Investment Positive: End of Retro Tax: RSTV - Big Picture

Anchor:

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Context:

The Taxation Laws (Amendment) Bill, 2021 passed by Lok Sabha offers to drop tax claims against companies on deals before May 2012 that involve the indirect transfer of Indian assets on the fulfilment of specified conditions including the withdrawal of pending litigation and the assurance that no claim for damages would be filed.

Initial Information:

Before discussing all the aspects of the issue, a few concepts require a brief introduction:

Capital Gains Tax:

As per the Income Tax Act, 1961, capital gains arise when a capital asset is sold over and above its cost of acquisition; and **Capital Gains Tax** is tax paid on the profits made from selling these notified capital assets.

Retrospective Taxation:

- As the name suggests, retrospective taxation allows a country to pass a rule on taxing certain products, items or services, and deals and charges companies from a time behind the date on which the law is passed.
- Countries use this route to correct any anomalies in their taxation policies that have, in the past, allowed companies to take advantage of such loopholes. While governments often use a retrospective amendment to taxation laws to “clarify” existing laws, it ends up hurting companies that had knowingly or unknowingly interpreted the tax rules differently.
- Apart from India, many countries including the US, the UK, the Netherlands, Canada, Belgium, Australia, and Italy have retrospectively taxed companies, which had taken the benefit of loopholes in the previous law.

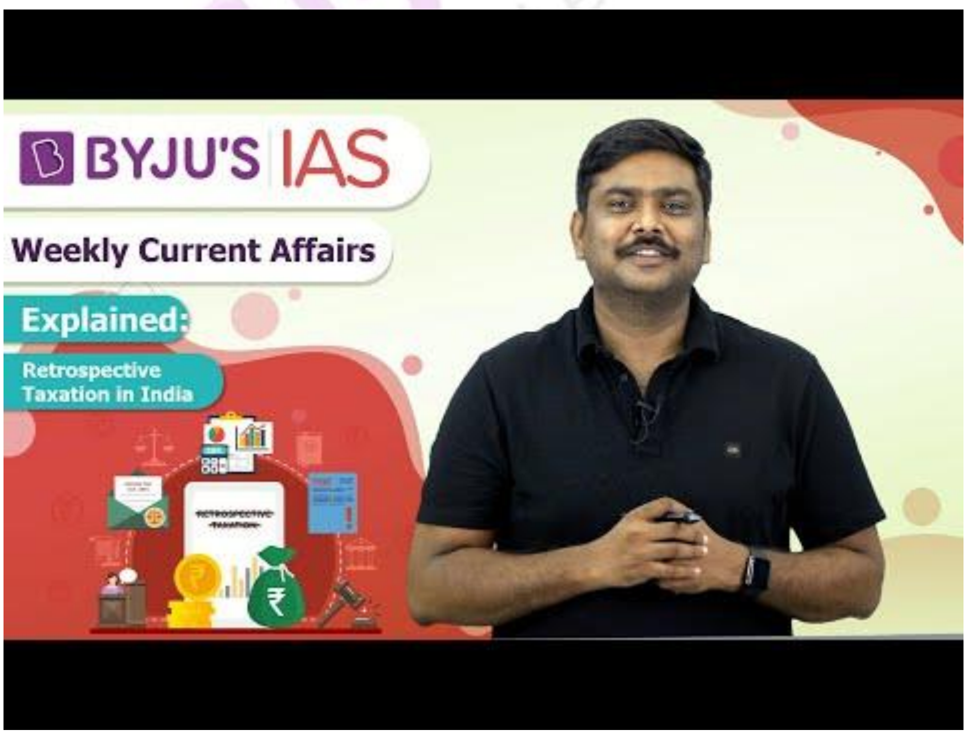
Vodafone Case:

- In 2007, Vodafone acquired ownership rights of the Indian company Hutchison Essar. This included the mobile telephony business and other assets of Hutchison in India.
- Here, capital gains took place as the shareholding of Hutchison moved to Vodafone and the selling cost was above the cost of acquisition.
- According to Indian tax laws, the capital gains tax was due on this transaction to the exchequer.

