

Cairn Tax Dispute

In December 2020, the Permanent Court of Arbitration (PCA) ruled against India in retrospective tax dispute between the Indian Government and Cairn Energy PLC. This is an important development and one with ramifications on India's relations with global corporations and also its tax regime. In this article, you can read all about this case, its background and findings of the PCA, with the way forward. This comes under the economy section of the [UPSC syllabus](#).

Cairn Tax Dispute with India Background

The dispute started when in 2014, Indian tax authorities started questioning Cairn about its 2006-07 internal reorganisation which also involved the setting up of an Indian subsidiary, Cairn India (which was listed in 2007 in the Indian stock market).

- Initially, Cairn Energy's assets in India were owned by Cairn India Holdings Ltd, which was a fully-owned subsidiary of Cairn UK Holdings (CUHL), which in turn, was fully owned by Cairn Energy PLC.
 - Cairn India Holdings Ltd was based in the UK.
 - Cairn Energy PLC is an oil and gas company headquartered in the UK and listed on the London Stock Exchange.
- In 2006, through the corporate reorganization, Cairn Energy transferred its Indian assets to Cairn India. [Cairn India acquired the entire share capital of Cairn India Holdings from Cairn UK Holdings, and in exchange, the latter acquired a 69% stake in Cairn India].
- This transaction, according to the Indian tax authorities, gave Cairn Energy capital gains of ₹24,500 crores. This was the basis on which the tax was demanded by India.
- In 2011, Cairn Energy sold Cairn India to Vedanta Group but the Income Tax Department did not permit it to sell all its stake, and 9.8% minor stake was still left with Cairn.
- The government also froze dividend payment to Cairn Energy by Cairn India.

Retrospective Taxation

In 2012, India amended its Income Tax Act, 1961 to ensure that a transfer of shares that takes place outside India can also be taxed if the value of the shares is based on assets in India. And, this was applied retrospectively.

- Retrospective taxation** permits countries to enact a rule or law that will enable it to tax products, services or deals/transactions and charge entities from a date before the date on which the law became effective.
- Countries use this method to rectify any anomalies in their tax regime that probably allowed companies to take advantage of any loopholes and avoid tax.
- Retrospective taxation generally hurts companies that had interpreted tax rules differently either on purpose or unknowingly.

- Countries like the US, the UK, Italy, Australia, Belgium and Canada have taxed companies retrospectively.

Appeals by the Company

After receiving a draft assessment order from the IT Dept, Cairn UK Holdings appealed to the Income Tax Appellate Tribunal (ITAT) and the Delhi High Court.

- The ITAT ruled against the company while the case is still pending in the High Court.
- Then, the company initiated arbitration proceedings in the [Permanent Court of Arbitration](#) under the U.K.-India Bilateral Investment Treaty.

Cairn's Arguments

- The claimants in the case were Cairn Energy and Cairn UK Holdings. They argued that up until the amendments were made to tax retrospectively, there was no tax levied on indirect transfers, ie., transfer of shares by a non-resident in non-Indian companies which indirectly owned assets in India.
- They said that this taxation breached the UK-India Bilateral Investment Treaty.

India's defence

- The main argument was that irrespective of the 2012 amendment to the IT Act, the transaction in 2006 by the company was taxable.
- India contended that "Indian law has long permitted taxation where a transaction has a strong economic nexus with India".

PCA Ruling

- Although the tribunal concluded hearing the case in 2018, the ruling was delivered only in December 2020.
- The tribunal unanimously awarded in favour of Cairn and ruled that India had breached the UK-India Bilateral Investment Treaty
- It also ordered the Indian Government to pay compensation to Cairn to the tune of about \$1.2 billion (about Rs.10000 crore).
- The tribunal said that the issue was not just a tax-related issue but an issue related to investment and so was under its jurisdiction.

The ruling is similar to India's case with Vodafone, in which the PCA ruled in the company's favour and asked India to pay compensation. Read more on the issue in [CNA dated Dec 25, 2020](#).

Finance Ministry's Response

- The government raised the issue of jurisdiction stating that the PCA had no jurisdiction over a national tax dispute that India never offered and/or agreed to arbitrate.
- It said that Cairn's claims are based on an abusive tax avoidance scheme which was in violation of Indian laws, hence, denying the company any protection under the UK-India Bilateral Treaty.

- The Ministry also said that the award also condoned Cairn's methods to achieve double non-taxation, ie, avoiding paying any tax anywhere in the world, which was a major public policy concern for many governments worldwide.

Cairn Tax Dispute Latest Development

After the award, Cairn had initiated proceedings against India in courts in the US, the UK, the Netherlands, Singapore and Canada to enforce the award. Notably, nothing was moved in any Indian court. Cairn also sued Air India in New York to seize its assets to enforce the award. Air India is India's national carrier and is wholly owned by the Indian government.

The Indian Government has petitioned the Dutch Court of Appeal to set aside the arbitration award.

Meanwhile, representative from Cairns had approached the Finance Ministry in a bid to resolve the matter amicably and positively.