Retrospective Taxation in India – Towards Legislative Finality at Last?


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Overview

On 13 August 2021, the Government of India ("**GoI**") adopted the watershed Taxation Laws (Amendment) Act, 2021 ("**Amendment Act**"), endeavouring to reverse India's erstwhile fiscal and legislative policy from 2012 ("**Retrospective Tax Regime**") purporting to tax, with retrospective effect, capital gains on the international transfer of shares and assets in India. GoI's 'clarificatory' promulgation in 2012 that any transaction involving a direct or indirect transfer of underlying shares in India would be taxable, has since been a unanimous source of global concern. For investors in India such as Vodafone and Cairn GoI's decision to tax antecedent (i.e., pre-2012) sale transactions with retrospective effect, smacked of bad faith, triggering a chain of high-profile international arbitrations against GoI.

Following a recent spate of arbitral setbacks and defeats to the GoI (including the much publicized and ignominious seizure of sovereign assets of the GoI to satisfy arbitral claims), GoI has finally crossed the legislative Rubicon by rolling back the Retrospective Tax Regime through amendatory legislation. The essence and spirit of the Taxation Laws (Amendment) Act is to exempt any M&A transactions (involving the indirect transfer of assets in India) that predate 28th May 2012 ("**Cut-off Date**") from any tax liability under India's Retrospective Tax Regime ("**Eligible Transactions**"). By implication, deals involving a transfer of Indian assets after the Cut-off Date, would be subject to capital gains tax in India.

While the Amendment Act is undoubtedly a step in the right direction, its implications for companies currently in litigation/under assessment for retrospective tax, is dependent on the fine print of rules under the Amendment Act that are still in draft form ("**Draft Rules**")[1]. The devil as they say, rests in the detail. This article analyses both the Amendment Act and the Draft Rules, with our view on implications for tax settlements under the new law.

Background

The taxability of indirect transfer of Indian assets through the transfer of shares of a foreign body corporate was the subject matter of the Supreme Court of India's landmark judgment in 2012 in *Vodafone International Holdings B.V v Union of India (UOI) and Ors.* (2012 (1) SCALE 530) ("**Vodafone Judgment**"). In the Vodafone Judgment the Supreme Court held that income arising in global M&A transactions involving the indirect transfer of Indian assets is not taxable under the Indian Income Tax Act, 1961 ("**IT Act**").

However, GoI viewed the Vodafone Judgment as incompatible with the statutory objectives of the IT Act. Accordingly, it amended the IT Act in 2012 ("**FA 2012**"), clarifying that gains arising from sale of shares of a foreign company are taxable in India if such share(s), directly or indirectly, derive value from assets located in India. The FA 2012 was criticized because it was felt that the retrospective amendments work against the principle of tax certainty.

The Amendment Act seeks to nullify the contentious FA 2012, by providing that no future tax demand shall be raised on any indirect transfer of Indian assets if the transaction was carried out before 28 May, 2012 (Eligible Transactions). However, to be eligible for tax relief, the assessee must comply with certain specified conditions such as withdrawal of pending litigation against GoI, forfeiture of interest, and furnishing a 'no-litigation' undertaking protecting GoI from claims in the future.

Issues

For investors seeking tax relief, the conditions levied under the Draft Rules read with the Amendment Act present a mixed bag requiring careful commercial evaluation:

(a) **Forfeiture of Interest:** The Draft Rules read with the Amendment Act provide that for Eligible Transactions, GoI shall refund amounts collected in lieu of tax but without interest. However, this conflicts with another section of the IT Act, which entitles assessees to receive interest on refunds under the IT Act. Therefore, before signing the dotted line, investors should procure a legal opinion on the efficacy and enforceability of the interest waiver clause.

(b) **Scope of Refund:** The Amendment Act states that where any money becomes refundable to the person as a result of him satisfying the specified conditions (pertaining to

[1] On 28 August 2021, GoI notified draft Amendment Rules (2021) under the Amendment Act, stipulating various conditions for investors to be able to avail of tax exemption under the Amendment Act

withdrawal of litigation/claims), then, such sum shall be refunded. It is unclear as to the heads of payment that refunds would subsume. Would this just mean amounts paid by the assessee in protest and assets expropriated by GoI in satisfaction of its claims, or would it also include ancillary costs such as litigation expenses? If GoI has attached assets, would "refund" include a restitution of the expropriated asset or its current market value? Accordingly, the Amendment Act leaves several consequences open ended and ambiguous. Investors should therefore negotiate each of their heads of claim carefully with the GoI, by contending that all of these would fall within the ambit of "refunds".

(c) **Third Party Claims :** While it appears recently that Cairn Energy PLC has agreed to drop litigation against the GoI vis-à-vis its retrospective tax row, it appears that it is not under the obligation to cause a third party (such as Cairn Oil & Gas, Vedanta Limited) to drop such third party's ongoing similar litigation pertaining to retrospective taxation with the GoI.

Conclusion

While what the Amendment Act offers is clear in the overall intent of the legislation, the Draft Rules leave several matters to future negotiation. Given the significant amounts involved, these uncertainties may undermine an otherwise progressive legislative step towards instilling confidence amongst foreign investors in India. The silver lining is, of course, the GoI's assurance at the highest level that if the specified conditions are met (withdrawal of litigations against GoI, etc.) then the tax assessment or reassessment order, to the extent that it taxes capital gains, shall be considered to never have been made.

Ultimately, the efficacy of the Amendment Act will be determined by future clarifications issued by the relevant governmental authority(ies) regarding the scope of the refunds and whether GoI will consider rolling back its condition regarding the exclusion of interest. For instance, investors embroiled in litigation against GoI may not find forfeiting interest and court fees as a financially feasible option. Third party litigation regarding the same subject matter (of retrospective taxation) appear to be a sticking point, as a party settling its dispute with the GoI vis-à-vis retrospective taxation in accordance with the Amendment Act and the Draft Rules does not necessarily bring a third party also involved in a similar litigation to settle the litigation in a comparable manner with the GoI. However, subject to evolving clarity on some of the contentious issues above, the clarity provided by the Amendment Act regarding retrospective taxation is a welcome step in restoring global perceptions of India as a desirable investment destination.

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