

# EQUITY IS STRANGER TO TAX

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## ABSTRACT:

Tax is an important source of revenue to the government. Taxing statutes is to be strictly interpreted and followed as such. The judiciary must not take recourse of equitable consideration for interpreting any ambiguous provision. The prerogative to deal with it lies solely with the Legislature. In other words, in case of any ambiguity in taxing statutes, equity principle cannot be used to provide justice. This gives rise to the phrase 'Equity is stranger to tax'. The study employed a case study research method in which a few cases were analysed in-depth to explore the concept that Equity is a stranger to tax. This paper scrutinizes significant legal judgments that have ruled that the application of the principle of equity falls outside the scope of taxing statutes and is to follow only strict interpretation. It seeks to provide the different method in which the court applies the concept of 'Equity is stranger to tax' while interpreting the different parts of taxing statutes. The findings of the paper is that the taxing statutes are to be strictly interpreted and if any ambiguity arises in the taxing liability provisions, the benefit is to be given to the assessee and the exception to this rule is that when ambiguity arises in the taxing exemption provision/notification, the benefit is to be given to the revenue or the state.

**KEYWORDS:** Strict Interpretation, Principle of Equity, Taxing Statutes, Exemption Provision, Liability Provision.

## I. INTRODUCTION

### Taxation in India

Tax is an important source of revenue to the government. It is a financial burden imposed on the people by the government to fund for the general welfare of the country that includes infrastructure development, public health care, and social welfare etc. India follows the degressive system of taxing where the rate of tax increases as the income increases and remains constant after reaching a particular level. The statute that provides for the rules, rate, exemptions, deductions and procedures for the imposition and collection of tax is called the Taxation Statute. In India, the legislature makes the taxing statutes and the Income Tax Act, 1961 is the principal taxation statute. There are other statutes also such as the Goods and Services Tax Act 2017, Central Excise Tax 1944, Customs Act 1962, Customs Tariff Act 1975 and etc. The taxation statutes are subject to amendments in a country from time to time due to the ever changing economic policies and social phenomenon. They are usually made during the union budget through the Finance Act. The Tax authorities issue circulars, notifications and guidelines to provide clarity on the interpretation and implementation of the statute occasionally.

## **Principle of Equity and Strict Interpretation in Taxing Statutes**

In the late 13th Century, the Chancery Court in England introduced the principle of equity. The term equity can be related to fairness, justice and natural justice. The principle of equity is invoked when the already established law lacks to meet the complete justice while resolving disputes. But it is to be noted that the principle of equity will not be in violation of the laws and precedents of the country. It sprung from the beliefs of good conscience, good faith and proper reason. The principle of morality also becomes a part of the principles of equity. The maxims of the equity such as the “Equity follows the law”, “He who seeks equity must do equity”, “Equality is equity” and “Delay defeats equity” makes the concept of equity more clear. Article 142 of the Indian Constitution provides for the Supreme Court to pass decrees or orders that are necessary for doing complete justice in any matter pending before it. The Supreme Court for doing complete justice invokes the principle of equity [1]. Many judgments declared that the application of the equity principle must not be there in case of taxation statutes. Nonetheless, it's significant to emphasize that the concept of fairness is embedded within tax laws, where individuals with equivalent income levels are taxed in accordance with the tax rates associated with their income categories.

The principle of Strict interpretation is used when the words of the statutes is vague or ambiguous. While strictly interpreting a statute, the exact meaning of the words of the statute is considered and applied with no equitable or reasonable consideration. The Judges should not draw inferences but simply rely on the statute to pronounce the judgments [2]. The judges should confine to the intention of the statute while interpreting an ambiguous provision. This is due to the significance of that particular statute in the country. The penal statutes and taxation statutes follow this rule of interpretation. The decision made in a criminal case based on the penal statutes is related to Article 21 of the Indian Constitution. In other words, penal statutes concern the lives of both criminals and victims, which is why a strict interpretation of such statutes is necessary. When it comes to the taxation statutes, Article 265 of the Indian Constitution provides that the Taxes are to be levied or collected only by an authority of law that is the legislature. This makes it clear that the taxing power is only with the legislature as the law of the land specifically confers the power to it. Due to this, the court insists upon the strict interpretation of the taxing statutes.

