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Retro Tax – Attempt to bury the Ghost, Better late than Never!

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In one of the significant and eye-catching moves by the Indian government, the controversial law on retrospective tax on indirect transfer of shares representing assets held in India was withdrawn and was made prospective[1]. The law passed recently also proposed to refund the amount paid in these cases without any interest thereon. The retrospective introduction in 2012 was mired in various legal controversies in Indian and overseas tax and arbitration courts, especially with the likes of Cairn Energy and Vodafone Group invoking arbitration using bilateral investment pacts.

Brief Background:

- The issue of taxation of 'indirect transfer' of underlying capital assets in offshore transactions, has been a matter of prolonged litigation in India ever since Vodafone first challenged the Revenue's stand before the Bombay High Court in 2007. It eventually culminated in a historic ruling by the Supreme Court in January 2012. In 2012, the Supreme Court in the landmark ruling of Vodafone International Holdings BV vs. Union of India [TS-23-SC-2012] (the "Vodafone case") ruled in favour of the taxpayers wherein it held that transfer of shares of a Cayman Islands company would not be subject to capital gains tax in India, since the shares of the Cayman Islands company were not located in India.
- The government found the judgement to be against legislative intent and consequently, what followed thereafter was a retrospective amendment[2] in domestic tax laws in India which 'clarified' that gains arising from sale of shares of a foreign company shall be taxable in India if such shares, directly or indirectly, derive their value substantially from assets located in India.
- The retrospectivity of the clarificatory amendment met widespread disapproval from stakeholders, who contended that such amendments were against the principle of tax certainty and were detrimental to India's image as an investor friendly nation. Pursuant to introduction of the indirect transfer tax provisions, massive tax demands were raised in 17 cases ranging from \$2.1 billion (Vodafone), \$1.6 billion (Cairn Energy) etc. It also resulted in both Vodafone and Cairn seeking protection under India's Bilateral Investment Treaties (BIT) with the Netherlands and the UK, respectively and the arbitration awards were in favor of the taxpayers.

- The ambit of these provisions was however restricted to tax treaty provisions as held in a High Court[3] ruling which upheld relief based on tax treaty to the taxpayer and held that such transfers were not taxable in India. A slew of capital exporting jurisdictions (e.g., US, UK etc.) continued to be haunted by the impact of the provisions under domestic tax law in India as the tax treaties did not have favorable clauses for the taxpayers. In recently concluded tax treaties though, India has negotiated to include indirect transfers under tax treaty ambit as well.

Recent Developments:

The retrospective amendment in 2012 brought unprecedented uncertainty among foreign investors in India and did not help much at a time when the government was promoting India as an investment destination. Though the government has since taken some measures to increase the ease of doing business and the reputation in global markets by pledging to not introduce retroactive measures of such instances, many investors did hesitate to fund money directly into India and were often exploring destinations outside India to route their investments into India. With a view to bringing in tax certainty and promoting a message of India being a reliable investment destination, an amendment introduced recently, whereby the retroactive amendment ceased to exist and was made prospective, subject to certain conditions. The object clause of the said amendment in fact states in as many words that such retrospective amendments have worked against the principle of tax certainty and damaged India's reputation as an attractive destination.

Summary of the proposed amendments:

- The amending law specifies that no tax demand shall be raised for any indirect transfer of Indian assets, if the transaction was undertaken before 28th May, 2012 (i.e. the date when the Finance Bill, 2012 received assent of the President). Thus, the income accruing or arising through or from such indirect transfer of Indian assets or capital assets shall not be taxable in India. Therefore, all assessments or rectification applications pending before the authorities, to the extent they relate to the computation of income from indirect transfer of assets that have taken place before 28th May, 2012 shall be deemed to be concluded without any additions.

- It has also been stated that any demand raised in concluded assessments or rectification orders for indirect transfer of Indian assets made before 28th May, 2012 shall be nullified/ deemed to never have been passed on fulfilment of 'specified conditions[4]'.

- Further, the amounts of demand collected /refund adjusted in these cases would be refunded albeit without any interest.
- The recent change seeks to provide no relief to taxpayers who have paid tax demands raised for indirect transfers undertaken prior to May 28, 2012, without contesting its applicability. It also does not address a situation wherein notices were issued but no tax demand was raised.

