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THE RETROSPECTIVE ANGLE OF INDIAN TAX LAWS: THE VODAFONE CASE

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ABSTRACT

India is one of the fastest growing economies of the world in terms of GDP. The income tax structure is order-less and structureless. For instance, he Income Tax Act,1961 suffered more than 60 amendments in less than 30 years of its existence and even these many changes were unable to cope with the situations. The Supreme Court while deciding the case observed that the expression "retrospective operation" is at times vague and misleading. The retrospective amendment to tax laws have caused serious damage to the economy and image of the country. One of the most defaming case was Vodafone case which portrayed the inability of the legislative arm of the government on the international level. It depicted how the administrative powers were misused to overturn the decision of the Supreme Court. Again, in Cairn UK case, India had to face serious criticism for the same. Though the Finance Ministry stated that it is now ending the retrospective taxes imposed on indirect transfer of Indian assets to boost India's dream of becoming a $5 trillion economy, but its evident that this step is because of the fact that the prediction of the Government for the law taking its own course has been proved wrong twice. The tax laws in the future needs to made simple and be published to serve for the public goods as well as public interest without being deterred by populism. Then only this country can prove itself a mature democracy which has both the capitalistic and socialist mindset.

INTRODUCTION

India is one of the fastest-growing economies of the world in terms of GDP. But it has seen its ups and downs. Being the tax to GDP ratio as 11.22% in FY19, 10.97% in FY19 to an all-time low 9.88% in FY20 of this decade, it is evident why the tax laws are one of the most sensitive and controversial issues and why there is a need of utmost attention to form a tax

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structure that can make a scope for the cagey idea of egalitarianism for a diversified State of 1.35 billion people.

Herman Wouk quotes that "**Income tax returns are the most imaginative fiction being written today"**. In simple terms, itreveals theshapeless and order-less structure in the tax law which is in place but is too subtle to be applied, exercised, and controlled that easily, depicting the failure of both the legislature and judiciary.For an instance, the Income Tax Act,1961 suffered more than 60 amendments in less than 30 years of its existence and even these many changes were unable to cope with the situations.

Prospective Amendments being those amendments that will apply or are likely to be applied in the future dates and Retrospective Amendment, those amendments which will take effect from a time in the past. Prospective Amendments are easier to apply and can be done in civil and criminal laws both while Retrospective Amendments find themselves impractical to be applied and are made mostly in the matters of Civil Laws only.

LEGISLATIVE EFFICACY

Tokeep the Legislative Bodies in check, the Indian Constitution imposes two fundamental limitations. First,is the doctrine of Separation of Power, which can be seen in Part VII where the State and the Union have their own jurisdiction and competency to make laws related in their list (Union List, State List, and Concurrent List). And the second limitation comes by way of Part III where any law can be challenged in view as they are discriminatory, unreasonable, or ultra-vires to the Fundamental Rights.

The legislature can exercise its power in respect to these limitations to make two types of Amendments based on their application date.The first case that gave the rise to the trend of retrospectivity in statutes and created challenges for its application is the famous Chhotabhai v. Union[2]. In this case,duty was imposed on a manufactured tobacco retrospectively from the date of the introduction of the Bill and not from the date in which the law came into force. This case showed how the State legislature was incompetent to legislative a retrospective sale tax law. The Supreme Court validating those laws stated that they are being brought into effect as to correct the earlier flaws which defeat the purpose of the legislation in the first place. The Supreme Court also dictated that the tax laws should be in confer with Part III of the Constitution of India. And these principles became a precedent for the upcoming cases.

[2]1962 Supp 2 SCR 1

Again, in the case of JK Jute Mills Co Ltd v. State of Uttar Pradesh[3], the Supreme Court while deciding the case observed that the expression "retrospective operation" is at times vague and misleading. It is sometimes loosely used or sometimes used in a different sense when the vested rights are sought to be affected.This interpretation depicts the unevaluated and inefficient results caused due to the back-dating application of laws. In recent times, there are several amendments that have been passed off as "clarificatory" or "declaratory". This legislative assertion also becomes of no use as in the last, it is the judiciary who will decide whether the law is constitutionally valid or not.

THE VODAFONE CASE:

In India, mobile telephone services were introduced in 1995. Trai was set up which reduced the interference of the Government in deciding tariffs and policy making. Initially, the revenue sharing regime was introduced, the prices were cut down and the Indian Telecom Sector saw a boom in its growth. Later, many foreign investments were pumped in the Indian market seeking a substantial future value when the licenses started to be given on a circle-wise basis. One of the foreign companies was Hutch, a Hong Kong based group which in very few times acquired a large chunk of the telecom industry. It made its investment in India through a listed company in Hong Company and with chain links, a Mauritius companies held shares in an Indian holding company which controlled operational subsidiaries in India.