## **II. DEMYSTIFYING THE NOTION: EQUITY AS A STRANGER TO TAX A CLOSER LOOK AT LEGAL JUDGMENTS**

The primary reason for the greater consideration of the interpretation of taxing statutes lies in its significance to a country's government revenue. Strict interpretation of taxing statutes, devoid of any consideration for equity, should be a key factor to bear in mind whenever interpreting tax-related laws. This principle of “Equity is a stranger to tax” has been detailed below with numerous legal judgments that consistently applied it.

### **CAPE BRANDY SYNDICATE VS. INLAND REVENUE COMMISSIONERS**

#### **Facts:**

The appellants Mr. Norris, Mr. White and Mr. Browning had certain transactions through a joint account though belonging to different firms which was called for the assessment of excess profits duty for the accounting periods March 11, 1916 to September 17, 1917. The appellants agreed to purchase brandy from the cape government on their joint account and it is to be noted that none among them had engaged in a brandy selling before. The appellants' intention was to buy all the brandies but bought it in three lots as they were not aware of how much casks is for sale in total. They bought them in three lots in the same year of a total of 3100 casks and sold on commission by the agents. It was sold in different directions and while on its shipment to London, French brandy was blended with the one's shipped to make more profit. Subsequently, the appellants received the profits of the

sales after deducting the commission and expenses which turns out to be an excess profit which was called for assessment to pay the excess profit duty. The very term “excess profit duty” implies that the duty is imposed on the excess profits over a set bench mark which was mentioned in the Finance (No.2) Act, 1915 referring to the pre-war standard. This standard was determined by assessing profits over a three-year period before the onset of the First World War. There were specific regulations with regards to business in operation for less than three years. The company contended that they are not liable to be paid as they are business was not in pre-war period. The commissioner after analyzing the case held the case in favour of the respondents. So, the appeal was made to the King’s Bench Division to not to charge the appellants with excess profit duty.

### Issues:

1. Whether the profit in question arose from trade or business or is a capital profits?
2. Whether the profit, if it had arisen from trade or business is to be charged with excess profit duty?

### Decision and Reasoning:

The Commissioners of the Special Purposes of the Income Tax for the first issue observed that the brandy was purchased to alter its character in order to sell it in smaller quantities and transport it with the intention of making a profit since the inception of purchasing and selling the brandy from the government. Agents were also appointed to sell them for quite a period of time by the appellants. The Commissioners for the second issue observed that Section 38 of the Finance (No.2) Act, 1915 provides that excess profits duty be imposed on the excess profit that is comparatively more than in the pre-war scenario. It was also stated in that Act that pre-war scenario is to be construed with Part II of Schedule IV in the Act whereby Para 4 says that when there is less number of years of the existence of the business in the pre-war period, the profit shall be taken to be the statutory percentage of the capital employed during the accounting period. Hence, the Commissioners held that the profit in question is out of trade and business and that the excess profit is to be chargeable with duty for the accounting periods. The first issue being a question of fact was settled as being the profit out of business by the commissioners itself and it was not an issue before the King’s Bench Division.

The appeal in this case was pertaining to the second issue which was to be decided by Sidney Rowlatt J of the King’s Bench Division. Rowlatt J considered the reasoning made by the respondent to be of an artificial construction as there was no existence of the business in the pre-war scenario. He rejected the contention of the commissioners based on the words of Sir William Finlay about the taxing statute which says that the

*“A taxing statute should have clear words for levying tax on subjects. A wide and fanciful construction must not be made in a taxing statute and this is not because of any bias towards the government. It is simply because taxing act should be merely looked at what it is. There is no room for any intendment or equity about a tax or presumption as to a tax. Nothing is to read in, nothing is to be implied. One can only look fairly at the language used.”*

Though the commissioners’ contention was rejected, Rowlatt J still held the case against the appellants and dismissed the appeal. In this case, the King’s Bench Division’s view is that both the Finance Acts 1915 and 1916 should be read together and when the Finance (No.2) Act, 1915, provisions read along with Section 45(2) of the Finance Act, 1916 makes the appellant liable to pay the excess profits duty of 60 percent. This judgment stands as a resolute precedent in many cases [3].



