

Corporate Guarantee - Tinkering with the Continued Debate of Prospective vs Retrospective application!

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Introduction

Retrospective amendments are not a new feature in the Income tax law. Many retrospective amendments have been made, not only in procedural law, but also as regards substantive provisions. One such debate of retrospectivity is in the context of amendment made to the definition of International Transaction under section 92B of the Income tax Act, 1961 (hereinafter referred to as 'the Act'). The definition of International Transaction was earlier limited to being a transaction in the nature of purchase, sale or lease of tangible or intangible property, or provision of services etc. or which has a bearing on the profits, income, losses or assets of such enterprises. This was widened in scope by inserting an Explanation to it by Finance Act 2021 w.e.f. 1/4/2002. The said Explanation covers in its ambit various transactions like *capital financing, including any type of long-term or short-term borrowing, lending or guarantee.....* And the list doesn't end!

With the increase in outbound investments, the Indian transfer pricing administration had come across cases of corporate guarantees extended by Indian parents to its associated entities (AEs) abroad, where the Indian parent, as guarantor, agrees to pay the entire amount due on a loan instrument on default by the borrower. The guarantee helps an AE of the Indian multi-national enterprise (MNE) to secure a loan from the bank. Transactions of giving corporate guarantee to AEs for the purposes of funding, are widely prevalent in corporate world but at the same time, is also a highly litigated issue during Transfer Pricing proceedings. Prior to the amendment in section 92B, the issue under controversy was whether giving corporate guarantee is covered under “Provision of services” and hence covered in the definition of an international transaction. The amendment, by including guarantee in the definition of international transaction, has clarified, and put to rest the said controversy. However, it has opened another area of litigation i.e., whether such insertion of “corporate guarantee” in the definition of international taxation has to be given effect retrospectively or prospectively.

Corporate Guarantee - Whether included in the definition of international Transaction retrospectively or prospectively?

Prior to the amendment brought about in Section 92B, the definition of international transaction did not specifically cover the transaction of Corporate Guarantee. However, as mentioned above, vide Finance Act 2012, the definition of international transaction was amended with retrospective effect from April 01, 2002, which provided that international transaction shall also include capital financing, including any type of long-term or short-term borrowing, lending or guarantee etc. It was only after Finance Act 2012 that list of transactions were inserted by way of an Explanation to the definition of International Transaction which has a wide coverage and seems to include even corporate guarantee in the definition of international transaction.

The wording of the Explanation to Section 92B starts with ‘*for removal of doubts, it is clarified that.....*’. Bare reading of the said Explanation would reveal that it’s a clarificatory amendment and hence, should be retrospective, but Tribunals in some cases had held that corporate guarantee is not an international transaction^[1]. This decision came as a relief to taxpayers, though the revenue authorities did not really consider the same and there were also divergent views of other Tribunals^[2], but not a single decision of High Court on this issue.

Then came the decision of Hon’ble Madras High Court which turned the tables! In the case of Redington (India) Ltd.^[3], though the Court rightly held that “**An Amendment made with the object of removal of doubts and to clarify, undoubtedly has to be read to be retrospective and Courts are bound to give effect to such retrospective legislation**”, however, with due respect to the decision of the Hon’ble Court, the said principle has been applied incorrectly because the insertion of definition of international transaction cannot be said to be clarificatory and a clarification cannot extend the scope. This decision was then followed by Delhi Tribunal in a recent case of DLF Limited (ITAs. No. 5940 & 5941/DEL/2017 pronounced on 10th September 2021) as well as Mumbai Tribunal

in case of Siro Clinpharm Private Limited (TS-475-ITAT-2021(Mum)-TP pronounced on 9th September 2021).

What exactly does a Retrospective Amendment mean? Can a retrospective amendment enhance the scope of international transaction by implementing it for a period prior to the law coming on the books of the Statute? Though the legislature can pass a law and make its provisions retrospective, it would be relevant to consider the effect of the said retroactive operation of the law both in respect of the legislative competence of the legislature and the reasonableness of the restrictions imposed by it. If one is to proceed on the premise that the provisions of Explanation to section 92B enlarge the scope of section 92B itself, even as it is timidly described as 'clarificatory' in nature, it is an issue to be examined whether an enhancement of scope of this anti avoidance provision can be implemented with retrospective effect. In the case Bharti Airtel Limited, the Delhi Tribunal had observed that *'Undoubtedly, the scope of a charging provision can be enlarged with retrospective effect, but an anti-avoidance measure, that the transfer pricing legislation inherently is, is not primarily a source of revenue as it mainly seeks complaint behaviour from the assessee vis-à-vis certain norms, and these norms cannot be given effect from a date earlier than the date norms are being introduced'*.