Take Away's:

- As India celebrates the 75th anniversary of its independence and the government is vocal on its plans to have humongous investments in various sectors to revive the economy as well as achieve its target to become a $5 trillion economy by 2025, certain basic aspects have to be course corrected. One of these was an assurance to investors to look at India as a certain and safe bet and not as one in which they have a sword hanging on their heads of the government de-settling a position which is not in their favor. While it took the Indian government almost a decade to come up with this decision, it is always better late than never. With the proposed U-turn by withdrawing the retrospectivity in the amendment on indirect transfers, the government has demonstrated its pragmatic and investor friendly approach and one more effort to combat 'tax terrorism'. It will help the country to emerge as the favourable investment destination, particularly at a time when quick recovery of the economy from the COVID-19 pandemic is the need of the hour.
- The amendment will impact retro tax dispute cases of Cairn Energy Plc and the Vodafone Group

of UK. Both the companies have won international arbitrations against levy of retrospective taxes on them. The amendment paves a way for the companies to withdraw the litigation pending in various courts, with the assurance from the Centre that the demand for retrospective tax will also be withdrawn. It is a welcome step in resolving the pending disputes at various forums including international forums.
- Further, the Bill may benefit a dozen firms besides Vodafone and Cairn Energy, where the Income Tax department had raised tax demands based on these retrospective changes to tax laws. Under the new Bill, in addition to withdrawing cases, companies like Vodafone, Cairn, and others will have to give an undertaking that they will not seek legal damages, recoup legal costs, or file cases against the Government for retrospective taxes in the future. Once such conditions are met, the government will repay the principal amount.
- The amendment shall create an expectation for companies to get refunded for the disputed taxes that may have been paid during litigation. The government's move would also build confidence of foreign investors to attract new investments that are crucial for reviving economic growth. Overall, this is an important step for our economy promoting higher tax certainty and improved investment climate.
- The actual impact of the Bill will depend on whether taxpayers actually choose to withdraw their appeals / arbitration proceedings from international courts on the basis of this sensational move by the Indian government. It has been reported that various impacted taxpayers have approached the government intending to conclude the litigations. This augurs well for the government and the ghost may finally be buried.

Views expressed are personal. The authors can be reached at sudin.sabnis@nangia-andersen.com.

[1] The tax would now be applicable for any indirect transfer made subsequent to May 28, 2012

[2] w.e.f. April 01, 1962

[3] Sanofi Pasteur Holding SA {(2013] 257 CTR 401}

[4] Withdrawal or submission of an undertaking to withdraw any appeal before an appellate forum or any writ petition before the High Court/ Supreme Court against any order on such income, or any claim in any proceedings for arbitration/ conciliation/ mediation/ notice under any law or agreement entered into by India with any other foreign country, for protection of investment or otherwise. In addition, furnishing of an undertaking is required, waiving the right to seek/ pursue any remedy or any claim in relation to the said income, which may otherwise be available, under any statute or agreement between India and a foreign country, for protection of investment or otherwise.

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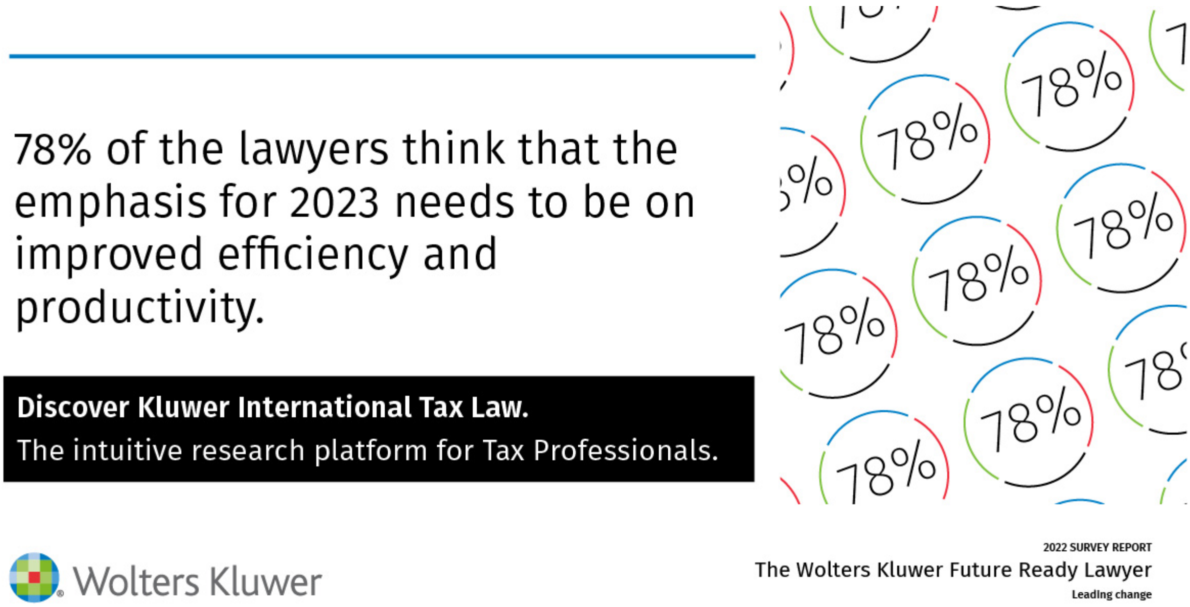

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