**Facts:**

The Supreme Court of India established a constitution bench to examine the correctness of the **Sun Exports Corporation, Bombay v. Collector of Customs, Bombay** case to determine the rule of interpretation to be applied while interpreting a tax exemption provision / notification when ambiguity arises as to whether the taxpayer is eligible for the exemption or the standard rate of tax without exemption should be applied. The Supreme Court held in the **Sun Exports** case that when there is ambiguity in a tax exemption provision or notification it must be interpreted in favour of the Assesses. In the case of Commissioner of Customs( Import) Mumbai v Dilip Kumar, Company and Ors, there was an import of consignment of Vitamin-E50 powder by the respondents which they claimed it to be a prawn feed and claimed exception. The respondents relied on **Sun Export case** and claimed the exemption. The department denied the exemption as the import contained chemical ingredients for animal feed and not animal feed/ prawn feed which is not eligible for exemption as it is classified under chapter 29 which attracts standard rate of customs duty. The Assistant Commissioner of Customs also denied the exemption. On appeal, the commissioner of customs accepted the claim of exemption relying on the Sun Exports Case. Thereafter, the department approached the Customs, Excise and Service Tax Tribunal (CESTAT) who upheld the order of the Commissioner of Customs. Dissatisfied with the order of the CESTAT, an appeal was made to the two bench judges of Supreme Court. In the appeal, the rule of favoring the assessee in case of ambiguity in a tax exemption provision or notification as given in the **Sun Exports Case** was considered as an unsatisfactory state of law and thereby to reconsider it, a reference was filed before the Hon'ble Chief Justice of India [4].

**Issues:**

1. Whether the ruling in the Sun Exports Case be reconsidered in light of a series of contradictory rulings and should the general principle of holding in favour of the assessee in case of any ambiguity in a taxing statute be applied for a taxing exemption provision or notification?

**Contentions:**

The appellants contended that the ruling in the Sun Exports Case is incorrect and the tax exemption provision or notification needs to be strictly interpreted. The literal meaning of the taxing statute should be construed and the benefit should be given to the revenue or the state in case of any ambiguity in a taxing statute.

The respondents contended that the ratio and observations in the Sun Exports Case must be construed holistically without any narrow meaning to the conclusion. This is because the Customs Tariff Entry is interpreted broadly and the same should be adopted in interpreting an exemption notification too.

**Decision and Reasoning:**

The Supreme Court took a number of judgments into consideration for deciding the interpretation of taxing statutes in general and with special reference to the taxing exemption provision/notification in this case.

## **Interpretation of Taxing Statutes**

The Supreme Court in this case provided a summary of the principles that governs the interpretation of the taxing statutes which is that:

The taxing statutes should follow the strict interpretation of statutes that involves both the literal and plain meaning rule to be followed. The contextual interpretation, purposive interpretation and any other method of interpretation cannot be used while interpreting the taxing statute. This is because of the well settled principle that Equity has no place in tax interpretation and strictly one has to look into the language used in the statute. Simply because of one class of legal entities is given a benefit which is specifically stated in the Act, does not mean that the benefit can be extended to legal entities not referred to in the Act as there is no equity in matters of taxation. Revenue Acts should be construed by giving fair and reasonable construction to their language without leaning on to the assessee or the revenue as the tax can be imposed only if it is mentioned in the legislation. Reliance upon equity does not avail both the assessee and the revenue. In case of any ambiguity in the words of the statute the benefit is to be given to the assessee or the subject as the legislation fails to express itself clearly.

## **Interpretation of Taxing Exemption Provision/ Notification**

The principle which is to be followed while interpreting a tax exemption provision/ notification is the primary issue that was summed up by the Supreme Court in this case by taking into consideration a number of decisions:

### **Commissioner of Inland Revenue vs. James Forrest**

In this case Lord Halsbury in his dissenting view, observed that a wide interpretation to a taxing exemption should not be in such a way that it makes the taxing provision inoperative as the intention of the legislation would not be so. This view of benefitting the revenue was accepted and applied in many subsequent cases even in the cases in India[5].

### **Union of India v. The Commercial Tax Officer, West Bengal and Ors**

The issue in this case was that whether the sale of goods by a private mill to the Government of India will get exemptions as per section 5(2)(a)(iii) of that particular statute which provides exemptions for sale of goods made to the Indian Stores Department, the Supply Department of the Government of India, and any railway or water transport administration. The reasoning of the majority was that the exemption was to be given to the sale of certain goods to the department mentioned in the provision and not for the sale of any goods to the department. The court held that the exemption is a part of the statute and so should be construed strictly and the benefit is to be given to the revenue or the state as otherwise will not be the intention of the legislature [6].

