

EY Tax Alert

India proposes to remove retrospective applicability of indirect transfer provisions

Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

Background and executive summary

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.

In January 2012, in a landmark judgment, the Indian Supreme Court (SC), in the case of Vodafone BV¹ ruled that transfer of shares of a company incorporated outside India would not be taxable in India².

However, considering the fact that the verdict of the SC was inconsistent with the legislative intent, Government of India (GoI) introduced certain "clarificatory" changes to the Income Tax Act (ITA) vide Finance Act, 2012 (FA 2012) with retroactive effect from 1 April 1962, to clarify that transfer of shares or interest in a foreign entity would be taxable in India, if such shares derive substantial value from assets located in India³.

¹ Vodafone International Holdings B.V. v. UOI (2012) 341 ITR 1

² Refer EY Tax Alert titled "The Vodafone case: SC rules transfer of shares of a foreign company that indirectly held underlying Indian assets not taxable" dated 20 January 2012)

³ Refer EY Tax Alert titled "Key amendments proposed by the Finance Bill, 2012 to international tax provisions of the Indian tax law" dated 16 March 2012

Pursuant to such amendment, the Indian tax authority issued demand orders in 17 cases including in the case of Vodafone and Cairn Group. Further Finance Act 2012, provided that any demand order/ notice etc. issued under the ITA in respect of indirect transfers undertaken prior to the 2012 amendment would continue to be valid. This was done to overcome the SC verdict in the case of Vodafone.

Out of the 17 cases, assessments are still pending in two cases owing to a stay granted by High Court. Furthermore, in four cases arbitration was invoked under the Bilateral Investment Protection Agreements (BIPAs) with United Kingdom and Netherlands. Out of the four arbitration cases, the Arbitration Tribunal has ruled in favor of the taxpayers in two cases viz., in the cases of Vodafone and Cairn.

The move of the Gol to levy retrospective taxes has been hugely criticized on the grounds that it militated against the objective of Gol to provide tax certainty and damaged India's reputation of an attractive investment destination. The retrospective amendment was considered to be breach of India's obligation under the BIPAs on the basis that India failed to provide stable, predictable and foreseeable tax regime and retroactive amendments are inimical and fundamental affront to the principles of legal certainty.

In the past few years, Gol has been undertaking major reforms in the financial and infrastructure sector to create a positive environment for the investors. However, the retrospective amendment and the criticism around such amendment continues to be a sore point for the investors.

Considering the importance and the need to attract foreign investments into India, especially post the economic set back due to COVID-19, GOI has proposed to remove the retrospective effect of the FA 2012 amendment.

In this regard a bill has been passed in the Lok Sabha (the lower house of Indian parliament) titled "The Taxation Laws (Amendment) Bill, 2021" (Bill) on 6 August 2021. The proposals of the Bill are aimed at achieving the following objectives:

- i. No levy of taxes on indirect transfers undertaken prior to 28 May 2012⁴ (specified date)
- ii. No assessment to be made/no enforcement of tax demand/ no notices to be issued in respect of indirect transfers undertaken prior to the specified date
- iii. Nullification of demand orders already raised/assessment made/ penalty levied in respect of indirect transfers undertaken

⁴ Date on which the FA 2012 received president's assent

prior to the specified date on fulfilment of specified conditions (viz. withdrawal of pending litigations)

- iv. Refund of taxes collected pursuant to demand order issued in respect of indirect transfers undertaken prior to the specified date. However, such refund would be without any interest.
- v. Amendment of FA 2012 (which provided for the validity of notices/ orders passed in respect of indirect transfers undertaken prior to the specified date) to provide that such notices/ orders shall cease to apply subject to satisfaction of the specified conditions.

The proposals of the bill

The Bill proposes to withdraw the retrospective applicability of indirect transfer provisions by proposing as follows:

A. Provisions relating to assessment and penalty order in respect of income arising from indirect transfer undertaken prior to the specified date

- ▶ Following orders (specified orders) are not to be passed if it pertains to income arising from indirect transfer undertaken prior to 28 May 2012

Description of the order which shall not be passed or deemed to never have been passed	ITA section reference
Assessment order	143/144 / 153A/153C
Reassessment order	147
Rectification orders which enhances the assessment or reduces a refund or otherwise increases the tax liability	154
Order for deeming a person to be assessee-in-default for failure to withhold taxes	201(1)

- ▶ In cases where a penalty order or any of the specified orders have already been passed in respect of indirect transfer undertaken prior to the specified date, then the same shall be deemed to never have been passed if the taxpayer satisfies the following conditions (specified conditions):

- The taxpayer should either withdraw or submit an undertaking to withdraw any pending appeals, writ

petitions, civil appeals, in such form and manner as may be prescribed in respect of income arising from indirect transfer undertaken prior to the specified date.

- Taxpayer shall withdraw or submit to withdraw any proceedings for arbitration, conciliation or mediation initiated by the taxpayer in respect of income arising from indirect transfer undertaken prior to the specified date in such form and manner as may be prescribed. Further, the taxpayer is to withdraw or submit an undertaking to withdraw any claim in such proceedings.
- The taxpayer shall submit an undertaking waiving its right to seek any remedy or claim which may otherwise be available to the taxpayer under any other law or agreement for the time being in force or under any international agreement entered into by India in such form and manner as may be prescribed.
- Such other conditions as may be prescribed by the Central Board of Direct Taxes⁵ (CBDT).