An Explanation, insofar as it seeks to bring a transaction of corporate guarantee within the ambit of international transaction should be termed as explanatory. Law does not expect anyone to perform an impossibility. Reiterating this legal position, Hon'ble Supreme Court has, in the case of Krishnaswamy S Pd v. Union of India [2006] 281 ITR 305, observed that *"The other relevant maxim is, lex non cogit ad impossibilia i.e., law does not compel a man to do what he cannot possibly perform. The law itself and its administration is understood to disclaim as it does in its general aphorisms, all intention of compelling impossibilities, and the administration of law must adopt that general exception in the consideration of particular cases."* **A taxpayer could not be intuitive to know how the law would change in future and hence, he cannot be fastened with a liability by a retrospective amendment.**

Further as observed by Hon'ble Delhi High Court in case of New Skies Satellite BV^[4]: *just because a provision is stated to be clarificatory, it does not become entitled to be treated as 'clarificatory' by the judicial forums as well.* The determination by the judiciary, i.e., whether the amendment is indeed clarificatory or is the amendment to overcome a judicial precedent, assumes great significance because when it is found that the purpose of such interpretive statute, or clarificatory amendment, is to correct a judicial interpretation of prior law, which the legislature considers inaccurate, the effect is prospective.

It is always important to consider the legislative intent while interpreting retrospective amendments. Amendments, though framed as clarificatory, which are in fact transformative substantive amendments, are incapable of being given retrospective effect more particularly, the anti-abuse legislations.

In this context, a taxpayer favouring precedence by the Hon'ble Supreme Court came

recently in case of M.M. Aqua Technologies Ltd.[\[5\]](#), wherein it was held that a retrospective provision in a tax act which is '**for removal of doubts**' cannot be presumed to be retrospective, even where such language is used, **if it alters or changes law as it earlier stood**. A taxpayer is bound not only by the law as legislated by the legislature, but by the judge made law as well. Once the law is laid down by Hon'ble Courts, then onus is on the taxpayer to perform in accordance with the provisions of the statute, in accordance with the law laid down by Hon'ble Courts and in the light of binding judicial precedents. **When a binding judicial precedent requires to deviate from the specific words of the provisions of a statute in a particular manner, then a taxpayer is required to do so**. Of course, whatever a taxpayer does, is and shall always remain, a subject matter of approval by judiciary.

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Conclusion

Taking recourse from the recent decision of Supreme Court would give some breathing space to the taxpayers because interpreting the amendment by way of insertion of the Explanation in Section 92B in any other manner would cause grave hardship. An amendment, if it expands or changes the law, should be read as prospective, even though it has been inserted with retrospective effect. For an amendment to be termed as clarificatory, the enactment, prior to the clarifications should be ambiguous, only then can one call it a clarificatory amendment and hence, a retrospective amendment. The legislature cannot sweep under the pretext of an amendment being clarificatory in nature and bring in a new enactment retrospectively. Though the government is granted the power to legislate laws and amendments with retrospective effect, its scope is restricted to exceptional cases and hence, before making any retro operative law, consideration of its necessity, applicability and effects by the government is vital. In fact, the Vodafone controversy is one such example and a significant case in retrospective amendment made to tax laws whereby the decision was in favour of Vodafone by Hon'ble Supreme Court, followed by complete U-turn due to retrospective amendment in section 9 of the Act, Arbitration proceedings and then making the amendment prospective by the recent Taxation Amendment Act 2021. Let's hope that the authorities interpret such amendments in similar manner as how Hon'ble Supreme Court has explained, and unnecessary litigation be avoided.

[\[1\]](#) Bharti Airtel Limited v. Addl. CIT [\[TS-76-ITAT-2014\(DEL\)-TP\]](#)

[\[2\]](#) M/s. Four Soft P. Ltd. v. DCIT [2014] [\[TS-104-ITAT-2014\(HYD\)-TP\]](#), Mahindra & Mahindra Ltd. v. DCIT [2012]

[\[3\]](#) Pr. CIT v. Redington (India) Limited [2021] [\[TS-656-HC-2020\(MAD\)-TP\]](#)

[\[4\]](#) [TS-64-HC-2016(Delhi High Court)]

[\[5\]](#) M.M. Aqua Technologies Ltd. v. CIT [2021]