Retrospective tax policy burial does not come as a surprise

In a welcome move that will potentially cheer the global investor community, the government has decided to withdraw the controversial retrospective tax laws on indirect transfer of assets. A bill to this effect that makes tax laws prospective (applicable in the future rather than backdated) was introduced in the Lok Sabha on August 5.

Such retrospective amendments militate against the principle of tax certainty and damage India's reputation as an attractive destination. This is a welcome step. It recognises the importance of certainty in tax laws, which is key in ensuring confidence in India as an attractive investment destination. The step could help restore India's reputation as a fair and predictable regime apart from helping put an end to unnecessary, prolonged and expensive litigation.

Even though India has been dragging its feet all these years, retrospective tax policy burial does not come as a surprise since India had suffered a series of setbacks in international arbitration on this issue. Reportedly, Cairn Energy had secured an order from a French court authorising the freezing of 20 Indian government properties in Paris valued at over 20 million euros.

As many as 17 entities stand to benefit from the proposed tax amendment on whom tax demand of Rs 1.1 trillion was made. Once the bill is passed, if the two U.K.-based companies (Cairn and Vodafone) agree to withdraw all pending litigation and agree to make no claim for cost, damages, interest, then the tax collected from them can be refunded, as per the bill's provisions.

While it is good to see the government take this step, the question remains whether investors who have obtained an award that comprises of interest component will take up the offer.

The country today stands at a juncture when quick recovery of the economy after the COVID-19 pandemic is the need of the hour and foreign investment has an important role to play in promoting faster economic growth and employment. This amendment would reignite the choice of India as a favourable investment destination which already has low tax rates.

In terms of impact on equity markets, sentimentally it may be a minor positive in the near term. However, in case the dispute is resolved favourably and the two large parties are willing to accept the proposed amendment and withdraw all litigations, then it could favourably impact foreign direct investment (FDI) inflows into the country and will have a trickle-down effect on the secondary markets. This, though, will be known over the next few weeks.

Retrospective tax