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TAX FLASH NEWS

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Government proposes to withdraw the retrospective application of 'indirect transfer' related provisions and make it prospective in nature

Background

The issue of taxability of capital gains arising from the transfer of assets located in India through the transfer of the shares of a foreign company (indirect transfer of Indian assets) was a subject matter of protracted litigation. In 2012, the Supreme Court in the case of Vodafone International Holdings BV[1] had given a verdict that gains arising from indirect transfer of Indian assets are not taxable under the provisions of the Income-tax Act, 1961 (the Act).

Subsequently, the provisions of the Act were amended by the Finance Act, 2012 with retrospective effect, to clarify that gains arising from sale of share of a foreign company is taxable in India if such share, directly or indirectly, derives its value substantially from the assets located in India. The Finance Act, 2012 also provided for validation of demand, etc., under the Act for cases relating to indirect transfer of Indian assets.

Pursuant thereto, income-tax demand had been raised in seventeen cases. In two cases assessments are pending due to stay granted by the High Court. Out of the said seventeen cases, arbitration under Bilateral Investment Protection Treaty with UK and Netherlands had been invoked in four cases. In two cases, the Arbitration Tribunal ruled in favour of the taxpayer and against the tax department.

The said clarificatory amendments made by the Finance Act, 2012 invited criticism from stakeholders mainly with respect to retrospective effect given to the amendments.

The government has introduced the Taxation Laws (Amendment) Bill 2021 (the Bill) in the Lok Sabha[2] and proposed to withdraw retrospective amendments relating to 'indirect transfer' taxation under Section 9(1)(i) of the Act. The Bill also proposed to amend provisions with respect to validation of demand, etc., under Section 119 of the Finance Act, 2012.

The Taxation Laws (Amendment) Bill 2021

Objects and reasons

The Bill provides a statement of objects and reasons for introduction of these provisions. It states that such retrospective amendments have worked against the principle of tax certainty and damaged India's reputation as an attractive destination. In the past few years, major reforms have been initiated in the financial and infrastructure sector which has created a positive environment for investment in the country. However, these retrospective clarificatory amendments and consequent demand created in a few cases continues to be a sore point with potential investors. The country today stands at a juncture when quick recovery of the economy after the COVID-19 pandemic is the need of the hour and foreign investment has an important role to play in promoting faster economic growth and employment. Thus, the government has proposed to withdraw the retrospective application of 'indirect transfer' related provisions and make it prospective in nature.

[1] UOI v. Vodafone International Holdings BV [2012] 19 taxmann.com 217 (SC)

[2] Source – Lok Sabha website http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/120_2021_LS_E.pdf

Executive summary

- 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 28 May 2012 (i.e., the date on which the Finance Bill, 2012 received the assent of the President).

- The demand raised for indirect transfer of Indian assets made before 28 May 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.

- Amount paid by of tax shall be refunded in these cases without any interest thereon.

- The validation of demand, etc., under Section 119 of the Finance Act, 2012 shall cease to apply on fulfilment of specified conditions such as withdrawal or furnishing of undertaking for withdrawal of pending litigation and furnishing of an undertaking that no claim for cost, damages, interest, etc., shall be filed.

Details of amendments proposed in the Bill are given in the following Annexure.

Annexure

Explanation 5 to Section 9(1)(i) provides 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 subject to certain conditions.

- The Bill proposes that the provisions of Explanation 5 to Section 9(1)(i) shall not apply to –

  - ➢ An assessment or reassessment to be made[3] or

  - ➢ An order to be passed enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the taxpayer under Section 154 or

  - ➢ An order to be passed deeming a person to be an assessee in default under Section 201(1)

  in respect of income accruing or arising through or from the transfer of an asset or a capital asset situated in India in consequence of the transfer of a share or interest in a company or entity registered or incorporated outside India before 28 May 2012.

- Further, where—

  - ➢ An assessment or reassessment has been made[4] or

  - ➢ An order has been passed enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the taxpayer under Section 154; or

  - ➢ An order has been passed deeming a person to be an assessee in default under Section 201(1) or

  - ➢ An order has been passed imposing a penalty under Chapter XXI or under Section 221

    - in respect of income accruing or arising through or from the transfer of an asset or a capital asset situated in India in consequence of the transfer of a share or interest in a company or entity registered or incorporated outside India before 28 May 2012 and

    - the person in whose case such assessment or reassessment or order has been passed or made fulfils the specified conditions

  then, such assessment or reassessment or order, to the extent it relates to the said income, shall be deemed never to have been passed or made.

- Where any amount becomes refundable to the person as a consequence of him fulfilling the specified conditions, then, such amount shall be refunded to him, but no interest under Section 244A shall be paid on that amount.

- The specified conditions for the above provisions are as under:

  - ➢ 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;

[3] Under Section 143, Section 144, Section 147 or Section 153A or Section 153C

[4] Under Section 143, Section 144, Section 147 or Section 153A or Section 153C

- 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 in such proceedings or notice, in such form and manner as may be prescribed;

- 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

- Such other conditions as may be prescribed.

Section 119 of the Finance Act, 2012 provides for validation of demand, etc. under the Act for cases relating to indirect transfer of Indian assets. The Bill proposes to amend the Finance Act, 2012 so as to provide that the validation of demand, etc., shall cease to apply on fulfilment of above conditions.

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