# TransPrice Times

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## Government of India introduces bill to scrap retrospective tax law

The Indian Finance Minister, Mrs. Nirmala Sitharaman introduced The Taxation Laws (Amendment) Bill, 2021 in the Lok Sabha which seeks to withdraw tax demands made on indirect transfer of Indian assets prior to 28 May 2012.

The tax demands shall stand withdrawn subject to the taxpayer withdrawing the appeal pending in litigation or giving an undertaking to withdraw the same and further giving an undertaking that no claim for cost, damages, interest etc. shall be filed.

An indirect transfer from an India perspective can be explained by way of a simple example highlighted below:

Company A Inc. (USA) holding 100% of the share capital of A India Private Limited (India) transfers its entire or partial holding in A India Private Limited to Company B B.V (Netherlands)

As can be seen from the above, the transaction of transfer of shares is undertaken offshore from an India perspective i.e., between USA and Netherlands. However, the asset being transferred by A Inc. is its investment in A India Private Limited (the value of this investment is derived from the assets located in India)

**Background:**

The erstwhile retrospective taxation law resulted into three international treaty arbitration cases viz Vodafone International Holdings B.V ('the Vodafone Group'), Cairn Energy Plc/ Cairn UK Holdings ('the Cairn Group') and Vedanta Resources Plc against the Government of India in the international arbitration tribunal in Hague, Netherlands. Out of the above three cases, the Vodafone Group as well as the Cairn Group have won their respective cases against India and therefore the Government of India has now decided to scrap this legislation which hampered the reputation of India as an investment friendly destination.

**History behind the introduction of the retrospective amendment**

*Supreme Court Decision in the case of Vodafone - 2012 (Pronounced in favour of Vodafone)*

In this case, the countries involved in the share transfer transaction were Cayman Islands (transferor) and Netherlands (transferee). The Cayman Islands Company held shares in another Cayman Islands Company which further held shares in an Indian company. The topmost Cayman Islands Company transferred its investment to a Dutch Company, however, it was concluded by the Indian Revenue Authorities, that since indirectly, investment in an India company (which derived its value from Indian assets) was being transferred, this transfer had capital gains tax implications in India.

In this landmark decision pronounced by the Hon'ble Supreme Court of India, the Supreme Court pronounced that no capital gains accrued in India on account of offshore transfer of an underlying Indian investment. In the same pronouncement, the Hon'ble SC recognised the fact that the Indian Tax Legislation (back then) was not equipped to tax such offshore transfers. The tax demand raised by the Revenue department of approximately INR 11,000 crore was quashed.

Soon after the said pronouncement, the Government of India introduced an amendment under section 9 of the Income-tax Act with a retrospective effect which empowered the Government to tax such offshore transfers subject to the fulfilment of certain thresholds. While, the main objective behind the introduction of this retrospective amendment was catching the Vodafone Group under its ambit, all other transfers made prior to 2012 were also caught. For instance, the restructuring exercise undertaken by the Cairn Group in 2006 where a similar fact pattern existed.

**TransPrice Comments/Conclusion:** This much delayed welcome move is a big respite to multinational groups like Vodafone and Cairn which are now expected to end their long-term legal dispute with the Government of India. As already highlighted earlier, these two Groups have already won at the international arbitration forum in Hague.

Further, the government reportedly told the Parliament that at least 17 entities stand to benefit from the proposed tax amendment and that the refund payable by it amounted to about Rs 8,100 crore.

**Inflow Technologies Private – Bangalore ITAT**
**Outcome: Partially In favour of the taxpayer**
**Category: Section 92(1) of the Income-tax Act, Section 92B of the Income-tax Act, Rule 10B of the Income-tax Rules, 1962,**

Adjustment to be restricted to the value of international transaction:

The first issue pertains to AY 2013-14 wherein during the course of appeal before the Commissioner of Income-tax Appeals ['CIT(A)'], the CIT(A) enhanced the transfer pricing adjustment to the income of the Appellant by directing the AO/TPO to recompute the arm's length price at an entity level instead of transactional level computation made by the Appellant.

Before the ITAT, the Appellant argued that according to the provisions contained under Chapter X of the Income-tax Act, TP adjustment has to be restricted to the value of international transactions.

The ITAT relying on the judgment pronounced in the case of *IKA India Private Limited v. DCIT in IT(TP)A No.2192/Bang/2017* accepted the arguments of the Appellant and concluded that the transfer pricing adjustment needs to computed with reference to the international transactions undertaken by the Appellant.

**Working capital adjustment:**

The second issue pertains to AY 2014-15. During the course of the assessment proceedings, the TPO denied the benefit of working capital adjustment to the assessee on the ground that the assessee failed to demonstrate the impact of differences on account of working capital on the profit margin of the assessee as well as the comparable companies of the assessee.

This view was endorsed by the DRP as well.

Before the ITAT, the assessee argued that denying the benefit of working capital adjustment is against the TP rules as well as the relevant judicial pronouncements in this regard. The ITAT accepted the arguments of the appellant and directed the AO/TPO to grant the benefit of working capital adjustment to the appellant.

Corporate guarantee an international transaction:

The third issue pertains to the transaction in the nature of corporate guarantee given by the assessee to its AE with respect to the purchases made by the AE from one of the suppliers of the Group.

The assessee in this regard argued that the said activity was in the nature of a shareholder activity and therefore the same did not warrant any compensation. Further, there was no cost incurred by the assessee with respect to the said activity and therefore the said transaction had no impact on the profit, loss, income, assets of the assessee and therefore section 92(1) of the Act was not applicable. During the course of the assessment proceedings, the assessee further submitted that the advances of AE were lying with the assessee, the amount being much higher as compared to the amount of corporate guarantee given by the assessee in favour of its AE.

The TPO as well as the DRP did not accept these arguments of the assessee and computed/endorsed the guarantee commission transfer pricing adjustment.

Aggrieved with the same, the assessee filed an appeal before the ITAT.

The ITAT held that corporate guarantee is without a doubt an international transaction requiring the computation of arm's length price under the Indian Transfer Pricing Legislation. However, the TPO and the DRP cannot ignore the factual argument of the assessee that the AE of the assessee granted interest free advances to the assessee and the amount of the advances was much higher than the corporate guarantee given by the assessee in favour of its AE. The matter was remanded back by the ITAT to the file of the AO/TPO for fresh adjudication.