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Doctrine of Legitimate Expectation w.r.t sec 48 and sec 112



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The proviso to section [48](#) is an offshoot of Government of India 1990 economic reforms to open up foreign investments in India which make an exception to the formula for computation of capital gains in case of foreign investments in India. The history and purpose of this amendment in section 48 is further explained in the explanatory Circular No 554 dated 13 February 1990 by way of an example to address the representation of the non-residents for protection against depreciating rupee.

Relevant sections and circular

Mode of computation.

48. The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

- (i) expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) the cost of acquisition of the asset and the cost of any improvement thereto;

Following shall be inserted in clause (ii) of section 48 by the Finance Act, 2023, w.e.f. 1-4-2024:

Provided that the cost of acquisition of the asset or the cost of improvement thereto shall not include the deductions claimed on the amount of interest under clause (b) of section 24 or under the provisions of Chapter VIA.

Explanation 1.—For the removal of doubt, it is hereby clarified that the cost of acquisition of a unit of a business trust shall be reduced and shall be deemed to have always been reduced by any sum received by a unit holder from the business trust with respect to such unit, which is not in the nature of income as referred to in clause (23FC) or clause (23FCA) of section [10](#) and which is not chargeable to tax under clause (xii) of sub-section (2) of section [56](#) and under sub-section (2) of section 115UA.

Explanation 2.—For the purposes of Explanation 1, it is clarified that where transaction of transfer of a unit is not considered as transfer under section 47 and cost of acquisition of such unit is determined under section 49, sum received with respect to such unit before such transaction as well as after such transaction shall be reduced from the cost of acquisition under the said Explanation;

- (iii) in case of value of any money or capital asset received by a specified person from a specified entity referred to in subsection (4) of section 45, the amount chargeable to income-tax as income of such specified entity under that sub-section which is attributable to the capital asset being transferred by the specified entity, calculated in the prescribed manner 94:

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so, however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company:

Provided further that where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" had respectively been substituted:

Provided also that nothing contained in the first and second provisos shall apply to the capital gains arising from the transfer of a long-term capital asset being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust referred to in section 112A:

Provided also that nothing contained in the second proviso shall apply to the long-term capital gain arising from the transfer of a long-term capital asset, being a bond or debenture other than—

- (a) capital indexed bonds issued by the Government; or
- (b) Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015:

Provided also that in case of an assessee being a non-resident, any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company held by him, shall be ignored for the purposes of computation of full value of consideration under this section:

Provided also that where shares, debentures or warrants referred to in the proviso to clause (iii) of section 47 are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of this section:

Provided also that no deduction shall be allowed in computing the income chargeable under the head "Capital gains" in respect of any sum paid on account of securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

Circular No. 554 of February 13, 1990 (see [1990] 183 ITR (St.) 130)

Subject : Explanatory Notes on the provisions of the Direct Tax Laws (Second Amendment) Act, 1989

Computation of capital gains in terms of foreign exchange in the case of non-resident Indians :

10.1 The non-resident Indians who invest in shares and debentures of Indian companies have been representing that due to the fall in the value of the Indian rupee vis-a-vis the foreign currency in which the investment is made by them, they are adversely affected when they sell such shares or debentures. In order to overcome this situation, sub-section (1) of section 48 of the Income-tax Act has been amended to provide that the computation of capital gains on the transfer of shares and debentures of Indian companies, in the case of non-resident Indians, shall be made by converting the cost of acquisition, the consideration for transfer and the expenditure incurred in connection with such transfer into the foreign currency in which the investment was made. The capital gains as computed in such foreign currency shall be reconverted into Indian currency. The conversion of Indian currency into foreign currency and the reconversion of foreign currency into Indian currency shall be at the rate of exchange prescribed by the Board in this behalf. The above method of computation of capital gains shall apply in respect of capital gains accruing or arising for every reinvestment made thereafter in the shares in and debentures of the Indian companies. The term 'non-resident Indian' shall have the meaning as given to it in clause (e) of section [115C](#) of the Income-tax Act. Therefore, it will cover not only the non-resident citizens of India but also non-resident persons of Indian origin who are not citizens of this country. For the purpose of this section, a person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in un-divided India.

