



PCA Decision on Retrospective Taxation by India

Why in News

The **Permanent Court of Arbitration (PCA)** at The Hague (Netherlands) ruled that **India's retrospective imposition of a tax liability, as well as interest and penalties** on Vodafone Group for a 2007 deal was **violation of the [Bilateral Investment Treaty](#)** with Netherlands and the arbitration rules of **[United Nations Commission on International Trade Law \(UNCITRAL\)](#)**.

Key Points

▪ About the Case:

- In May 2007, the British telecommunication company Vodafone Group had bought a 67% stake in a company called Hutchison Whampoa.
- For this, the Indian government for the first time **raised a demand of capital gains and withholding tax** from Vodafone, under the **Income Tax Act of 1961**. The government argued that Vodafone should have **deducted the tax at source** before making a payment to Hutchison.
 - **Capital gains tax** : It is the tax paid on income that derives from the sale or exchange of an asset, such as a stock or property that's categorized as a capital asset.
- In 2012, the **Supreme Court ruled in favour of the Vodafone** Group.
- Later, the **Finance Act was amended (2012)** giving the Income Tax Department the power to **retrospectively tax** such deals.
- Vodafone then initiated arbitration in 2014 invoking the **Bilateral Investment Treaty** signed between India and the Netherlands in 1995.
- **Ruling:** The **International Arbitration Tribunal** at **Permanent Court of Arbitration** ruled that the government's demand is in breach of fair and equitable treatment.
 - The government must **cease seeking the dues from Vodafone**.
 - This was a **unanimous decision** meaning that India's appointed arbitrator also ruled in favour of Vodafone.
- **Future Course for India:** India has said it would study the order and all its aspects and take a decision on further course of action including legal remedies before appropriate fora.
 - According to Indian Government, as Vodafone had not paid the initial tax demand and interest and penalty on it, the question of India paying back the amount does not arise.
 - India has the option to move to **[Singapore International Arbitration Centre](#)** as well.

▪ 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.
- **Bilateral Investment Treaty:**
 - On 6th November, 1995, India and the Netherlands had signed a BIT for **promotion and protection of investment by companies of each country** in the other's jurisdiction.
 - The two countries would ensure that companies present in each other's jurisdictions would at all times be accorded **fair and equitable treatment** and shall enjoy full **protection and security** in the territory of the other.
 - The BIT between India and the **Netherlands expired on 22nd September, 2016.**
 - **Relation to Vodafone Case:** Vodafone invoked BIT as its Dutch unit, Vodafone International Holdings BV, had bought the Indian business operations of Hutchison Telecommunication International Ltd. This made it a transaction between a **Dutch firm and an Indian firm.**
- **United Nations Commission on International Trade Law:**
 - UNCITRAL was established in 1966 as a subsidiary body of the [United Nations General Assembly](#) (UNGA).
 - It is the core legal body of the United Nations system in the field of international trade law.
 - **Mandate:** To further the progressive harmonization and modernization of rules on international business and reform commercial laws.
 - It adopted the **UNCITRAL Model Law on International Commercial Arbitration** in 1985 and **the UNCITRAL Conciliation Rules** in 1980.
 - The UNGA has recommended the use of the said Model Law and Rules in cases where a dispute arises in the context of international commercial relations and the parties seek an amicable settlement of that dispute by recourse to conciliation.
 - India has also incorporated these uniform principles of Arbitration and Dispute Resolution (ADR) in the [Arbitration and Conciliation Act, 1996](#) which has been amended several times.
 - The Arbitration Act provides for ADR mechanisms like arbitration, conciliations, etc. for national and international stakeholders.

Significance

- Vodafone's win in the arbitration against the government in the retrospective taxation is very significant as it may cause other **similarly placed companies to seek arbitral reliefs.**
- India is entangled in more than a dozen such cases against companies over retrospective tax claims and cancellation of contracts. The exchequer could end up paying billions of dollars in damages if it loses.
- To reduce future arbitration claims, India has **ended such bilateral investment agreements with over 50 countries** and is working on a new law to protect foreign investors by **offering relief from possible policy changes** even as it **upholds the right to tax** them.
- The victory of Vodafone at PCA may provide it some relief as the telecom sector is already facing a number of [issues and challenges](#). The ruling comes days after the Supreme Court allowed a period of [10 years for telecom companies to clear Adjusted Gross Revenue](#) (AGR) related dues, causing heavy financial [burden on the telecom sector](#).

International Arbitration Tribunal

- It is an **independent non-governmental panel** of independent and impartial experts.
- It generally comprises three members nominated by the Parties (or appointed by the International Arbitration Institution, or by a National Court) on the basis of their legal and practical expertise and knowledge, to render a **final and binding award.**

Permanent Court of Arbitration

- **Established** in: 1899.
- **HQ:** 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.
- **Structure:** The PCA 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

- 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 [ease of doing business](#).

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