Tax Alert

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Retrospective effect of Indirect Transfer provisions proposed to be withdrawn

The Central Government tables The Taxation Laws (Amendment) Bill, 2021 ('the Bill') on floor of Parliament to withdraw retrospective effect of indirect transfer provisions.

Background

- The issue of taxability of capital gains arising from the transfer of assets located in India through the transfer of the shares of a foreign company ('indirect transfer') has been a subject matter of protracted litigation.

- The Supreme Court in case of *Vodafone International Holdings B.V. v. UOI*[1] put the controversy to rest and held that indirect transfers are not taxable in India basis the law prevailing at that point of time. Therefore, transfer of shares of a foreign company (which holds underlying assets in India) was held to be not taxable in India.

- Pursuant to the Supreme Court ruling, the law was amended in the year 2012 wherein a clarification was inserted to the effect that indirect transfer of shares is taxable in India if the shares of the foreign company derive their value substantially from assets located in India. **The amendment was a clarificatory one and was stated to apply retrospectively from April 1, 1962.**

- This retrospective amendment invited much criticism from international stakeholders' and was perceived to cause damage to the investment climate of the country.

[1] [2012] 341 ITR 1 (SC)

- Pursuant to the retrospective amendment, tax demands were raised in seventeen cases. In four cases, aggrieved taxpayers preferred arbitration under India's Bilateral Investment Treaty with United Kingdom and Netherlands.

- Recently, the Permanent Court of Arbitration at The Hague in case of *Vodafone International* Holdings *BV v. The Republic of India* vindicated taxpayers' position and reproached the retrospective amendment made by the Indian government as breach of guarantee of fair and equitable treatment. The Indian Government thereafter preferred appeal before the Courts in Singapore.

- Similarly, the Arbitral Tribunal in the case of *Cairn Energy PLC v. The Republic of India* ruled against the Government of India and directed the Indian Government to refund the taxes along with interest and other costs to *Cairn Energy*.

- Recognising importance of foreign investment in fostering economic growth post COVID-19 and to gain investors' confidence in the Indian economy, the Legislature has tabled *The Taxation Laws (Amendment) Bill, 2021*, before the august house of Parliament. The Bill seeks to withdraw the retrospective effect of the indirect transfer provisions and nullify all related tax demands and proceedings which may be underway.

The Proposals in the Bill

- The Bill proposes to withdraw the retrospective effect of indirect transfer provisions. Pursuant thereto, any pending proceedings assessment or re-assessment proceedings, order enhancing assessment or reduction in refund claim or order deeming a person in default for not withholding taxes in respect of capital gains arising from indirect transfer of shares before May 28, 2012[2] would be terminated.

- The Bill also provides that any order pertaining to assessment or re-assessment proceedings, order enhancing assessment or reduction of refund claim or increase in liability, order deeming a person in default for not withholding taxes or any penalty order passed in respect of capital gains arising from indirect transfer of shares before May 28, 2012 shall be, subject to conditions, deemed to have never been passed.

- In case any amount becomes refundable to the taxpayer as a consequence of the above, the same shall be refunded to him without any interest.

- However, the above relief would be available, inter-alia, on fulfilment of following conditions:
  - The taxpayer would need to either withdraw or give an undertaking to withdraw the appeal filed before any appellate forum or High Court or Supreme Court in connection with indirect transfer matters. These need to be done in the prescribed form and manner.
  - The taxpayer would also need to either withdraw or undertake to withdraw any proceedings which may be initiated for arbitration, conciliation, or mediation. These need to be done in the prescribed form and manner.
  - An undertaking also needs to be furnished by the taxpayer waiving his right to seek or pursue any other remedy which may otherwise be available to the taxpayer.

[2] This is the date when the Finance Bill, 2012 received the assent of the President of India.

Dhruva Comments

- The issue on taxation of indirect transfer of shares is perhaps the most discussed tax controversy in India that has garnered attention from investors across the globe. Ranging from High Courts till the International Court of Arbitration, the controversy on retrospective taxability of indirect transfer controversy had created its own buzz amongst the investors' community.
- Prolonged litigations involving high stakes of taxpayer and exchequer has been a major cause of concern for the investor community. While International Arbitration Tribunal passed an award in favour of *Cairn Energy*, media reports of *Cairn Energy* moving the international courts with a prayer to seize assets of Indian Government was perhaps something which was completely unheard of.
- Albeit a bit late, this is certainly a stupendous step which will successfully exorcise the ghost of retrospective amendments. More importantly, this comes at a time when there are a multitude of focused efforts to make India an attractive destination for foreign direct investment, especially given the anti-China sentiments.
- This now marks an end of a saga and certainly manifests strong statesmanship which will go a long way in enhancing India's credibility and standing in the international investor community. This action will also play an important role in assuaging the concerns that investors have and will restore the credibility of the Indian tax and judicial system.
- While withdrawal of indirect transfer provisions is expected to result into refund of billions of dollars from the coffers of exchequers, it clearly resonates India's commitment for tax certainty and invites foreign investors with open arms.

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