THE TAXATION LAWS (AMENDMENT) ACT, 2021 – NULLIFIES RETRO TAX ON INDIRECT TRANSFER*

Before going into the brief analysis of the Indian retrospective tax legislation, let's have a brief look on Supreme Court decision in Vodafone Case in 2012.

Vodafone Case

Fact of the Case: The Dutch group Vodafone International Holding (VIH) purchased 100 % shares in CGP Investments (Holding) Ltd (CGP), a Cayman Islands group, from Hutchison Telecommunications International Limited for USD 11.1 billion in February 2007.

Hutchison Essar Limited (hereinafter HEL), an Indian Company, was governed by CGP (hold 67% shares) through various transitional organisations / authoritative courses of action.

The acquisition resulted in Vodafone acquiring control over CGP and its subsidiaries downstream, including eventually Hutchison Essar Limited.

Vodafone Company received a show-cause notice from the Indian Tax Department in September 2007 to explain why tax was not withheld on payments made to HTIL in connection with the transaction in question above.

The tax department argued that the aforementioned transaction involving the sale of CGP shares had an effect on the aberrant or indirect sale of India-based properties.

Issue: Should the indirect transfer of "India - based capital assets" be subject to taxation?

Judgment: Prior to 2012, the issue of taxability of gains arising from transfer of shares of a foreign company deriving substantial value from assets in India (indirect transfer) was a subject matter of intense litigation in India.

Section 9 of the Income Tax Act, 1961 mentions about the Incomes which shall be deemed to accrue or arise in India. (Such deeming provision is mentioned to mainly enable the Scope of Total Income under Section 5(2) of Income Tax Act, 1961 and thus to cover the same in the Charging Section i.e., Section 4 of Income Tax Act)

* *CA Govind Agarwal, Assistant Director, The ICSI*

Views expressed in the Article are the sole expression of the Author and may not express the views of the Institute.

Section 9(1)(i) specifies that any Income accruing or arising, whether directly or indirectly, through the transfer of a capital asset situated in India, shall be deemed to be accrue or arise in India.

With regard to Section 9 of the Income tax Act, 1961, which states that income is considered to accrue or arise in India if it accrues to or arises from a transfer of capital assets in India or to a non-resident, the Court observed that there is an omission under Section 9(1)(i) of the word 'indirect transfer.' If the word 'indirect' used is read with the phrase' Capital asset located in India 'on the off chance, then it would be made worthless.

And there is no 'look through' clause in Section 9(1)(i) and can therefore not be expanded to include indirect transfers of capital assets located in India. Therefore, the transfer of shares to CGP did not result in the transfer of capital assets located in India and was not subject to taxation.

Pursuant to a challenge by Vodafone International Holdings B.V in the Supreme Court of India against imposition of tax by Income Tax Department, the Supreme Court of India on January 20, 2012 discharged VIHBV of the tax liability and held that sale of share in question to Vodafone did not amount to transfer of a capital asset within the meaning of Section 2(14) of the Income Tax Act, 1961. Further, the Apex Court not only quashed the demand of INR 120 billion by way of capital gains tax but also directed the Income tax department to refund of INR 25 billion which was deposited by the Vodafone in terms of the interim order along with interest at 4% p.a. within two months.

Amendment vide Finance Act, 2012 [Post Supreme Court Judgment in Vodafone case with respect to Taxability of Indirect Transfer of India based Capital Assets]

After the Supreme Court's verdict in Vodafone Case, the Central Board of Direct Taxes came out with an amendment vide Finance Act 2012, which provided for the insertion of explanations 4 and 5 in Section 9(1)(i) of the Income Tax Act, 1961 as under:

Explanation 4 *clarified the meaning of the term "through", stating that: "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 accordance of' or 'by reason of'."*

Explanation 5 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".

The above amendments also clarified that the term "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights had been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

Analysis of Amendment made vide Finance Act, 2012

Explanation 5 to the provisions of Section 9(1)(i) covered all the transactions which took place from the year 1961 till 2012 that involved transfer of the shares of foreign company which derives its value substantially from assets located in India.

Eg., A company XYZ of UK holds shares of a company ABC in USA, The company ABC holds substantial shares of a company PQR in India. Now, as per the amendment made in the Finance Act, 2012; if the company XYZ sells shares of ABC, it shall be deemed (and shall always be deemed) that the transferred shares of ABC of USA (Capital asset) have been situated in India. This would attract the deeming provision mentioned in Section 9(1)(i) and tax would be payable to Indian Government.