Hutch sold its 67% stake including the telecom business and its other assets to Vodafone for $11 billion in May 2007 when it decided to exit India. The Income Tax Department ran a test case on this and in September, the Indian government stated that the company should have deducted the tax at source before making a payment to Hutch and asked Vodafone to pay around Rs 7,990 crores because of capital gain and withholding taxes.

The transaction was made outside India, the agreements were entered into in England and Hong Kong and the controls were transferred outside India at the Cayman Islands and Mauritius Etc. And one of the major flaws that came above in the test case run was that it amounted to extending procedural provisions for withholding tax to offshore transactions which haveconsummated in jurisdictions to which Indian tax law does not apply.

Later, Vodafone challenged the demand notice in Bombay High Court, which decided in favor of the Income Tax Department. Vodafone moved to Supreme Court against this

[3](1961) 12 STC 429 (SC)

decision. The Supreme Court ruled that Vodafone Group's interpretation of the Income Tax Act of 1961 was correct and it didn't have to pay any taxes for the stake purchases. The Indian Law was not applicable to commercial transactions which happened outside India between two non-Indians were no part of the transaction takes place in India – which would be contrary to settled principles of Conflict of laws.[4]

Later, the Parliament passed the Finance Act in 2012 which made the obligation to clear the due taxes fall back on Vodafone. The parliament stated that these amendments were brought "for the removal of doubts". This amendment was badly drafted in its wide generalities and was just passed to overturn the decision of the Apex Court.This was the biggest blow to the reputation of Indian System[5] and now this case was infamously called as the "retrospective taxation case".

The Vodafone refused to perform the onus and it invoked the Bilateral Investment Treaty signed by Indian and Netherlands in 1995. This treaty basically was for the promotion and protection of investment by companies of each country in the other's jurisdiction. In 2014, arbitration proceedings were initiated against India under Article 3 of the arbitration rule of UNCITRAL and Article 9 of the Bilateral Investment Treaty (BIT).

Article 3(5) of the arbitration rule of UNCITRAL[6] states that

"The constitution of the arbitral tribunal shall not be hindered by any controversy with respect to the sufficiency of the notice of arbitration, which shall be finally resolved by the arbitral tribunal."

Article 9 of the BIT[7] states that

"Any dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute. The party intending to resolve such dispute through negotiations shall give notice to the other of its intentions."

[4]Harish Salve – Retrospective Taxation – the Indian Experience

[6]UNCITRAL Arbitration Rules, Article 3

[7]https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1584/download

The arbitration tribunal at Hague ruled that now since it was established that India had breached the terms of the BIT and United National Commission on International Trade Law (UNCITRAL) and hence India needs to stop all the efforts to recover the said taxes from Vodafone. The tribunal also directed to pay $5.47 million to Vodafone for compensating the legal costs incurred.

After this ruling, two expert committees categorically held that that the amendment fallout establishes a clear picture that it was a huge mistake. This amendment proved to be a lesson for how parliament should not misuse the power to amend the laws and put an assault on the rule of law.

CURRENT SCENARIO AND TRENDS

In the case of UOI v. Martin Lottery[8], the Apex Court held that mere assertion by the legislature that an amendment is a clarification (for the removal of doubts) is not conclusive and whether a change is clarificatory or a substantive change (not a retrospective one) as it is a matter of statutory interpretation and therefore for the Courts to adjudicate. If the law will be proved unconstitutional, the legislative assertion that the law or amendment was for the removal of doubts and clarificatory in nature would be of no avail.

The Indian Constitution clarifies that a law does not become unconstitutional merely on the ground that it has some extraterritorial operation. To prove that it is unconstitutional, one needs to show that there is no territorial nexus with India. After the decision in Ishikawajimas Case[9] in 2007, several amendments were brought to modify the decision where the principle of presumption against extraterritorial would apply. The Supreme Court had accepted that the provisions of a statute must be construed in harmony with the principle that income which has no territorial nexus with India would not fall within the mischief of the fiction of "income deemed to accrue arise in India".

After the LPG Policy, India has seen an exponential growth in Foreign Direct Investment and setting up of MNCs, which further brings in a significant portion of tax revenue. Indian tax laws have gone significant changes to deal with this situation. One of the areas of change is the provision for taxing in India offshore income of non-residents and provisions for a fair balance of tax attributed to India from the enterprises operating. within and outside India.

[8] 2009 12 SCC 209

[9]Ishikawajma-Harima Heavy ... vs Director Of Income Tax, Mumbai, 2007 3 SCC 481

These all reforms have somewhere restored the public confidence in the procedure prescribed by the administrative laws and various tax laws and established certainty.

