Indirect transfer provisions to apply prospectively from 28 May 2012

The government has introduced ‘The Taxation Laws (Amendment) Bill, 2021’ proposing to withdraw retrospective applicability of provisions relating to indirect transfer under the Income-tax Act, 1961 (i.e. the indirect transfer related provisions would not apply to transactions undertaken before 28 May 2012).

Background:

- The issue of taxability of gains arising from the transfer of assets located in India, through the transfer of the shares of a foreign company (known as “indirect transfer of Indian assets”), has been a subject matter of protracted litigation. The Supreme Court in 2012 had held that gains arising from indirect transfer of Indian assets are not taxable under the extant provisions of the Income-tax Act, 1961 (ITA).

- Subsequently, the relevant provisions of the ITA were amended by the Finance Act, 2012 (FA 2012) [with retrospective effect from 1 April 1962], to clarify that gains arising from sale of shares of a foreign company are taxable in India, if such share(s), directly or indirectly, derive(s) value substantially from the assets located in India. The FA 2012 also provided for validation of demand, etc. under ITA for cases relating to indirect transfer of Indian assets.

As per section 9 (1)(i) of the ITA, income deemed to accrue or arise in India includes all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Amongst others, the FA 2012 had introduced Explanation 5 to Section 9 of the ITA (relating to income deemed to accrue or arise in India) [with retrospective effect from 1 April 1962], as per which 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.

- The retrospective effect of said amendments made by the FA 2012, invited criticism from stakeholders. Further, representations were also received from various stakeholders to rationalise and amend some of the retrospective amendments brought in by FA 2012.

- In view of the above, ‘The Taxation Laws (Amendment) Bill, 2021’ (Bill) has been introduced in the Lok Sabha on 5 August 2021 to relax and amend certain provisions of the ITA relating to indirect transfer.

- We have provided below the key highlights of the Bill.
Key highlights of the Bill:

1. No tax demand shall be raised in future based on the retrospective amendment brought in by FA 2012 for any indirect transfer of Indian assets if the transaction was undertaken before 28 May 2012 (i.e. the date on which the FA 2012 received the President’s assent).

   In this regard, as per the Bill, the provisions of Explanation 5 to section 9(1)(i) of the ITA (in respect of income from indirect transfers* made before 28 May 2012) would not apply to:

   — An assessment or reassessment to be made under section 143, section 144, section 147, section 153A or 153C of the ITA; or
   — A rectification order to be passed under section 154 of the ITA enhancing assessment or reducing refund already made or increasing the liability; or
   — An order to be passed deeming a person to be an assessee in default under section 201(1) of the ITA (i.e. relating to consequences of failure to deduct applicable tax at source).

   *Income accruing or arising through or from the transfer of an asset or capital asset situate in India in consequence of the transfer of share or interest in a company or entity registered or incorporated outside India.

2. 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.

   As per the Bill, where:

   — Assessment or reassessment has been made under section 143, section 144, section 147, section 153A or 153C of the ITA; or
   — Rectification order has been passed under section 154 of the ITA enhancing assessment or reducing refund already made or increasing the liability; or
   — Order has been passed deeming a person to be an assessee in default under section 201(1) of the ITA; or
   — Order has been passed imposing penalty under Chapter XXI of the ITA (relating to penalties imposable) or under section 221 of the ITA (relating to penalty payable when tax in default).

   Then, in respect of income accruing or arising through or from indirect transfer* made before 28 May 2012 and the taxpayer / person in whose case such assessment or reassessment or order has been passed or made (to the extent it relates to such income), shall be deemed never to have been passed or made, subject to fulfilment of specified conditions.

   Further, where any amount becomes refundable to such taxpayer / person on fulfilment of specified conditions, then, such amount shall be refunded to the taxpayer / person without any interest under section 244A.
*Income accruing or arising through or from the transfer of an asset or capital asset situate in India in consequence of the transfer of share or interest in a company or entity registered or incorporated outside India.

3. The specified conditions (referred to in point 2 above) as per the Bill, are as follows:

i. The relevant taxpayer / person shall withdraw or submit an undertaking to withdraw (in prescribed form and manner) any appeal before an appellate forum or any writ petition before the High Court or the Supreme Court against any order in respect of the said income;

ii. The relevant taxpayer / person shall withdraw or submit an undertaking to withdraw (in prescribed form and manner) the claim in any proceeding for arbitration, conciliation or mediation which has been initiated or where notice has been given thereof, under any law for the time being in force or under any agreement between India and any country / territory outside India, whether for protection of investment or otherwise;

iii. The relevant taxpayer / person shall furnish an undertaking (in prescribed form and manner), waiving his right (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 between India and any country / territory outside India, whether for protection of investment or otherwise); and

iv. Such other conditions as may be prescribed.

Thus, the validation of demand under section 119 of the FA 2012 shall cease to apply on fulfilment of the above-mentioned conditions.

**Comments:**

The indirect transfer provisions under the ITA have been a matter of debate and discussion, especially with respect to their retrospective applicability. The Bill once enacted would give certainty to the tax treatment of indirect transfer transactions undertaken prior to 28 May 2012.

The Bill has been tabled before the Lok Sabha and will be enacted once it receives Presidential assent.