10.2 The following example will make the impact of the new provision clear :

Assume that Mr. X, a non-resident Indian, remits US \$20,000, to India to purchase shares in an Indian company. Assume further that Mr. X holds the shares for 18 months (long-term) before selling them. If, at the time of purchasing the shares, the prescribed rate of exchange of US dollar into the Indian rupee was Rs. 14, then the value of the shares purchased would be Rs. 2,80,000. It is further assumed that when the shares are finally sold after a lapse of 18 months, the full value of transfer consideration received is Rs. 4,40,000. As per the provisions of section 48 as they existed prior to the aforesaid amendment, the long term capital gains would have been computed as under:

Sale consideration of shares –	Rs. 4,40,000
Less: purchase consideration of shares-	Rs.2,80,000
Gross capital gains on the sale of shares-	Rs.1,60,000

The above calculations are now compared with the calculations of the capital gains after the amendment to section 48 has come into force:

Sale consideration of shares in foreign currency, assuming the prescribed rate of exchange of US dollar to the Indian rupee at the time of sale was Rs. 16 to one US dollar- US \$ 27,500

Purchase consideration of shares-	US \$ 20,000
Gross capital gains-	US \$ 7,500

Gross capital gains in Indian rupees at the aforesaid prescribed rate of exchange of US dollar into Indian rupee- Rs. 1,20,000

Thus, on account of the amended provisions of sub-section (1) of section 48, the non-resident Indian investor will be compensated for the lower earning in foreign currency on account of the fall in the value of the Indian rupee.

10.3 The aforesaid amendment shall come into force with effect from 1st April, 1990, and will, accordingly, apply to the assessment year 1990-91 and subsequent years.

Section 112

Tax on long-term capital gains.

112. (1) Where the total income of an assessee includes any income, arising from the transfer of a long-term capital asset, which is chargeable under the head "Capital gains", the tax payable by the assessee on the total income shall be the aggregate of,—

(a) in the case of an individual or a Hindu undivided family, being a resident,—

- (i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been his total income ; and
- (ii) the amount of income-tax calculated on such long-term capital gains at the rate of twenty per cent :

Provided that where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax, then, such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance of such long-term capital gains shall be computed at the rate of twenty per cent ;

(b) in the case of a domestic company,—

- (i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been its total income ; and
- (ii) the amount of income-tax calculated on such long-term capital gains at the rate of twenty per cent;

(c) in the case of a non-resident (not being a company) or a foreign company,—

- (i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been its total income ; and
- (ii) the amount of income-tax calculated on long-term capital gains [except where such gain arises from transfer of capital asset referred to in sub-clause (iii)] at the rate of twenty per cent; and
- (iii) the amount of income-tax on long-term capital gains arising from the transfer of a capital asset, being unlisted securities or shares of a company not being a company in which the public are substantially interested, calculated at the rate of ten per cent on the capital gains in respect of such asset as computed without giving effect to the first and second proviso to section 48;

Section 112 has been amended w.e.f. 1.4 2013 with a purpose to provide for a concession to non-residents as explained vide explanatory CIRCULAR NO. 3/2012, DATED 12-6-2012 to FINANCE ACT, 2012 :—

Concessional rate of taxation on long term capital gain in case of non-resident investors

Currently, under the Income-tax Act, a long term capital gain arising from sale of unlisted securities in the case of Foreign Institutional Investors (FIIs) is taxed at the rate of 10% without giving benefit of indexation or of currency fluctuation. In the case of other non-resident investors, including Private Equity investors, such capital gains are taxable at the rate of 20% with the benefit of currency fluctuation but without indexation. In order to give parity to such non-resident investors, the Finance Act reduces the rate of tax on long term capital gains arising from transfer of unlisted securities from 20% to 10% on the gains computed without giving benefit of currency fluctuations and indexation by amending section [112](#) of the Income-tax Act.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

Consequential amendments to provide for tax deduction at source have also been made in the First Schedule and will be effective from 1st April, 2012

Difference between sec 48 and sec 112 provisions:

