Sedco Forex International Drill. Inc. & ... vs Commissioner Of Income Tax, Dehradun & ... on 17 November, 2005

Equivalent citations: AIR 2006 SUPREME COURT 428, 2005 (12) SCC 717, 2005 AIR SCW 6082, 2006 (1) ALL LJ 347, 2006 TAX. L. R. 1, 2005 (8) SLT 657, (2005) 9 JT 639 (SC), (2005) 149 TAXMAN 352, 2005 (9) SCALE 388, (2006) 1 SCJ 53, (2006) 192 TAXATION 27, (2005) 9 SCALE 388, (2005) 199 CURTAXREP 320, (2005) 279 ITR 310, (2005) 8 SUPREME 174

Author: Ruma Pal

Bench: Ruma Pal, Tarun Chatterjee

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           CASE NO.:
Appeal (civil)  351-355 of 2005

PETITIONER:
Sedco Forex International Drill. Inc. & Ors.

RESPONDENT:
Commissioner of Income Tax, Dehradun  & Anr.

DATE OF JUDGMENT: 17/11/2005

BENCH:
Ruma Pal & Tarun Chatterjee

JUDGMENT:
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J U D G M E N T With Civil Appeal Nos.375-426, 428-447, 462, 465-472, 474-476, 478, 480-481, 483-484, 545, 502-511, 513-521, 526-530, 534-544,546 of 2005 RUMA PAL, J The appellant has filed these appeals as the agent of its employees who are the assessees in the present case. The appellant itself is a company which was incorporated in Panama. It entered into a wet lease with the Oil and Natural Gas Commission (ONGC) under which the appellant agreed to supply oil rigs and the employees to man the rigs to enable ONGC to carry on offshore drilling within the territorial waters of this country. The appellant also entered into agreements (which were executed in the United Kingdom) with each of its employees who are residents of the United Kingdom. The schedule of work as specified in the agreements envisaged 35 days or 28 days work in a foreign location (in this case India) followed by 35 days or 28 days "field break" in the United Kingdom (UK). "Field break" was defined in the agreements to include, but was not limited to, undergoing training by attending classes at such places as may be specified, on the spot demonstration to update the knowledge in the latest techniques and attending to the offshore drilling work on any project of the appellant in any part of the world. The agreements further provided that such assignments would be obligatory and compulsory and that the employee would have no option to deny or reject the same.

The alternative schedule of time at location and at field breaks was to be repeated continuously during the period of the agreements. The employees were to be paid the same monthly salaries for the alternating periods.

The issue is whether the salary of the employees of the appellant payable for field breaks outside India would be subjected to tax under Section 9(1)(ii) read with the Explanation thereto in the Income Tax Act 1961 (hereinafter referred to as 'the Act') for the Assessment years 1992-93, 1993-94.

The Assessing Authority assessed the employees of the appellant including the salary for the field breaks as part of the total income under Section 9 (1)(ii) of the Act. The Commissioner of Income Tax dismissed the employees' appeal. The Tribunal however held that the addition of such salary was not justified and the same was deleted. The Department's appeal to the High Court was allowed on the ground that the 'Off period' and 'On periods' formed an integral part of the agreement between the appellant and its employees and that it was not possible to give separate tax treatment to the two periods. It was further held that during the field breaks the employees had to remain fit and had to undergo demonstration and training and all that had a nexus with the services the assessees had to render in India. Construing Section 9(1)(ii), the High Court rejected the submission that the phrase "income earned in India" meant that in all cases where services were rendered outside India, the salary could not be deemed to accrue in India, ipso facto. The High Court held that the training during the period of field breaks was directly connected with the works on the rigs in India, and as such the salary for the 'Off period' was income "earned" in India within the meaning of the phrase in Section 9(1) (ii) of the Act. The third ground for reversing the view taken by the Tribunal was that the assessment records showed that the employer company had paid the salary of the employees including salary for the 'Off period' out of the income of the Indian operations.

Assailing the decision of the High Court, the employees, through the appellant, have submitted that the High Court had not taken into account the statutory change effected to Section 9(1)(ii). It was submitted that in 1999 the scope of the section was amended to include salary for 'Off periods' outside India for the first time with effect from 1st April, 2000. It was submitted that the impugned decision in fact purported to give retrospective effect to the provisions introduced in 1999 to cover the assessment years in question. It was submitted that the scope of Section 9(1)(ii) after its amendment in 1999 had been clarified by a circular issued by the Central Board of Direct Taxes (CBDT) as being prospective and this was binding on the Department. It was contended that in any event the provisions of the section must be construed in accordance with international understanding and norms. According to the appellant during the field breaks, its employees were kept on standby in the UK for serving anywhere in the world which was not necessarily in India. Appearing on behalf of the respondents, the Additional Solicitor General submitted that the employees of the appellant company were paid salary during the field breaks only as a consequence of and in relation to the services rendered by them during the period that they actually worked in India. It necessarily followed that the salary received for the 'Off period' was taxable as arising out of services rendered in India. There was a reasonable nexus between salary earned for the 'Off periods' and the services rendered in India. It was further submitted that the amendment to the Explanation to Section 9(1) (ii) was brought about by the Finance Act 1999 and was retrospective since it was

