

RETROSPECTIVE APPLICATION OF TAX STATUTES – WHY ALWAYS AN UNWELCOME?

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ABSTRACT

This paper basically analyses the retrospective application of tax statutes and how it affects the tax system. Retrospective tax is not so easily welcomed by taxpayers as it creates an additional levy on the transaction which is already concluded when the provisions of law were different. Taxpayer would have planned his finance and tax based on the law as it existed at that time and disturbing the same by way of unjust and unwarranted retrospective amendments is unreasonable. However, retrospective amendment / retrospective tax by itself does not become unreasonable or invalid. Validity/reasonableness of retrospective amendment/tax depends on facts and circumstance of each case and need to be analysed on the merits of amendment in light of facts and circumstance under which such amendment is made. The aim of the study is to a detailed study on the subject matter- retrospective application of tax statutes. The scope of the study is restricted to tax laws in India. The study helps to understand the retrospective application of tax statutes in India and its current position.

I. INTRODUCTION

Tax assessment in India additionally has a history like different charges forced in different settlements by outside rulers. Two of the common topics constituting the recent changes in the tax law are the general anti avoidance regulations and the retrospective amendment relating to indirect transfer.¹This paper briefly analyses the second set of laws that has been active in India and the effect of the same. This law continued in force, with amendments made from time to time although it went through amendments which left it "shapeless and order less"². Aside from the Income Tax Act, the three critical duty enactment in the field of indirect tax in India were the Central Excise and Salt act which was forced in 1944, the Customs Act which was first forced in 1868 and deals charge laws which worked at the provincial and afterward the State dimension of

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¹ Talreja, Anil. "Changing Tax Reforms in India – What Next?" National Law School of India Review, vol. 24, no. 2, 2013, p. 76.

² The law of income Tax by Kanga and Palkhivala – 8th Edition.

government. Furthermore, GAAR's retrospective application to pre-DTC structures cannot be ruled out. The possibility of GAAR provisions overriding any tax treaty signed by India, the absence of high level scrutiny (evidenced from the fact that GAAR can be invoked by the Commissioner of Income Tax) and the onus of proof imposed on taxpayers and the scope for burdensome litigation due to the uncertainty in GAAR.³ The Finance Act, 2012, introduced retrospective amendments intending to clarify the legislative intent of the source rule of taxation of non-residents in India, particularly in respect of indirect transfer of underlying assets in India.⁴

II. RETROSPECTIVE LAWS AND LEGISLATIVE COMPETENCE IN TAX LAWS

Any place the legislation was forced retrospectively, the weight of the past couldn't be so passed on to the buyer and hence it stopped to be a roundabout duty and therefore was unconstitutional. This contention was dispatched, following choices of the Privy Council holding that the technique for gathering the assessment was a mishap of its organization, and the way that it couldn't be passed on did not influence its fundamental trademark. The Court also followed and cited with approval the decision of the Privy Council in Colonial's sugar refining Co Ltd v. Irving⁵ in a case which had stated “*the proposition with clarity-if there was a power to impose taxation conferred by a constitution, the legislature could equally make the law retroactive and impose the duties from a date earlier than that from which it was imposed.*”⁶ The Supreme Court acknowledged that expense laws were liable to the control of Part III of the Constitution. Anyway the Indian Supreme Court pursued the American choices that had rejected the proposal that negligible retrospectivity would render an expense laws discretionary and capricious. The same has been observed in the following cases.

- **Rai Ramkrishna v. State of Bihar:**

In the case of *Rai Ramkrishna v. State of Bihar*⁷, the Supreme Court observed that “*no mechanical test can be applied in determining the validity of the retrospective operation of the Act and it is conceivable that a case may arise in which the retrospective operation of the taxing or other statute may introduce such an element of unreasonableness that the restrictions imposed by it may be open to serious challenge as unconstitutional*”

³ Kumar, Y. Shiva Santosh. “India's Taxation Regime: Perspectives on the Proposed Changes.” National Law School of India Review, vol. 23, no. 2, 2012, p. 30.

⁴ See supra 1, p. 84.

⁵ *The colonial sugar refining company limited v irving*: PC 28 MAR 1906

⁶ *Chhotabhai v Union* 1962 Supp 2 SCR 1

⁷ 1963 AIR 1667.

- **Asstt. CIT of Urban Land Tax v. Buckingham & Carnatic Co. Ltd:**

In the case of *Asstt. CIT of Urban Land Tax v. Buckingham & Carnatic Co. Ltd.*⁸, the Supreme Court observed that *“it is not right to say as general proposition that the imposition of tax with retrospective effect per se renders that law unconstitutional, but in applying the test of reasonableness to a taxing statute, it is of course a relevant consideration that the tax is being enforced with retrospective effect but that is not conclusive in itself. With regard to the validity of a retrospective amendment, one has to take into account the facts and circumstances under which the impugned amendment was made and to enquire as to how the retrospective effect of the impugned amendment operated.”*