- But, this transaction happened completely offshore which means not within the Indian tax jurisdiction, the companies did not make any provision for capital gains tax allocation to the central government of India.
- But, the government of India realized that the big transaction that took place pertains to underlying assets that were located in India. The income-tax authority filed a tax notice against Vodafone and Hutchison Whampoa saying that tax evasion has been done by these companies.
- This became a high profile case and went to the Bombay High Court where the HC ruled in Vodafone’s favour, saying that they do not have to pay any capital gains tax.

Retrospective Amendment to the Finance Act:

- In 2012, the Supreme Court ruled that the government of India was wrong in levying the capital gains tax because the transaction took place outside the country and the current laws do not allow the government of India to levy capital gains tax on international transactions even when the underlying assets of that international transitions are located in India.
- In 2012, the then Finance Minister, late Shri Pranab Mukherjee, circumvented the Supreme Court’s ruling by proposing an amendment to the Finance Act, thereby giving the Income Tax Department the power to retrospectively tax such deals.
- The amendment says that from April 1962 onwards, for any capital gain arising out of a transaction even if it is international, the entities will have to pay the capital gains tax if the underlying assets of that particular transaction are located in India.
- The Act was passed by Parliament that year and the onus to pay the taxes fell back on Vodafone. The case had by then become infamous as the **‘retrospective taxation case’.**



The Taxation Laws (Amendment) Bill, 2021:

- The Taxation Laws (Amendment) Bill, 2021 was introduced in Lok Sabha by the Minister of Finance, Ms. Nirmala Sitharaman, on August 5, 2021. The Bill amends the Income Tax Act, 1961 (IT Act) and the Finance Act, 2012.
- The 2012 Act had amended the IT Act to impose tax liability on the income earned from the sale of shares of a foreign company on a retrospective basis (i.e., also applicable to the transactions done before May 28, 2012). The Bill proposes to nullify this retrospective basis for taxation.

Long-awaited decision:

- There were 17 cases for which retrospective taxation was applied for transactions prior to 2012.
- Out of these, two (Vodafone and Cairn) went to the court where they stayed. The claims couldn't be pursued further.
- The then Finance Minister Arun Jaitley promised that the current cases of retrospective taxation will be allowed to reach a logical conclusion.
- Now, the cases have reached their conclusion. The suspense has ended with this amendment over the government's approach to retrospective taxation cases.

Also read: Cairn Tax Dispute

Conditions required under the Amendment:

- The Bill proposes to nullify this tax liability imposed on such persons provided they fulfil certain conditions. These conditions are:
  - If the person has filed an appeal or petition in this regard, it must be withdrawn or the person must submit an undertaking to withdraw it,
  - if the person has initiated or given notice for any arbitration, conciliation, or mediation proceedings in this regard, the notices or claims under such proceedings must be withdrawn or the person must submit an undertaking to withdraw them,
  - the person must submit an undertaking to waive the right to seek or pursue any remedy or claim in this regard, which may otherwise be available under any law in force or any bilateral agreement, and
  - other conditions, as may be prescribed.
- The Bill provides that if a concerned person fulfils the above conditions, all assessment or reassessment orders issued in relation to such tax liability will be deemed to have never been issued. Further, if a person becomes eligible for a refund after fulfilling these conditions, the amount will be refunded to him, without any interest.

Key Benefits of the Taxation Amendment Laws:

- Will instil foreign as well as domestic investors with confidence in the Indian economy.
- Will spur companies that are at the cusp of deciding their investments into investing in India.
- Will avoid unnecessary litigation and save time and costs for the government.
- Will boost the policy of the government to have a predictable tax regime.
- Will provide impetus to the country's goal of becoming a $5 trillion economy.

- Will improve the credibility of industries and also enhance the confidence of people in the commitments of the government.

Conclusion:

The government should be watchful about the successful and timely implementation of the law because this is an opportunity to address some stressed sectors such as the telecom sector and the oil exploration sector. This amendment will attract investments into the country.

Read all the RSTV articles in the link.