clarificatory. It was also stated that the issue whether a statute is to be construed as being retrospective, if it did not itself indicate either in terms or by necessary implication that it was to operate retrospectively, has been referred to a Constitution Bench. As far as the CBDT Circular is concerned, it was said that it was not binding on the respondents.

In our view, the opinion of the High Court is contrary to the legislative history, context and construction of Section 9(1)(ii). Under Section 4(1) of the Act the total income of the previous year of every person is subject to income tax. Section 5(2) defines the scope of total income as far as non residents are concerned, "as all income from whatever source derived which

a) is received or deemed to be received in India by or on behalf of such person or

b) accrues or arises or is deemed to accrue or arise to him in India in such year".

In other words it is the receipt or accrual in India, whether deemed or actual, which determines the taxability under the Act. Section 9 of the Act defines income "deemed to accrue or arise in India". By Clause (ii) of sub-section (1) of Section 9 "income which falls under the head 'Salaries' if it is earned in India" is included in such income. In 1980 the Gujarat High Court in Commissioner of Income-Tax vs. S.G. Pgnatale :([1980] 124 ITR 391 held that the words 'earned in India" occurring in Clause (ii) must be interpreted as "arising or accruing in India" and not "from service rendered in India". Therefore as long as the liability to pay the amount under the head "salaries" arose in India, Clause (ii) could be invoked. But if the liability to pay arose out of India and the amount was payable outside India, Clause (ii), as it stood then, could not be invoked. To overcome this decision, Section 9 (1) (ii) was amended by the Finance Act, 1983 with effect from 1.4.1979 to include an Explanation to Section 9(1)(ii) which read as follows:-

> "Explanation For the removal of doubts, it is hereby declared that income of the nature referred to in this clause payable for service rendered in India shall be regarded as income earned in India."

Therefore with this Explanation, irrespective of where the contract was entered into or where the liability to pay arose or where the payment was actually received, if the service was rendered in India, the salary for such service was exigible to tax as income under the Act.

The High Court proceeded on the incorrect hypothesis that the field breaks were limited to the training of the employees to render them more fit for service in India. That was not what the agreements between the appellant and its employees said and there was no ground for the High Court to have assumed that it was. The High Court also did not address itself to the other aspects of the field break namely the readiness of the employees for service anywhere at all. The employees in this case had not in fact 'served' in India during the field break period but they earned the income in UK as UK residents the consideration for the salary being the undergoing of training or updating of knowledge and being in a state of readiness to serve anywhere at all. The contract does not mention that the salary was for a well earned rest. That was a presumption which the High Court raised but which was based on no evidence. Besides, the clause in the contract relating to salary for service in

India was distinct from the clause relating to payment of salary for field breaks. The first clause clearly fell within the extended meaning given to the words 'earned in India' in the main provision. But the second clause relating to the salary paid by the appellants to its UK employees for the field break was not 'earned in India'. Since it did not fall within the phrase. The phrase is part of the statutory fiction created by Section 9(1). There is no question of introducing a further fiction by extending the Explanation to include whatever has a possible nexus with service in India . Therefore the salary paid for the field breaks in the UK was not for "service rendered in India" within the meaning of 1983 Explanation to Section 9(1)(ii) of the Act.

The High Court did not refer to the 1999 Explanation in upholding the inclusion of salary for the field break periods in the assessable income of the employees of the appellant. However the respondents have urged the point before us.

In our view the 1999 Explanation could not apply to assessment years for the simple reason that it had not come into effect then. Prior to introducing the 1999 Explanation, the decision in CIT vs. S.G. Pgnatale (supra) was followed in 1989 by a Division Bench of the Gauhati High Court in Commissioner of Income Tax vs. Goslino Mario reported in [2000] 241 ITR 314. It found that the 1983 Explanation had been given effect from 1.4.1979 whereas the year in question in that case was 1976-77 and said :

> " ..it is settled law that assessment has to be made with reference to the law which is in existence at the relevant time. The mere fact that the assessments in question has(sic) somehow remained pending on April 1, 1979, cannot be cogent reason to make the Explanation applicable to the cases of the present assessees. This fortuitous circumstance cannot take away the vested rights of the assessees at hand".