The amendment was made retrospectively by mentioning the word "and shall always be deemed". Huge reactions were received from India and around the world for bringing in a law which goes back to 1961 retrospectively, which created an uncertainty and lack of trust among the foreign investors in India.

The issue however remained unsolved for a long time and huge demands were raised for transactions which took place before 2012 as well.

Later on, the issue was taken to the Permanent Court of Arbitration by invoking the clauses of the Bilateral Investment Treaty with the United Kingdom & Netherlands. In the year 2020, the International Arbitration Court (of Netherlands) ruled in favour of the taxpayer and the said demand raised using retrospective legislation was said to be "breach of the guarantee of fair and equitable treatment" guaranteed under the bilateral investment protection pact between India and the Netherlands.

The Taxation Laws (Amendment) Act, 2021

'The Taxation Laws (Amendment) Act, 2021 received the assent of the President amend the Income Tax Act, 1961 and the Finance Act, 2012 to scrap the effect of **RETRO TAX** amendment which took place in the year 2012 after Supreme Court judgement (January 20, 2012 in the case of *Vodafone International B.V* vs. *Union of India & Anr*.

Analysis of Amendment in "The Taxation Laws (Amendment) Act, 2021

The Taxation Laws (Amendment) Act, 2021 scraped the said retrospective clarificatory amendment made in Finance Act, 2012. The Act amend the Income Tax Act, 1961 so as to provide that no tax demand shall be raised in future on the basis of the retrospective amendment for any indirect transfer of Indian Assets if the transaction was undertaken before May 28, 2012 (Date on which the Finance Bill, 2012 received the assent of the President).

The following proposals have been made to scrap the retrospective amendment:

No tax demand to be raised in future for transactions made before May 28, 2012.

Demands already raised for transactions made before May 28, 2012 shall be nullified to the extent it relates to the said income 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.)

Where any amount has been collected as per the retrospective amendment in Finance Act, 2012 or any amount becomes refundable after nullifying the order already passed; such amount shall be refunded to him without any interest under Section 244A on fulfilment of specified conditions.

Further, Section 119 of Finance Act, 2012 provides that "Notwithstanding anything contained in any judgment, decree or order of any Court or Tribunal or any authority, all notices sent or purporting to have been sent, or taxes levied, demanded, assessed, imposed, collected or recovered or purporting to have been levied, demanded, assessed, imposed, collected or recovered under the provisions of Income-tax Act, 1961 (43 of 1961). in respect of income accruing or arising through or from the transfer of a capital asset situate in India in consequence of the transfer of a share or shares of a company registered or incorporated outside India or in consequence of an agreement, or otherwise, outside India, shall be deemed to have been validly made, and the notice, levy, demand, assessment, imposition, collection or recovery of tax shall be valid and shall be deemed always to have been valid and shall not be called in question on the ground that the tax was not chargeable or any ground including that it is a tax on capital gains arising out of transactions which have taken place outside India, and accordingly, any tax levied, demanded, assessed, imposed or deposited before the commencement of this Act and chargeable for a period prior to such commencement but not collected or recovered before such commencement, may be collected or recovered and appropriated in accordance with the provisions of the Income-tax Act, 1961 as amended by this Act, and the rules made thereunder and there shall be no liability or obligation to make any refund whatsoever."

Accordingly, The Act also amend the Finance Act, 2012 so as to provide that the validation of demand, etc., under section 119 of the Finance Act, 2012 shall cease to apply and refunds shall be made on fulfilment of specified conditions.

Specified Conditions have been mentioned as under:

i. where the said person has filed any appeal before an appellate forum or any writ petition before the High Court or the Supreme Court against any order in respect of said income, he shall either withdraw or submit an undertaking to withdraw such appeal or writ petition, in such form and manner as may be prescribed;

ii. where the said person has initiated any proceeding for arbitration, conciliation or mediation, or has given any notice thereof 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, he shall either withdraw or shall submit an undertaking to withdraw the claim, if any, in such proceedings or notice, in such form and manner as may be prescribed;

iii. the said person shall furnish an undertaking in such form and manner as may be prescribed, waiving his right, whether direct or indirect, to seek or pursue any remedy or any claim in relation to the said income which may otherwise be available to him 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; and

iv. such other conditions as may be prescribed.

Now that the bill has been passed in Lok Sabha, it is expected that the foreign investment may increase and help in promoting faster economic growth and investment as said by the Finance Minister.

Source: The Taxation Laws (Amendment) Bill, 2021
http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/120_2021_LS_E.pdf

***