CURRENTIST

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INDIA'S TRYST WITH RETROSPECTION

Finance Act 2012 provided more clarification on taxation of capital asset transfer and amended Sections 9 and 195 of the Income Tax Act, 1962, retrospectively from AY 1962-63. Memorandum to the Finance Bill of 2012 explained the need for this amendment. "Certain judicial pronouncements have created doubts about the scope and purpose of sections 9 and 195. Further, there are certain issues in respect of income deemed to accrue or arise where there are conflicting decisions of various judicial authorities. Therefore, there is a need to provide clarificatory retrospective amendment to restate the legislative intent in respect of scope and applicability of section 9 and 195 and also to make other clarificatory amendments for providing certainty in law."

The impugned judicial pronouncement was the infamous Hutch-Vodafone case. Let's understand in brief.

Hutchison Essar Ltd. (HEL) was an Indian Company which was a joint venture of Hutchison group and Essar group. 51.95% of shares of HEL directly and 15.05% of shares indirectly (i.e. through subsidiaries) were owned by a company named CGP Investments Ltd. (CGPIL), registered in the Cayman Islands.

100% of CGPIL's shares were owned by Hutchison Telecommunication International Ltd.(HTIL), registered in Hong Kong. Vodafone International Holdings B.V., registered in Netherland, purchased 100% shares in CGPIL from HTIL (Apparently, it was just one share in number). On the face of it, a Netherland based company was buying another company based in Cayman Islands. However the underlying asset was obviously the Indian business.

Indian Income Tax Department claimed HTIL was liable to pay tax on the capital gains accrued on such transfer and that Vodafone was liable to deduct tax at source on payment made to HTIL.

India retrospectively amended the IT Act to tax Hutch-Vodafone and likewise capital gain transactions.

Although the Bombay High court ruled in favour of the IT department, the Supreme Court reversed the decision of the High court. It held that an Indian assessing officer has no jurisdiction to tax a transaction happening outside India wherein the transfer happens of asset— shares of a foreign company by another foreign company. (Ignoring the underlying asset i.e. Indian business).

Snubbing its own Supreme Court, showing the world who is actually "Supreme" is in India, then Finance Minister, Bharat Ratna (Late) Pranab Mukherjee made the retrospective amendment. He in his memoir "The Coalition Years" justified this move. "Just because some foreign investors choose to structure their investments through tax havens, they should not, as a matter of policy, get away without paying any taxes. What foreign investors need is certainty in tax laws and not a tax-free environment, which no emerging economy can afford. I was convinced that this certainty of payment of taxes needed to be embedded in our tax policy."

"This retrospective arrangement was not merely to check the erosion of revenues in present cases, but also to prevent the outgo of revenues in old cases. As the Finance Minister, I was convinced of my duty to protect the interest of the country from the revenue point of view."[1]

("Prevent the outgo of revenue in old cases." The actual reason why any government would take up such a step.)

After amendment, it was now within IT department's jurisdiction to tax the transaction, proceedings begin again (2013). Vodafone sought for settlement of this case, but the committee set up failed to resolve. It later (2014) served Arbitration notice to India under India-Netherland Investment Treaty. In 2015, honourable Prime Minister of India made a public statement in London that India will not resort to retrospective taxation, highlighting the need for a clear tax regime.[2]

However, in early 2016, IT department issued a fresh demand of around Rs. 22,000 crores. Vodafone then pursued its international arbitration seriously and ultimately in September 2020, India lost the case at the Permanent Court of Arbitration located at The Hague.Why and how did it actually lose? We shall come to it after discussing another related case.

Cairn India Holdings, registered in Cayman Island was a fully owned subsidiary of Cairn UK Holdings which in turn is a fully owned subsidiary of Cairn Energy based in Scotland, UK. A new company was formed in 2006 with name Cairn India and Cairn UK Holdings transferred all its shares of Cairn India Holdings to this new company in consideration of 69% shares of this Cairn India.

So now, in effect, Cairn Energy, through Cairn UK Holdings, held 69% in Cairn India (and balance through other subsidiaries) before the IPO.

Similar to Vodafone case, in 2014, tax demand was raised for capital gains earned on this transfer. The company claimed it to be an internal transfer/ group structuring and no real capital gain had accrued. The case of valuation of the capital gain is still pending (2021) with Delhi High court and Cairn had lost at ITAT level. However, in 2011, almost all of Cairn UK Holdings' stake was sold to Vedanta Ltd. except for some around 10% which wasn't transferred and which the Indian tax authorities later attached. The attached shares, were then sold in 2018 (pending valuation at Delhi HC) to recover the tax demand.

Cairn too tried for an out-of-court settlement with India, which didn't work. Later, Cairn also initiated arbitration proceedings in 2015 under India-UK Investment treaty and in December 2020, India lost that case too at the same Permanent Court of Arbitration.

International court has ruled against India as this retrospection violates fair and equitable treatment of foreign companies.

Prima facie, both the above cases relate to tax disputes and have got nothing to do with "investment". India claimed (and correctly so) that taxation of any transaction is India's internal matter and that international arbitration courts do not have any jurisdiction over Indian tax disputes. It is India's sovereign right to impose taxes on transactions involving Indian companies or assets, and anything relating to it would be deliberated in Indian courts or at the Parliament, not internationally. Any investment treaty is for protection and facilitation of investment only and not for taxation.

What has been held by the international court is that there is a difference between tax dispute and tax related investment dispute. Cairn falls in the second category as there is an Indian company (Cairn India) involved. This view was held so strongly that even the India-nominatedjudge (total three— one nominated by Cairn and another neutral) at The Hague voted against India, in favour of Cairn. Further, retrospective taxation has made

the Permanent Court of Arbitration alsosay that the principle of "fair and equitable treatment" as covered under both the treaties has been violated by India.This is also why India has been asked to pay Vodafone around Rs. 85 crores and Cairn India around Rs. 10,570 crores (high amount for recovering the value of shares sold by IT dept.).Considering that only around 1.5 crore Indians actually pay Income Tax (as per one of PM's speech in February 2020),[3]liability comes to around Rs. 7,100 per person.

India should go for further appeal at Singapore's International Court. It may use the Singapore Supreme Court's verdict in case of "Swissbourgh Diamond Mines Ltd. and Ors. vs. The Kingdom of Lesotho". Lesotho is a landlocked country encircled by South Africa. Without going into the details of the case, Lesotho was found violating the principle of "fair and equitable treatment". However, the appeal was dismissedciting jurisdictional constraints of the Permanent Court of Arbitration (in effect favouring Lesotho).[4][5] Let's see does that court rule in favour of India or not.

Amount payable by India to Vodafone & Cairn will burden the tax-payers by Rs. 7,100 per person.

Point to ponder:

On one hand settlement attempts initiated by foreign companies failed and on the other hand India is losing cases internationally. What would India's position be if it loses at Singapore too? Would India's tryst with retrospection stillbe justifiable?

Think over it. Think different!

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