



## PCA Ruling on Retrospective Taxation

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### Why in News

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Recently, the **Permanent Court of Arbitration** (PCA) has ruled that the **Indian government was wrong in applying a retrospective tax on energy giant Cairn Plc.**

The verdict comes barely three months after **India lost arbitration to Vodafone Plc** over the retrospective tax legislation amendment.

### Key Points

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- **Background:**
  - In **2006-07**, **Cairn UK transferred shares** of Cairn India Holdings to Cairn India on which **Income Tax authorities** slapped a **tax demand of Rs. 24,500 crore** as it contended that Cairn UK had made capital gains.  
Owing to different interpretations of capital gains, the **company refused to pay the tax**, which prompted **cases being filed at the Income Tax Appellate Tribunal** (ITAT) and the **Delhi High Court**.
  - In **2012**, Indian government's budget **retrospectively amended the tax code**, giving itself the power to go after **mergers and acquisitions (M&A) deals all the way back to 1962** if the underlying asset was in India.
  - In **2015**, Cairn Energy Plc **commenced international arbitration** proceedings against the Indian government.
- **PCA Ruling:**
  - The **Indian government must pay roughly Rs. 8,000 crore in damages** to Cairn.
  - Cairn Tax Issue was **not just a tax-related issue but an investment-related dispute**, and therefore the issue comes under its jurisdiction.
  - The Indian government's **retrospective demand was in breach of the guarantee of fair and equitable treatment**.
  - The Centre had **failed to uphold its obligations under the UK-India Bilateral Investment Treaty** and international laws in seeking tax payments from the company for its business reorganisation in the country.

- **India's Stand:**

- The government **will study the award and all its aspects** carefully in consultation with its counsel.
- After such consultations, the government will **consider all options and make a decision on the further course of action**, including legal remedies before appropriate fora.

## **Retrospective Taxation**

- It **allows a country to pass a rule on taxing certain products, items or services** and deals and charge companies from a time behind the date on which the law is passed.
- Countries **use this route to correct any anomalies in their taxation policies** that have, in the past, allowed companies to take advantage of such loopholes.
- Retrospective Taxation **hurts companies that had knowingly or unknowingly interpreted the tax rules differently.**
- Apart from India, many countries including the **USA, the UK, the Netherlands, Canada, Belgium, Australia and Italy** have retrospectively taxed companies.

## **Permanent Court of Arbitration**

- It was **established in 1899** and is **headquartered in The Hague, Netherlands.**
- **Purpose:** It is an **intergovernmental organization** dedicated to serve the international community in the field of dispute resolution and to facilitate arbitration and other forms of dispute resolution between States.
- It has a **three-part organizational structure** consisting of:
  - **Administrative Council** - to oversee its policies and budgets,
  - **Members of the Court** - a panel of independent potential arbitrators, and
  - **International Bureau** - its Secretariat, headed by the Secretary-General.
- **Funds:** It has a **Financial Assistance Fund** which aims at helping developing countries meet part of the costs involved in international arbitration or other means of dispute settlement offered by the PCA.

## **Way Forward**

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- An investment-friendly business environment would increase economic activity and help raise more revenue over time for the government. It is to be hoped that tax officials' desire to deny their defeat and to try and hang on to legally untenable revenue finds an unsympathetic hearing from politicians in the finance ministry.
- India needs to craft meaningful and clear dispute resolution mechanisms in cross-border transactions to prevent the disputes from going to international courts, and save the cost and time expenditure. Improving the arbitration ecosystem will have a positive impact on the **ease of doing business**.

**Source: IE**