B. Amendment to the Finance Act 2012

- ▶ FA 2012 which inserted the indirect transfer provisions under ITA also provided for a validation provision under Section 119 of the FA 2012 itself. The validation provision provided that any notices or demand orders passed or taxes levied, imposed or collected in respect of indirect transfer prior to the enforcement of FA 2012 would remain valid without prejudice to any judgement or order of any Court or Tribunal. Through this validation clause, FA sought to ensure that past notices, demand, taxes levied/demanded etc. which would have otherwise become invalid due to the SC ruling in Vodafone (*supra*) were made valid.
- ▶ In light of the proposed removal of the retrospective applicability of indirect transfer provisions, this Bill provides that the validation clause shall not apply if the taxpayer fulfills the specified conditions listed above.

C. Refund upon cancellation of assessment/ Inapplicability of notices issue

- ▶ Any refund that becomes due to the taxpayer as a consequence of any assessment or demand order or recovery becoming invalid as indicated above, shall be granted to the taxpayer. However, there would be no payment of interest on such refund amount.

Effective date

The Bill will take effect from the date it is enacted into law. Taxpayers will need to wait for the enactment of the Bill and conditions to be prescribed by CBDT to take benefit of this opportunity to close litigation for past years.

Comments

The proposals of withdrawing the retrospective levy suggests that the international treaties and policies may have a huge influence on framing of the legislative policies of any country.

Due to the open-textured protection granted in terms of assuring fair and equitable treatment, BIPAs have entrenched regulatory space of various countries. As a fall out of Vodafone and Cairn disputes under BIPA, India has terminated most of its BIPAs and adopted new model which specifically excludes tax from the scope of BIPAs while it also has restrictive coverage. New model has specifically excluded generic protection in terms of fair and equitable treatment. However, it is likely that BIPAs can have survival clause which might make BIPAs relevant for the investment made during the subsistence of BIPAs. Also, since retroactive amendment is considered as impermissible, India may face difficulty even in respect of its other retroactive measures if the foreign investor succeeds in indicating the adverse effect on its direct or indirect India investments.

Retroactive amendment frustrates the ability of the taxpayer to comply with legal obligations or to ascertain its actual incidence of taxes and, hence, they are considered to be contrary to the fundamental rule of law resulting in breach of the BIPA obligation requiring India to provide fair treatment to the foreign investors. The retrospective amendments and the subsequent international arbitrations have had an adverse impact on India's image as an investor-friendly jurisdiction.

⁵ The apex direct tax administrative body in India

Hence the withdrawal of retroactive effect of indirect transfer is a welcome move. The withdrawal is, however, subject to multiple conditions such as withdrawal of pending appeals, writs and special leave petitions (SLPs), arbitration, mediations and conciliations if any initiated by the taxpayer. In addition, the taxpayer is required to give an undertaking waiving all taxpayer's rights to pursue any claim or remedy under any other law in force. As indicated above, there are about 17 cases which may get protected by the amendment if the option is availed by the taxpayers by satisfying the conditions specified in the Bill. The Bill also refers to compliance with other conditions which may be prescribed by CBDT. This is an uncertain area.

The taxpayers who wish to avail the benefits of the proposals under the Bill will thus need to weigh all their options and take a call on whether they would wish to settle the dispute in relation to the FA 2012 amendment or not. Taxpayers will need to carefully evaluate the trade-off between enforcing the arbitral award comprising damages and interest in addition to tax and complying with conditions prescribed in the Bill to get demands annulled/refund of principal amount of tax without interest.

However, taxpayers who may have already settled their disputes under Vivad Se Vishwa Scheme⁶ (VSV) may face difficulty in claiming any refund by taking the shelter of the proposed Bill since no refund is available for payments made under VSV.

As a legislative process, the Bill will be transmitted to Rajya Sabha (upper house of Parliament) and then to the President of India for their assent, before it is enacted as law.

⁶ The Direct Tax - Vivad Se Vishwas Act 2020" was introduced as part of Union Budget 2020 to provide an opportunity for taxpayers to settle their direct tax disputes, by filing a declaration in the prescribed form to the Designated Authority (DA) and by paying the prescribed amount before a notified date.

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon,
Ambli BRT Road, Behind Iskcon Temple,
Off SG Highway,
Ahmedabad - 380 015
Tel: +91 79 6608 3800

Bengaluru

6th, 12th & 13th floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: +91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: +91 80 6727 5000

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A,
Industrial & Business Park, Phase-I,
Chandigarh - 160002
Tel: +91 172 671 7800

Chennai

Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: +91 44 6654 8100

Delhi NCR

Golf View Corporate Tower B
Sector 42, Sector Road
Gurgaon - 122 002
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: +91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Budh Nagar, U.P.
Tel: +91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "Zone A"
Survey No 83/1, Raidurgam
Hyderabad - 500032
Tel: +91 40 6736 2000

Jamshedpur

1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur - 831 001
Tel: +91 657 663 1000

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: +91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: +91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: +91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: +91 22 6192 0000

Pune

C-401, 4th floor
Panchshil Tech Park
Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: +91 20 4912 6000

Ernst & Young LLP

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