and pass a validating law to make the earlier law effective from the date when it was passed.

## **An incident :**

In the context of depreciation, a debate had been raging for several years on the issue of whether depreciation claim is optional or mandatory on the assessee. There had been cases at various levels of adjudication both under the existing provisions of Section 32 of the I-T Act as well as under the depreciation provisions as it stood when Section 34(1) was in the tax statute.

In the same context of depreciation, based on a Supreme Court decision I once suggested a client of mine running a factory in a backward area not to claim depreciation, advising him to revise his previous year Return to his advantage by claiming 100 per cent deduction of profits u/s 80IA. The benefit of the advice was shortlived due to an amendment of Section 32 and insertion of clause 5 thereunder. Nani Palkiwala rightly observed “retrospective provisions can only serve to bring law into contempt. They imply that the citizen’s right to appeal is illusory, that the executive is omnipotent”

## ***Problems that may arise due to amendments with retrospective effect :***

□ **Impact on pending matters:** A retrospective amendment of law must be given effect to by all, including the appellate and revisional authorities. A completed assessment may be re-opened under Section 147 of the I-T Act or rectified under Section 154, if the relevant provisions of the law are amended with retrospective effect. However, such reassessment/rectification proceeding cannot be initiated where the prescribed period of limitation has elapsed.

□ Retrospective amendments result in potential complications and hardships to the tax payers. For example, if any tax assumptions are built into business plans, the same have to be revisited. Where such business plans and financial models are used by bankers and project lenders to make lending decisions, the change in law provisions are often invoked and rates renegotiated by them. Needless to say, this results in avoidable litigation.

□ Irregular Decline in Profit :In the case of listed companies, where an additional tax provision needs to be booked as a result of past years' adjustments due to retrospective amendments to the law, the profit figure show an irregular decline, which affect stock market sentiments.

□ Discretion : With retrospection galore ,even in cases of amendments with prospective effect ,it is quite possible that tax authorities would be inclined to treat these explanation as clarificatory in nature and apply the same for earlier years.

## **SUPREME COURT CASE ANALYSIS- a study**

**Case 1 :** Rajasthan State Warehousing Corpn.vs. CIT (2000)159 CTR(SC)132

**Held:** When an assessee is carrying on one indivisible business in various ventures and some among them yield taxable income and the others do not, the entire expenditure is a permissible deduction without any apportionment .(Date of judgement: 23.02.2000)

**Budget reaction:** Section 14A has been introduced with retrospective effect from 1<sup>st</sup> April,1962 to nullify the above decision

**Case II :** Bharat Earth Movers vs. CIT (2000)162 CTR (SC)325 :

**Held:** Provision for liability towards leave encashment entitlement is entitled to deduction out of the gross receipt for the accounting year during which the provision is made for the liability. (Date of judgement: 9.08.2000)

**Budget reaction :**

**Section 43B stands amended, w.e.f. 1.4.2002, thus nullifying the above decision.**

**Case III:** CIT vs. Ranchi Club Limited (2000)164 CTR (SC)200

**Held:** Interest under section 234A and 234B is leviable on the tax on the total income as declared in the return and not on the income as determined by the assessing authority.(Date of judgement : (1.08.2000)

**Budget reaction:**

Section 234A and 234B of the I-T Act have been amended w.e.f 1.4.1989 to provide that assessed tax shall mean the tax on total income determined u/s 143(1) or on regular assessment as reduced by the amount of tax deducted at source.

Other amendments with retrospective effect in the Finance Act,2001 are as follows:

1. An explanation has been inserted to Section 36(1) (vii) of the I-T Act with effect from April 1,1989, to provide that a bad debt written-off as irrecoverable does not include provision for bad and doubtful debts.

2. Section 90 has been amended with effect from the assessment year 1962-63 to clarify that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. By implication therefore, it appears that this amendment has been inserted to prevent the application of the non-discrimination clause of treaties on the grounds of differences in tax rates between Indian companies and foreign companies.

3. There is nothing in section 201 to treat the payer as an assessee in default where there is a shortfall in deduction of tax at source and, therefore the provisions of section 201 shall not apply in a case where there is short deduction of tax at source by the payer, as Held by the Andhra Pradesh HighCourt in the case of P.V.Rajagopal vs.Union of India:233 ITR 678 and by the Mumbai Bench of the Tribunal in the case of Associated Cement Company: 74 ITD 369. Subsection (1) and (1A) has been amended with retrospective effect from the assessment year 1962-63 to clarify that section 201 shall apply if the principal officer, company or the concerned person fails to deduct the whole or any part of the tax.

**Effect :**

This amendment with retrospective effect can cause hardship & avoidable complication especially in cases where the assessee could have recovered or adjusted in later years the part of tax unrecovered if any in previous years but did not do it since it was not open to penalty for recovering part TDS in the respective previous years

Although it is clear that the Parliament has the right to legislate retrospectively and often it is necessary to do so, caution is essential to ensure that retrospective amendments do not result in unsettling existing commercial and business arrangements.

In an era of reorganization and massive restructuring of the revenue departments and roof top slogan of being assessee friendly I am sure this is not a step in the right direction. By slapping fresh liabilities with retrospective effect we play the 'Bully Big Brother' and this is what we wanted to wash off while giving the new facelift to the department. Amendments with retrospective effect will bring litigation and grief to the already ailing economy such additional demands shall be an undesirable dent on the purse and which in some cases would not be even in a position to be met. and the worst thing is that the assessee has not been given a chance to plan or provide for such liabilities in the respective previous years. The assessee is going to feel let down by the supreme court in cases where the apex court decisions had been relied upon in the past (now nullified with retrospective effect). Who knows that in cases of amendments of clarificatory nature the department may draw inference that may only suit the revenue and that too with retrospective effect. The true face is yet to emerge - will it be assessee friendly ?

**A retrospective amendment of law must be given effect to by all, including the appellate and revisional authorities. A completed assessment may be re-opened under Section 17 of the I-T Act or rectified under Section 154, if the relevant provisions of the law are amended with retrospective effect. However, such re-assessment/rectification proceeding cannot be initiated where the prescribed period of limitation has lapsed.**