1. The third proviso to sec 48 categorically excludes shares falling in sec [112A](#)- "...an equity share in a company or a unit of an equity oriented fund or a unit of a business trust referred to in section 112A" and sec 112A provides for taxation of long-term capital gains **on listed securities at 10%** for gains exceeding the threshold limit of Rs. 1 lakh. *Thus it is inferred that sec 48 aims to include unlisted securities. And therefore it is covered under the mode of computation of explanatory circular. (emphasis supplied)*
2. Sec 112(C) on the other hand clarifies the rate of tax on such capital gains.
3. Sec 48 falls under the Chapter IV and sec 112 falls under Chapter XII of the Income-tax Act.
4. Section 112 begins with the words 'Where the total income of an assessee includes any income, arising from the transfer of a long-term capital asset, which is chargeable under the head "Capital gains",'. The words "which is chargeable under the head "Capital gains" clearly suggests that section 112 is subject to section 48 and therefore not superior to section 48 so that in case of any discord section 48 shall prevail. Moreover, section 112 is basically meant to provide for special and concessional rates of taxes.

A little ambiguity is created by reading clause (iii) of sec 112 (c) that states –

"the amount of income-tax on long-term capital gains arising from the transfer of a capital asset, being unlisted securities or shares of a company not being a company in which the public are substantially interested, calculated at the rate of ten per cent on the capital **gains in respect of such asset as computed without giving effect to the first and second proviso to section 48**";

The elementary interpretation of the words "**in respect of such asset as computed**" implies the general application of this clause to all unlisted shares which are to be necessarily treated without giving effect to first and second proviso of sec 48 that means sec 48 has no relevance but this is not the real intent of law as it would make sec 48 redundant and the sole purpose of Government of India 1990 economic reforms to open up foreign investments in India which will make an exception to the formula for computation of capital gains in case of foreign investments in India would render fatal.

Thus following the golden rule of interpretation sec 112(c) (iii) only covers those transactions that are not

calculated under first and second proviso to sec 48 for some reasons and the operation of the words "**in respect of such asset as computed**" is only an exception clause to cover only those assets that are not by default calculated under first and second proviso of sec 48 (for some reasons) **and NOT FOR ALL transactions** as generally construed.

In *Gian Chand Ashok Kumar and Company v. Union of India* [1991] 56 Taxman 282/187 ITR 188 (HP) the Court held that in construing an enactment and determining its true scope, it is permissible to have regard to all such factors as can legitimately be taken into account to ascertain the intention of the Legislature such as the history of the Act, the reasons which led to its being passed, the mischief which had to be cured as well as also the other provisions of the statute. A proviso excepts and deals with a case which would otherwise fall within the general language of the main enactment and its effect is confined to the cases covered by it. A proviso for exemption or relief should be construed liberally and in favour of the assessee. In *Maharajadhiraja Madhav Rao Jiwaji Rao Scindia Bahadur (H. H.) v. Union of India* AIR 1971 SC 530 the Apex Court held that the Court will interpret a statute as far as possible, agreeably to justice and reason and that in case of two or more interpretations, one which is more reasonable and just will be adopted, for there is always a presumption against the law maker intending injustice and unreason.

This being a concessional provision, it is also governed by **Doctrine of Legitimate expectation**. It cannot take away the effect of existing concession and benefit already available under first proviso to section 48 unless otherwise stated which is not the case here. The Government has not lifted from section 48 the first proviso which stands even today. In other words, even otherwise the assessee has an option to be governed by either of the two provisions more beneficial to the case of the assessee. In case there is a loss situation the concession in the rate of tax visualized in section 112 does not suit better so much so that the assessee has a valid and good reason to stick to his claim of method of computation of capital gains in the manner described under section 48 read with first proviso thereto. More importantly both first proviso to section 48 as well as the provision under section 112 provide concessional treatment to non-residents income from capital gains and in the absence of two making exceptions to each other there is every reason for the non-resident taxpayer to seek the method of computation of capital gains to his choice. Even section 43A also provide protection against currency fluctuations in case of liability incurred for acquisition of capital assets. In other words, currency fluctuations in the normal course are eligible deductions no matter the head under which the corresponding investment falls.

As also held on 12th May 2023 by Hon'ble Justice **KRISHNA MURARI (SC) in K.B. Tea Product (P.) Ltd. v. CTO In CIVIL APPEAL NO. 2297 OF 2011 as under :**

"44. The doctrine of legitimate expectation, as has been mentioned above, is a facet of Article 14, and is essential to maintain the rule of law. Such a doctrine, which ensures predictability in the application of law, in its very essence, fights against the corrosion of the rule of law, and prevents arbitrary state action.