III. VALIDITY OF RETROSPECTIVE APPLICATION IN TAX STATUTES

One of the attractive issue that had come back in Indian context is test of validating clause that want to override judicial decisions. The validity of the retrospective application in tax statutes can be analysed by following the role of legislation and the decisions of the court. In broad terms, most of India's tax treaties place a greater emphasis on source-based taxation, reflecting India's historic position as a net importer of capital and technology.⁹ In the UK, India and other Commonwealth countries, this view of tax jurisdiction is buttressed by the constitutional argument that extraterritorial law-making of any nature is within Parliamentary competence.¹⁰ As the Court explained *“a Court's decision must always bind unless the conditions on which it is based are so fundamentally altered that the decision could not have been given in the altered circumstances.”*¹¹ The system of retrospective taxation would tax the income on such initial capital appropriately but would not tax the initial income associated with the capitalization of the successful idea.¹² It is recommended that under the law of the land, retrospective amendment to a tax law should occur only after exhaustive and transparent consultation with stakeholders who would be affected and in the rarest of rare cases.¹³

IV. THE VODAFONE CASE:¹⁴

⁸ (1970) 75 ITR 603 (SC)

⁹ For a detailed comparison see S. Rao & R. Nayak, *“India and International Community Split over Treaty”*, 19 Int'l Tax Rev. 32 (2001)

¹⁰ Loomer, Geoffrey T. *“The Vodafone Essar Dispute: Inadequate Tax Principles Create Difficult Choices for India.”* National Law School of India Review, vol. 21, no. 1, 2009, p. 99

¹¹ Prithvi Cottons case 1969 2 SCC 283

¹² Auerbach, Alan J. *“Retrospective Capital Gains Taxation.”* The American Economic Review, vol. 81, no. 1, 1991, p. 177

¹³ See Supra 1, p.85.

¹⁴ *Vodafone International Holdings BV v. Union of India and another*, Writ Petition No. 2550 of 2007 (Dec. 3)

There were three main questions in this case. This case primarily covered the retrospective amendment imposed in the finance act, 2012.

- Whether Vodafone, as purchaser, should or should not be treated as a "person" liable to withhold tax on payments to non-residents within the meaning of section 195 of the Act, given that Vodafone B V had no taxable presence in India?¹⁵
- Whether the retrospective amendment to the Act (finance act, 2012) providing that a failure to withhold tax at source by a withholding agent may be subject to penalties and interest is constitutional valid?¹⁶
- Whether India's jurisdiction to tax can be interpreted in such a way that the gain on the disposition by HTI, which was formally an alienation of shares situated offshore, is nonetheless taxable as a gain arising or accruing from the underlying shares or assets in India?¹⁷

Doubtlessly, it would mean applying Indian law to a business trade outside India between two non-Indians were no bit of the trade occurs in India-which would be contrary to settled principles of Conflict of laws. Vodafone along these lines shut the trade by paying the entire arrangement thought to Hutchison, acquired the upstream offer and control of the Indian components. The Indian cost office imagined that it was less complex to look for after Vodafone and the principle way it could do it was by guaranteeing that Vodafone was an assessee in default for having fail to deduct charge.

V. THE FALLOUT OF THE RETROSPECTIVE AMENDMENT

Tragically for the administration, Vodafone wouldn't oblige and as the press reports propose, it has chosen to seek after its cures under respective speculation settlements. Left with the political issue of unscrambling such a change when legitimization for such a correction neglected to persuade the individuals who made a difference consequently making a genuine scratch in FDI proposition to India, the administration at that point took to designating a specialist board of trustees for rendering guidance on the issue. Net FDI in India has been estimated at US\$ 4.7 billion

¹⁵ See, Clark v. Oceanic Contractors Inc, [1983] 2 A. C. 130

¹⁶ See, G. T. Loomer, "Taxing Out of Time: Parliamentary Supremacy and Retroactive Tax Legislation", B. T. R. 64 (2006)

¹⁷ See also Loomer, Geoffrey T. "The Vodafone Essar Dispute: Inadequate Tax Principles Create Difficult Choices for India." National Law School of India Review, vol. 21, no. 1, 2009, p. 97.

for the 2005-06 fiscal year, increasing to US\$ 8.5 billion for the 2006/ 2007 fiscal year.¹⁸ Consequently, the above actualities unmistakably show not just the nonattendance of any proof demonstrating that these review corrections are Clarificatory in nature yet in addition exhibit absence of any administrative purpose of tax assessment of capital increases emerging because of circuitous exchange. The States providing the greatest amount of FDI into India in recent years are, beginning with the largest source, Mauritius, the US and the United Kingdom.¹⁹ At some point 2013, the World Bank distributed a report downsizing India in the list of speculation neighbourliness from its situation of 131 out of 2011, India was moved to 134. The theme of recent challenges brought by the ITD is the preservation or amplification of India's tax jurisdiction as a source/host State.²⁰ There is presently close unanimity among legal advisers and business analysts on what comprises the ideal models for reasonable tax assessment. Among the ten ordinarily acknowledged principles, are value and decency, conviction, charge lack of bias, monetary development and proficiency, straightforwardness and perceivability. Significant changes to impose laws which revise key standards reflectively are obviously violative of every one of these ideal models. Assesseees are qualified for plan their undertakings and make speculations dependent on the condition of the law when they make venture. It is fair to say that, while issues related to selective establishment in tax havens and selective reliance on treaty networks are not new, it is only recently that governments have come to regard such issues as socio-political rather than merely technical.²¹