### **Hansraj Gordhandas v. H.H. Dave, Asst. Collector of Central Excise & Customs, Surat and Ors**

The court in this case explained that the notifications should not be interpreted with the objective of the statute but by the words employed by the legislature [7].

### **Union of India v Wood Papers Limited**

The Supreme Court in this case held that the rule of strict construction should be applied at the stage for finding out the eligibility to seek exemption and the liberal and wider rule of construction should be applied for determining the nature of exemption [8].

Mangalore Chemicals & Fertilizers Ltd. v. Dy. Commissioner of Commercial Taxes

The Supreme Court in this case observed that ambiguity in an exemption provision will be construed in favour of the revenue as the burden of the not exempted class of tax payers tends to increase. The court made three important aspects clear in this case with regards to the interpretation of exemption provision which are the application of strict interpretation rule for recognition of horizontal equity, the plain meaning rule above strict interpretation and the interpretation in favour of revenue if ambiguity [9].

Commissioner of Central Excise, New Delhi v. Hari Chand Shri Gopal

The Constitution Bench in this case took into consideration the Doctrine of substantial compliance and intended use. The court reiterated, “It is an established rule that the assessee to claim for exemption should comply with certain conditions as in the provision. The requirements of the conditions may be both mandatory and directory. In that case, the mandatory requirements must be fulfilled exactly and the non-compliance of directory requirements will not affect the essence of the exemption provision.” In simple words, the exemption provision should be strictly construed with certain exceptions based on how the provision is made and placed in the statute [10].

The Supreme Court after the reviewing of the cases above held that

1. A taxing exemption provision or notification should follow strict interpretation.
2. The burden of proof of proving that he is entitled to exemption lies on the subject.
3. In case of any ambiguity, the benefit is to be given to the revenue.
4. The ruling in the Sun Exports Case incorrect and stands over-ruled [11].

### **III. CONCLUSION AND SUGGESTIONS:**

The revenue to the government is very much important for the overall development of the country. Tax, which is one of the sources of revenue to the government, imparts its significance to the taxing statutes. Hence, the strict interpretation of taxing statutes becomes a rule. The application of the principle of equity for interpreting the taxing statute is not allowed even in the case of ambiguity in the provisions. This leads to the assertion that 'Equity is a stranger to tax.' Any ambiguity must be addressed only by the legislature. The judiciary must not take the recourse of equitable consideration for interpreting an ambiguous taxing provision. When any ambiguity arises in the taxing liability provisions the benefit is to be given to the assessee and ambiguity in the case of taxing exemption provisions/notification, the benefit should be given to the revenue/state. These rules of interpretation ensure that equality is achieved by the taxing statutes. This paper adopted a case study method where only a limited number of judgments were analysed in depth to understand as to which rule of interpretation should be followed. Further research in this area can be done with a lot more judgments. The future study can also be about the views of different countries on the notion 'Equity is stranger to tax' and about the rules of interpretation of taxing statutes adopted by different countries. It should be remembered that Equity is stranger to tax only in terms of interpretation but the principle of equity is ingrained in the taxing statutes when it is being made.



#### IV. REFERENCES:

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- [2] Debatree Banerjee, Interpretation of Taxation Statutes, 1.2 JCLJ (2021) 107.
- [3] Cape Brandy Syndicate vs. Inland Revenue Commissioners, [1921] 1 K.B. 64.
- [4] Sun Export Corporation, Bombay v. Collector of Customs, Bombay and Anr, AIR 1997 SC 2658.
- [5] Commissioner of Inland Revenue vs. James Forrest (1890), 15 AC 334 (HL).
- [6] Union of India v. The Commercial Tax Officer, West Bengal and Ors, AIR 1956 SC 202.
- [7] Hansraj Gordhandas v H.H.Dave, Asst.Collector of Central Excise & Customs, Surat and Ors, AIR 1970 SC 755.
- [8] Union of India v Wood Papers Limited 1991 AIR 2049.
- [9] Mangalore Chemicals & Fertilizers Ltd. v. Dy. Commissioner of Commercial Taxes AIR 1992 SC 152.
- [10] Commissioner of Central Excise, New Delhi v. Hari Chand Shri Gopal MANU / SC / 0955 / 2010
- [11] Commissioner of Customs (Import) Mumbai v. Dilip Kumar, Company & Ors. AIR 2018 SC 3606 (India)

