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# Amendment Digest:

## Taxation Laws (Amendment) Act, 2021

### Introduction

After several years of indecisiveness, the Centre has finally done away with the retrospective tax law introduced in 2012 by the erstwhile finance minister, Pranab Mukherjee. The founding objective for the introduction of the Taxation Laws (Amendment) Act, 2021 (“2021 Act”) was to nullify the retrospective basis for taxation. The bill to the 2021 Act was first introduced in the Lok Sabha by Ms. Nirmala Sitharaman, Minister of Finance, on August 5, 2021. The 2021 Act enunciates amendment of the Income Tax Act, 1961 and the Finance Act, 2012, and aims to bring tax certainty. For the purpose of implementing the said amendment, draft rules have reportedly been prepared for modifying the Income Tax Rules, 1962, which explicitly specify the conditions to be fulfilled and the process to be followed to give effect to the 2021 Act.

### Background to the retrospective amendment

In 2007, for a consideration of USD 11.1 billion, Vodafone International Holdings (a Netherlands company) acquired a stake of Hutchinson Telecommunications International Limited (Hong Kong entity) in Hutchinson Essar limited, an Indian entity. As per the Income Tax Department, the transaction was liable to be charged under section 195 of the Income Tax Act, 1961. Legal action against Vodafone was brought before the [Hon’ble Supreme Court](#) in 2012 where the Hon’ble Court removed the tax liability and asked the Income Tax Department to refund the interim amount collected so far. The Supreme Court while ruling in favor of Vodafone explained that the transaction was not a transfer of capital asset as envisaged under section 2(14) of the Income Tax Act, 1961.

As understood by the ruling dispensation, later, the judgment was inconsistent with the legislative intent. Thus, to undo the decision of the Supreme Court, the Finance Act, 2012 was introduced with

retrospective effect to amend section 9(1)(i) of the Income Tax Act, 1961 and to clarify that gains arising from sale of shares of a foreign company were taxable in India if such shares, directly or indirectly, derived their value substantially from the assets located in India. A similar explanation was given for the term “transfer” under the Income Tax Act, 1961. These amendments allowed the government to charge tax retrospectively on merger and acquisition deals with international entities having a majority of assets in India.

The retrospective effect of the Finance Act, 2012 enabled the Income Tax Department to raise demands in seventeen cases, four of which led to arbitration proceedings under Bilateral Investment Protection Treaty with United Kingdom and Netherlands.<sup>1</sup> In two such cases, namely the Vodafone and Cairn disputes, the Arbitration Tribunal ruled against the Income Tax Department of India.

## The significant effect of the 2021 Act

The amendments introduced by the 2021 Act have gained importance as they effectively scrap the controversial retrospective tax provisions introduced in 2012. Retrospective tax and the subsequent awards under international treaties tarnished the image of India as a foreign-investment friendly jurisdiction. The object of the 2021 Act is to ensure that “*no tax demand shall be raised in future on the basis of the said retrospective amendment for any indirect transfer of Indian assets if the transaction was undertaken before May 28, 2012*”.<sup>2</sup>

The Act addresses two discrete circumstances. According to section 2 of the 2021 Act, “*no order shall be passed 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 transfer of a share or interest in any entity registered or incorporated outside India*”. The [end effect](#) would purportedly be beneficial to pending cases that have not yet culminated in a final order or demand. The second part encompasses that orders of assessment, re-assessment, and rectification or in withholding proceedings in respect of demand raised for indirect transfer of Indian assets made before 28 May 2012, shall be nullified on the fulfillment of the specific conditions such as withdrawal or submission of an undertaking to withdraw the claim, if any, furnishing an undertaking to the effect that no claim for costs, damages,

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<sup>1</sup> Taxation Laws (Amendment) Bill, 2021, Statement of Objects and Reasons.

<sup>2</sup> Taxation Laws (Amendment) Bill, 2021, Statement of Objects and Reasons.

interest etc. shall be filed.<sup>3</sup> Herein, when any amount becomes refundable to the said person as a consequence of fulfilling the conditions specified and such amount shall be refunded to him, without any interest being paid thereon on that amount.<sup>4</sup>

## Conclusion

It is essential for India to make reasonable decisions with respect to foreign investors and investments to create a more investment-friendly reputation and abide by its sovereign commitments to other nations under international treaties. The flow of foreign direct investment was impacted at a large scale due to the implications of the retrospective tax laws. However, scrapping the retrospective tax provisions will definitely bring balance to the flow of foreign direct investment. It will not only pose as an aid to the government in terms of saving time and costs, but will also help in avoiding unnecessary litigation.

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<sup>3</sup> Taxation Laws (Amendment) Act, 2021, s 2, explanation to fifth and sixth proviso.

<sup>4</sup> Taxation Laws (Amendment) Act, 2021, s 2, sixth proviso.