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The Taxation Laws (Amendment) Bill, 2021

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Indian Government steps away from the retro taxation of indirect transfer of shares

The chargeability of any income of a person (resident/nonresident) to tax is dealt with in sections 5 and 9 of the Income tax Act. In the context of a non-resident, his income is taxed in India if the income is 'received' or 'deemed to be received' or 'accrues' or 'arises' or 'deemed to accrue or arise' to him in India. Section 9 defines Income deemed to accrue or arise in India. This is a legal fiction created to tax income, which may or may not arise in India and would not have been taxable but for the deeming provision created by this section.

In 2007 the Income tax department noted that two foreign companies, Vodafone International Holding (Vodafone) and Hutchison Telecommunication International Limited (HTIL), entered into a transaction by which Vodafone indirectly acquired a majority interest in an Indian company, Hutchison Essar Limited (HEL). The tax authorities contended that though the transaction involved transfer of shares of a foreign company (which event was not otherwise exigible to tax in India), it ultimately resulted in transfer of interest in Indian company (HEL) to Vodafone. The Department brought the alleged gain to tax. The Supreme Court in 2012 held such gains were not taxable under the extant provisions of the Act. Soon after the verdict of the Supreme Court Finance Act 2012 introduced Explanations 4 and 5 to section 9(1)(i), with retrospective effect from April 1, 1962, to clarify and overrule the decision of the Supreme Court. Explanations read as under:

“Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.”

Ever since this amendment, in several cases large tax demands were raised, of course, the prominent among them being Vodafone and Cairn.

This resulted in the Government being dragged into international arbitration proceedings which went against the Government of India requiring it to honor huge demands. The government faced the prospect of attachment of its assets to enforce these demands. Needless to say this attracted a lot of negative publicity for the Government of India.

What particularly triggered the back lash in the first place was the retrospectivity of the amendment which was perceived to be against the principles of fair play and tax certainty. This amendment had even then dented the investors' confidence and damaged India's reputation as an attractive destination.

Now, faced with the outcome of adverse publicity arising out of unfavorable arbitration awards the Indian Government vide The Taxation Laws (Amendment) Bill, 2021 has proposed to recall the retrospectivity of the 2012 amendment in respect of indirect transfers of Indian assets made prior to May 28, 2012 thereby making the 2012 amendment prospective i.e. after May 28, 2012.

It is proposed to amend section 9 to the following effect

• That no tax demand shall be raised in future on the basis of the said retrospective amendment for any indirect transfer of Indian assets if the transaction was undertaken before May 28, 2012 (i.e., the date on which the Finance Bill, 2012 was enacted).

• That the demand raised for indirect transfer of Indian assets made before May 28, 2012 shall be nullified on fulfilment of specified conditions such as withdrawal or furnishing of undertaking for withdrawal of pending litigation and furnishing of an undertaking to the effect that no claim for cost, damages, interest, etc., shall be filed.

• To refund the amount paid without any interest thereon.

Needless to say, indirect transfer of Indian assets after May 28, 2012 shall continue to be taxed in India if the foreign share or interest substantially derived its value from Indian asset in accordance with the then amended provisions.

Indeed, the proposal is welcome! The litigants may however see a dampener in that refund of taxes collected by the government pursuant to the demands raised would not be entitled to interest. So, even if the arbitral tribunal has awarded interest, costs or damages, the litigants will not be able to claim the same if they decide to opt for the 2021 amendment. It would appear that the litigants can choose to still pursue litigation by not complying with the conditions proposed in the bill for making the amendment applicable.