

Decoded: Why Vodafone, Cairn retro tax cases are in for a long haul

The government sticking to its stand that bilateral investment treaties cannot override a nation's sovereign right to tax

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Sources said the government might have to refund Rs 45 crore only if it does not go for appeal against the award.

A fresh round of legal battles is looming in the retrospective tax cases involving the Vodafone group and Cairn Energy with the government sticking to its stand that bilateral investment treaties cannot override a nation's sovereign right to tax. The government this week moved the Singapore Court of Appeal, challenging an international tribunal's verdict that went in favour of the Vodafone group in the decade-long Rs 20,000 crore tax dispute. The government is expected to follow a similar path in the Cairn Energy case in which an international tribunal award earlier this week asked India to pay damages worth around Rs 8000 crore in the six-year-old retrospective tax case. Here's why both the cases are in for a long haul.

Why is it taking so long to resolve these landmark cases?

This is to do with the stand India has taken: That matters relating to taxation are outside the purview of bilateral investment treaties with other countries. “So long as this position does not change, further contests are unavoidable,” says Mukesh Butani, managing partner, BMR Legal. While it is possible that similar tax disputes could face different outcomes as the tribunals are different and each matter is independent, it is likely that the governments will continue to defend its retrospective taxation powers going forward, adds Kshama A. Loya, leader, Nishith Desai Associates.

The impact of this approach on foreign investor sentiment could cause damage to efforts for providing stable investment climate in India. Cairn Energy, for instance, is owned by a clutch of international investors, such as Blackrock, Fidelity, Franklin Templeton. “International investors seek a consistent and predictable policy environment and amending tax laws retrospectively creates uncertainty and unpredictability,” says Niti Dixit, partner, S&R Associates, a law firm advising Cairn Energy in the case.

Can Indian courts disallow retrospective amendments in the tax law on ground of constitutionality?

The stated objective of the current government has been that it will not legislate retrospective law, within the Constitutional framework. Despite these commitments, the government has not repealed the 2012 amendment in the tax law, or its retrospectivity.

Experts say the Indian courts have the right to pronounce upon constitutionality of retrospective Indian laws. “Judicial history is replete with such challenges, with mixed outcomes,” says Butani. Interestingly, Vodafone group and Cairn Energy have both so far avoided a direct legal challenge to the constitutionality of the 2012 amendments in the tax laws.

Many experts, including Abhishek A Rastogi, partner at Khaitan & Co, believe that retrospective tax amendments should be used in rarest of rare cases, “such as misuse of statutory provision with a malafide intent to evade taxes”.

Do domestic courts have the power to overrule international arbitration orders?

In the existing legal framework, a foreign arbitration award can be enforced in India only through an order of an Indian court. “In such proceedings, the Indian courts invariably are obliged to examine the compatibility of an arbitration award with the Indian legal framework as such a foreign award is binding and it’s only the enforceability that becomes a subject matter of dispute,” says Butani.

He points out that there have been many instances where Indian courts have refused to enforce foreign arbitration awards on the ground that they are contrary to “public policy” of India. “In 2020, the Supreme Court has delivered three judgements on the subject of enforceability of foreign awards in light of public policy,” he adds.

However, this could trigger a fresh round of contest before the Indian courts, feel experts, prolonging the final outcome.

What steps can tax authorities take to mitigate the bad optics that arise from such prolonged international litigation?

The government must carefully analyse whether the relevant clauses were legally open-ended or the foreign investor was strictly required to adhere to the tax provisions, says Rastogi.

Loya is of the view that going forward tax authorities need to be mindful of the government's international treaty obligations. "It's one thing to raise a legitimate tax demand, and another to exercise executive powers arbitrarily and expropriate assets of foreign investors," she adds.

Dixit points out that it is important to recognise whether amendments could violate international law standards of fair and equitable treatment of international investment in India and expose India to claims under international law. "Such laws can be scrutinised for compliance with international law, and not just the Constitution," she adds.