The reasoning of the Gauhati High Court was expressly affirmed by this Court in Commissioner of Income Tax vs. Goslino Mario [2000] 241 ITR 312 at 314] These decisions are thus authorities for the proposition that the 1983 Explanation expressly introduced with effect from a particular date would not effect earlier assessment years.

In this state of the law, on 27th February, 1999 the Finance Bill, 1999 substituted the Explanation to Section 9 (1) (ii) (or what has been referred to by us as the 1999 Explanation). Section 5 of the Bill expressly stated that with effect from 1st April, 2000, the substituted Explanation would read:

> "Explanation For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for
>
> (a) service rendered in India; and
>
> (b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment, shall be regarded as income earned in India."

The Finance Act 1999 which followed the Bill incorporated the substituted Explanation to Section (9)(1)(ii) without any change. The Explanation as introduced in 1983 was construed by the Kerala High Court in Commissioner of Income tax vs. S.R. Patton [1992] 193 ITR 49, while following the Gujarat High Court's decision in S.G. Pgnatale (supra), to hold that the Explanation was not declaratory but widened the scope of Section 9(1)(ii). It was further held that even if it were assumed to be clarificatory or that it removed whatever ambiguity there was in Section 9(1)(ii) of the Act, it did not operate in respect of periods which were prior to 1.4.1979. It was held that since the Explanation came into force from 1.4.1979, it could not be relied on for any purpose for an anterior period. In the appeal preferred from the decision by the Revenue before this Court, the Revenue did not question this reading of the Explanation by the Kerala High Court, but restricted itself to a question of fact viz., whether the Tribunal had correctly found that the salary of the assessee was paid by a foreign company. This Court dismissed the appeal holding it was a question of fact. [Commissioner of Income tax vs. S.R. Patton (1998) 8 SCC 608].

Given this legislative history of Section 9(1)(ii), we can only assume that it was deliberately introduced with effect from 1.4.2000 and therefore intended to apply prospectively . It was also understood as such by the CBDT which issued Circular No. 779 dated 14th September, 1999 containing explanatory notes on the provisions of the Finance Act, 1999 in so far as it related to direct taxes. It said in paragraphs 5.2 and 5.3.

5.2 The Act has expanded the existing Explanation which states that salary paid for services rendered in India shall be regarded as income earned in India, so as to specifically provide that any salary payable for rest period or leave period which is both preceded and succeeded by service in India and forms part of the service contract of employment will also be regarded as income earned in India.

5.3 This amendment will take effect from 1st April, 2000, and will accordingly, apply in relation to the assessment year 2000-2001 and subsequent years".

The Departmental understanding of the effect of the 1999 amendment even if it were assumed not to bind the respondents under Section 119 of the Act, nevertheless affords a reasonable construction of it, and there is no reason why we should not adopt it. As was affirmed by this Court in Goslino Mario (supra), a cardinal principle of the tax law is that the law to be applied is that which is in force in the relevant assessment year unless otherwise provided expressly or by necessary implication. [See also: Reliance Jute and Industries vs. CIT (1980) 1 SCC 139]. An Explanation to a statutory provision may fulfil the purpose of clearing up an ambiguity in the main provision or an Explanation can add to and widen the scope of the main section . If it is in its nature clarificatory then the Explanation must be read into the main provision with effect from the time that the main provision came into force . But if it changes the law it is not presumed to be retrospective irrespective of the fact that the phrase used are 'it is declared' or 'for the removal of doubts'.

There was and is no ambiguity in the main provision of Section 9(1)(ii). It includes salaries in the total income of an assessee if the assessee has earned it in India. The word "earned" had been judicially defined in S.G. Pgnatale (supra) by the High Court of Gujarat, in our view, correctly, to

mean as income "arising or accruing in India". The amendment to the section by way of an Explanation in 1983 effected a change in the scope of that judicial definition so as to include with effect from 1979, "income payable for service rendered in India".

When the Explanation seeks to give an artificial meaning 'earned in India' and bring about a change effectively in the existing law and in addition is stated to come into force with effect from a future date, there is no principle of interpretation which would justify reading the Explanation as operating retrospectively.

Even if it were to be held that the 1999 Explanation to Section 9(1)(ii) were applicable to the facts of the present case, it is doubtful whether in the facts of this case the activity of the employees in the UK could be said to be "rest" period or "leave" period within the meaning of the words in Clause (b) of the 1999 Explanation. However, it is not necessary to decide the issue as we are satisfied that the 1999 Explanation would not apply to the assessment years in question.

For the reasons aforesaid, the decision of the High Court is set aside and the appeals are allowed. There will be no order as to costs.