Apart from affecting the domestic tax laws, LPG and increasing globalization also possessa threat to international taxations also. While doing transactions with different countries, double taxations happen vis-à-vis to companies which are being taxed in countries from where they belong or are residents and are also taxed in the source countries where they are carrying out their economic activities. It makes highly important for an economically rising country like India to provide relief to the domestic companies operating in foreign lands and enter the Double Tax Avoidance Agreements (DTAA) with numerous countries on a bilateral treaty. This won't just help to avoid erosion of tax base but will also be beneficial in the shifting of profits from the trading countries and reduction of trade deficits in the long run. If we look in recent data of exports, July2021[10] exports were the highest in atleast 9 years which signals a swift recovery in global demand which raises concern to think and amend tax laws for better future advantages and low complications

Before introducing any retrospective amendments, the Parliament must go through some tests so that thesame mistakes as one in the Vodafone case don't happen again. Being a growing economy, it needs to make stable laws which are not just certain but clear also to attract foreign investments as well as promotedomestic investments. A liberal tax policy should be made and administered to promote more social and economic welfare.

Imposing a tax law with a retrospective effect, may be beneficial for the government treasury but it becomes a hurdle for the company to operate effectively. A company's decision is based on future which is forecasted and needed to be ideal and stable, but the problem starts to occur when activities are organized today based on future law that will be made applicable from today. The Shome Committee[11] thus had rightly pointed out in its first recommendation only that any taxations of indirect transfer of assets located within the territory of India should be prospective and not retrospective.

After the Vodafone Case, there were several initiatives that were taken to modify, simplify and strengthen the tax laws. Some of the initiatives were:

[10] The Hindu, Jul.3, 2021 at Pg.8
[11] Report of the Expert Committee on Retrospective Amendments made by the Finance Act, 2012 to Income-Tax Act, 1961

1. A committee was set up under Justice R V Easwar in October 2015 to simplify the provisions of the Income Tax Act,1961.One of the essential recommendations by the committee for the modern times was the simplification & rationalization of the provisions of Section 197 and Rules for lower or non-deduction of TDS, aimed to improve ease of doing business.
2. The government launched the e-Sahyog app as e-initiative pilot project to counter and reduce compliance cost, especially targeting the small and medium taxpayers.
3. The appraisal system of the tax officers now can be revamped to consider the proportions of orders sanctioned by them that were upheld on appeal. This was designed so that an objectivity in the orders of tax officers can be brought.
4. The Shome Committee panel also recommended that any taxation involving the indirect transfer of assets and capital gains located in India should be prospective and not retrospective.

AN END OF RETROSPECTIVE TAX LAWS:

Recently, the most highlighted case was the Cairn UK case[12] which induced the scraping of the retrospectively applied tax laws. Similar to Vodafone case, India lost to Cairn UK in an international court of arbitration and the court also allowed Cairn to claim for $1.2 billion as compensation. And if the dues are not paid, then they have the right to identify foreign assets and sell them to recover.

Though the present Finance Minister Nirmala Sitharaman has clarified that the Finance Ministry is ending the retrospective taxes imposed on indirect transfer of Indian assets to boost India's dream of becoming a $5 trillion economy, but its evident that this step is because of the fact that the prediction of the Government for the law taking its own course has been proved wrong twice. On the international stand,the government got a negative press and was very much in a jam. There are many positive reasons for taking a step to end these kinds of laws like economy boost, FDI attractions, etc but the most significant factor is the fear of government to get its international assets seized.

The journey of Retrospective Tax law has not been a good one and the government has got a lot to learn from this all chaos. The ambiguous nature of tax laws needs to be made simpler.

[12] Cairn Energy PLC and Cairn UK Holdings Limited v. The Republic of India (PCA Case No. 2016-7)

NaniPalkhiwala, being a renowned tax jurist from time to time criticized tax laws amendment as "shapeless and order less"[13] and referred the action of the government as "a triumph of bureaucratic obstinacy over good sense". Though in this whole process, the judgement of Supreme Court in favor of Vodafone established that the judiciary has no bias.

Now, this retrospective tax amendment is ending which means Indian Legislature is evolving. And this evolution is needed as India is one of the fastest growing economy which keens to achieve the $5 trillion mark in coming 3-4 years. The Institution needs toacknowledge their mistakes from time to time and serve for the public goods as well as public interest without being deterred by populism. Then only this country can prove itself a mature democracy which has boththe capitalistic and socialist mindset.

[13] The law of Income Tax by Kanga and Palkhivala – 8th Edition.