45. For a democratic state to function on the principles of equality and justice, the state must be ruled, not by its ruler, but by the law. In such a circumstance, to prevent such a contamination of the rule of law, the application of the doctrine of legitimate expectation becomes most important. If a state is allowed to make promises, and rescind the same without justification or explanation, it would lead to a situation wherein every action of the state would be bereft of accountability, and every person governed by the laws of this country would live in a state of fear and unrest, causing a chilling effect on the civil liberties of the people."

Non-resident investor story

In the case of ***Legatum Ventures Ltd. v. Asstt. CIT (IT)*** [2023] 149 taxmann.com 436 (Mum. – Trib.) the assessee sold unlisted shares of a Private Limited Indian company and declared a long-term capital loss of Rs.3,63,87,392 after applying proviso 1 to section 48 of the Act. Since the assessee is a foreign company the AO invoked section 112(1)(c)(iii) and asked the assessee why the fresh computation should not be done without giving effect to the 1st proviso to section 48 of the Act and further recomputed the capital gains at Rs. 171,359,838/-.

In response thereto, the assessee submitted that section 112(1)(c)(iii) merely provides the rate of tax and does not provide a mechanism for the computation of capital gains. The assessee further submitted that the capital gain/loss has been computed applying the mechanism provided under section 48 of the Act after giving effect to exchange fluctuation benefit as provided in 1st proviso to section 48. It was further submitted that since the aforesaid mode of computation results in a long-term capital loss in the present case, section 112(1)(c)(iii) of the Act is not applicable. The assessee submitted that before coming to section 112, the capital gains on shares by applying the 1st proviso to section 48 results in loss, which in terms of section 74 of the Act is required to be carried forward to the subsequent assessment year. Thus, there is no income in the current year to which provisions of section 112 of the Act can be applied.

Before the ITAT the department succeeded and the assessee failed on the following pointers:

1. In the case of a non-resident (not being a company) or a foreign company, sub-clause (iii) of clause (c) to sub-section (1) of section 112 also provides the mode of computation of capital gains;
2. Section 112(1)(c)(iii) is a special provision for the computation of capital gains, in case of a non-resident, arising from the transfer of unlisted shares and securities;
3. Section 48 of the Act is a general provision.

The Tribunal in their big blow order held that section 112(1)(c)(iii) is the specific provision, therefore, in case the ingredients of the said section, i.e. (i) in case of non-resident or foreign company; (ii) long-term capital gains arise; (iii) from the transfer of unlisted shares or securities of a company not being a company in which public are substantially interested, are fulfilled, capital gains is required to be computed as per the manner provided under the said section. It is a well-settled rule of interpretation that if a special provision is made respecting a certain matter, that matter is excluded from the general provision under the rule which is expressed by the maxim "Generallia specialibus non derogant". Further, it is also a well-settled rule of construction that when, in an enactment, two provisions exist, which cannot be reconciled with each other, they should be so interpreted that, if possible, the effect should be given to both. Therefore, if the submission of the assessee that in the present case the income chargeable under the head "capital gains" is to be computed only as per section 48 of the Act is accepted, then the same would render the computation mechanism provided in section 112(1)(c)(iii) of the Act completely otiose and redundant. In the present case, the capital gains have to be computed only by reference to provisions of section 112(1)(c)(iii) of the Act.

Our Take on the above deliberation:

In the instant case, since the assessee has made a loss and is taking the assets are eligible under sec 48, it is excluded from 112(C) (iii) under the exclusion clause thus not liable to be assessed under sec 112. Hence in our understanding to label section 112 as a special provision and section 48 as a general provision will be misnomers. Even the Circular No. 3/2012 has failed to bring out the real intent under the law.

Additionally, in the light of Supreme Court decision in ***Krishna Murari in M/s. K.B. Tea Product***

Pvt. Ltd. (supra) dated 12 May 2023, it becomes clear that second provision **cannot take away the legitimate expectation** of the assessee and consequently **ITA no.1627/Mum./2022 dated 15 March 2023** is eligible to be quashed.

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