VI. CURRENT POSITION OF RETROSPECTIVE APPLICATION

Retrospective enactment has occurred every once in a while yet for the most it was intended to manage some Court decision which upset the current law or upset the current comprehension of the law. A major exception to this conclusion would seem to arise in the case of professional securities traders, who devote most of their labour input to this endeavour. However, such income is taxed as ordinary income without any deferral advantage, even under present law. Such treatment would presumably continue even if retrospective taxation were introduced for other investors.²²

¹⁸ Ministry of Finance, Government of India, Economic Survey 128 (2006-2007), Ministry of Finance, Government of India, Economic Survey 126 (2007-2008), Office of Industries, Competitive Conditions for Foreign Direct Investment in India 1-1, 2-1 (USITC Staff Research Study 30, 2007)

¹⁹ Ibid, USITC, at 1-2, 2-11.

²⁰ S. Chakrabarti & R. Joseph, "Permanent Establishment and Income Attribution in India", Tax Notes Int'l 517 (2008); K.A. Parillo, Will Bureaucracy Hinder India's Rise?, Tax Notes Int'l 886

²¹ Picciotto, "Tackling Tax Havens and "Offshore" Finance", (Transnational Institute Conference Paper, Money Laundering, Tax Evasion and Financial Regulation 2007) at 1-2.

²² Auerbach, Alan J. "Retrospective Capital Gains Taxation" The American Economic Review, vol. 81, no. 1, 1991, p. 176.

The Income charge Act presented a duty exclusion upon new mechanical endeavours as level of Capital utilized in such endeavours. Since the origin of the exclusion, a Rule that had been set up for calculation of the capital utilized. Parliament reflectively revised the parent resolution itself and engrafted the Rule in the parent rule as *“This review correction was tested on the ground that business endeavours had modified their position following up on the face and conviction that the parent law would win and that the Rules that were clearly conflicting would be disregarded, and in this manner if the law was currently reflectively adjusted to sanction so to speak decides that were unlawful, it would genuinely irritated settled undertakings and along these lines be brutal a difficult.”*²³ The pattern has plainly changed since 2000. In addition this is unmistakably noticeable in the domain of direct assessment law-potentially because of the way that in current occasions, after the legitimization of roundabout charges (somewhat by virtue of WTO duties) direct expenses especially corporate duty have turned into the biggest wellspring of income. The most productive corrections were to the meaning of eminence earned by an outside ventures in an undertaking to charge livelihoods in which the main association with India was that the administration gotten from the non-occupant was utilized by an inhabitant assessee in India. It was the same as burdening Ede and Ravenscroft’s for the benefits they gain at a bargain of collars and groups to Indian advice. In one judgement in 2007 the Supreme Court acknowledged the suggestion that *“the arrangements of a rule must be interpreted in concordance with the rule that pay which has no regional nexus with India would not fall inside the wickedness of the fiction of salary esteemed to accumulate emerge in India.”*²⁴

VII. CONCLUSION

The post-change vacillating regardless of master board of trustees reports despite what might be expected are proof of the way that the Indian political framework has developed up to the point of welcoming analysis however needs political development to make the last stride. The growth of multinational activity in India has inevitably been accompanied by mergers, acquisitions, divestments and other corporate restructurings, giving rise to complex tax and commercial issue.²⁵ The greatest hit to the notoriety of the Indian framework has been the review revision in the Vodafone case. In achieving the economic benefits of ac cruel taxation without its associated liquidity or information problems, the new approach makes a less distortionary capital gains tax more feasible and eliminates the need for the additional distortions associated with compensating

²³ *Lobia Machines Ltd and Anr vs. Union of India* -(1985) 152 ITR 308 (SC)

²⁴ *Ishikawajima’s* Case 2007 3 SCC 481

²⁵ See generally K. Dalai, *“International Restructurings : Tax Consequences for Operations in India”*, 53 Bull. in YI Fiscal Doc. 560

antiarbitrage provisions such as limited loss offsets.²⁶ The advancement will be finished when the political framework acknowledges that great financial matters is, in the 21st Century great governmental issues, and great administration is the boldness to recognize botches, for open great and open intrigue are best served by organizations that have the versatility and quality not simply to welcome analysis but rather to make the best decision without being hindered by populism or passing political impulses. The ability to act in light of a legitimate concern for open great rising above political impulses is a definitive trial of a develop majority rules system. The Indian courts should take a positive step in applying the tax laws retrospectively and widen the scope of the application. Limit of the application retrospectively should be widened, but such process should be done with a proper caution that such action would not cause an unjustifiable harm to the assessee.

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