India withdraws the infamous retrospective amendment

Indirect transfer tax provision would apply prospectively

Background

The Government of India has finally passed a bill to withdraw the retrospective nature of the Indirect Transfer tax amendment. This retrospective amendment to the Income Tax Act was introduced after the Hon'ble Supreme Court's verdict in the case of Vodafone. It was held by Hon'ble Supreme Court that gains arising from indirect transfer of Indian assets in respect of transaction between Vodafone and Hutchison Essar are not taxable under the provisions of the Act.

However, as per the Government, the verdict was inconsistent with the intention of the law, and thus an amendment was brought by the Finance Act, 2012, with a retrospective effect from 1961. The amendment clarified that the gains arising from the sale of a foreign company's share are taxable in India if such a share, directly or indirectly, derives its value substantially from the assets located in India.

Vodafone and Cairn Case Overview

This amendment had impacted around 17 cases, out of which Vodafone and Cairn Energy were the major ones. The Indian tax department had slapped a demand of around USD 295 Million[1] on Vodafone and USD 1,600 Million[2] on Cairn by virtue of the retrospective amendment. The companies had commenced the international arbitration proceedings against the Indian government under the respective Bilateral Investment Treaty. The companies made a case that India has breached the guarantee of fair and equitable treatment laid under the bilateral investment treaties.

In response to the arbitration claims, the Indian government argued that the exercise of jurisdiction by the Tribunal over a national tax dispute is improper. Furthermore, the claim is based on the alleged violation of the Indian income-tax laws, which are not covered within the scope of the Bilateral Investment Treaty. After years of prolonged battle, the Arbitrational Tribunals in both cases ruled in favor of the taxpayers. The Indian government was directed to refund the taxes collected along with interest and were also awarded costs.

India had filed an appeal against both the arbitration orders which are yet to be heard.

In the meantime, Cairn had also initiated proceedings to enforce the award in several jurisdictions where India has assets, and which recognize and enforce the award made in the Netherlands.

Proposed Change

The Government of India, now has passed the Bill in Parliament which proposes to withdraw the retrospective portion of the amendment made in 2012. The Government has proposed that such indirect transfer provisions wouldn't apply for transactions done till 28th May 2012 (day of enactment of 2012 law) subject to fulfilment of certain conditions.

Thus, Vodafone and Cairn, and other taxpayers would be greatly benefitted from this change as they no longer have battle out with the Indian Government and would also get refund of taxes paid (without interest), if any with respect to the same.

Conditions for nullifying the demand raised for Indirect Transfer

Now that the Indian government has proposed to withdraw the retrospective amendment, the initial assessment proceedings and raising the demands on the company can be nullified. However, the proceedings can be quashed only if the following conditions, among others, are satisfied:

- The companies withdraw or undertake to withdraw arbitration, conciliation, or mediation initiated under any law for the time being in force or under any agreement entered into by India with any other country or territory outside India, whether for protection of investment or otherwise.
- The companies are also required to waive the right to seek or pursue any remedy or any claim in relation to the income from indirect transfer which may otherwise be available to under any law for the time being in force, in equity, under any statute or under any agreement entered into by India with any country or territory outside India, whether for protection of investment or otherwise.
- No interest would be payable while refunding taxes that the Company would have earlier paid under protest.

Note: All the figures in the article are approximate numbers converted in USD at the average conversion rate.
1. 1 USD = INR 75, 1£ = USD 1.39, 1€ = USD 1.18
2. Business Standard
3. Kluwer Arbitration Blog, 2nd July 2021

Key Takeaways

With this bill, it is hoped that the sheer volume of litigation on this matter would be put to rest. Also, the Government has promised that no new demand would be raised in respect of indirect transfer, which is carried out prior to 28 May 2012. However, it would be interesting to see whether Vodafone and Cairn would opt for withdrawal of the arbitration process as they may stand to lose out the interest on the demand already paid.

It is unsure whether the entire retrospective amendment introduced in 2012 resulted in any collection of tax, however it managed to portray India as an unfriendly tax jurisdiction for foreign business. Despite the delay in scrapping this controversial amendment, it is still a pragmatic move by the Indian government that will render tax certainty and hopefully boost the foreign investor sentiment.

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