A tale of two retrospective legislative amendments

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Amendment of any existing law with a retrospective effect erodes public trust in the rule of law and promotes uncertainty. Such amendments should therefore be subject to the strictest test of public scrutiny.

In the recent times, there have been two contentious instances of such legislative amendments, both of which have caused a wide range of public concerns.

The first was when the then UPA government retrospectively amended Section 9 (1) of Income Tax Act, 1961w.e.f April 1, 1962. The implicit objective of this was to "clarify" the ambit of the State's sovereign right to tax profits/ capital gains arising from the transfer of shares of an Indian company held by a foreign entity to another foreign entity. While the intention underlying this amendment was to safeguard the revenue that should legitimately accrue to India, BJP's 2014 election manifesto described this amendment as "tax terrorism" and a cause of "uncertainty" for the business class, negatively impacting the investment climate and denting the image of the country. The manifesto promised to revamp the tax regime.

The second instance of such a retrospective amendment was when the present NDA regime, through the backdoor of the Finance Acts of 2016 and 2018, retrospectively amended the Foreign Contributions Regulation Acts (FCRAs) of 2010 and 1976 to open the floodgates to donations to political parties from foreign sources. When judicial pronouncements held that the foreign donations accepted in the past by the BJP and the Congress violated the provisions of the 1976 and 2010 FCRAs, which meant that both the political parties should be prosecuted under the two FCRAs, the NDA government found a convenient escape route by amending the two Acts to "legalise" the illegality. The most extraordinary aspect of the 2018 amendment was that the already lapsed FCRA of 1976 was temporarily revived only to be amended w.e.f. August 5, 1976! What compounded this further was that the NDA government, in the same breath, also amended the relevant provisions of the Companies Act to lift the cap on corporate political donations and introduced total opacity in political donations through the so-called "electoral bond" scheme. This time, there was no murmur or opposition from the major opposition party, the Congress, as these amendments would help it as much as it would help the BJP. After all, corporate political donations are the lifeline of most of the political parties in India and there are *quid pro quo*s that the political parties are ever ready to dole out to the corporates, whenever they come to power.

A quick look at the implications of these two amendments will reveal how such *quid pro quo*s between the political parties and the large corporate businesses in India can have far reaching adverse implications for the economy and the well being of the people.

2012 Amendment to Income Tax Act:

The trigger for this was the manner in which Vodaphone Plc made a major foray into the Indian telecom market in 2007 by acquiring a dominant stake in the Indian telecom company, Hutchinson Essar Ltd. through a deal with the Hong Kong-based Hutchison Telecommunication International Ltd. (HTIL). The Indian tax authorities thought that these circuitous transactions were aimed at evading taxes and therefore proceeded to tax the profits/ capital gains arising from the transactions on the ground that, though based offshore, they had implications for domestic tax revenue accruals from the related Indian operations. In the absence of sufficient clarity in the relevant provisions of the Income Tax Act, the income tax officials found it difficult to defend their action in the consequent legal proceedings in India.

It was at this stage that the then UPA Finance Minister stepped in and introduced the necessary clarification of Section 9 (1) of the Income Tax Act, 1961, which in effect not only retrospectively amended the Act w.e.f April 1, 1962 but also empowered the tax authorities to tax profits/ capital gains from offshore transactions, if they amount to tax avoidance in India.

This resulted in Vodaphone invoking the Bilateral Investment Protection Agreement (BIPA) that India had signed with the Netherlands years ago and seeking intervention of the local courts to protect its interests. However, the company was advised to seek arbitration under the UNCITRAL Arbitration Rules, which resulted in arbitration proceedings being initiated before the Permanent Court of Arbitration (PCA) at the Hague. The PCA pronounced its award in favour of Vodaphone on September 25, 2020. The PCA came to the conclusion that the investment protection provisions of BIPA should override India's sovereign right to amend the Income Tax Act.

There was another somewhat similar case, that of the UK-based Cairn Group, which was carrying out hydrocarbons exploration and development operations in India. Before 2006, the India operations of Cairn Energy were owned by the UK-based Cairn India Holdings Ltd (CIHL). CIHL was in turn fully owned by Cairn UK Holdings Ltd. (CUHL), which in itself was a subsidiary of another UK-based company, Cairn Energy PLC (CPLC). In 2006, the ownership of the India assets was transferred from CUHL to a new company, Cairn India Ltd (CIL). CIL acquired the entire share capital of CIHL from CUHL and, in exchange, 69% of the shares in Cairn India were issued to CUHL. Later, in 2011, CPLC sold CIL to the Vedanta group, barring a minor stake of 9.8%. It wanted to sell the residual stake as well but was barred by the Income Tax Department from doing so on the ground that this maze of share transactions involved profits/ capital gains attributable to the group's India operations and are therefore taxable. Since there was a tax demand already raised by the department against the Cairn Group and since it was the Vedanta Group that acquired a dominant interest in Cairn's India operations, the Income Tax department held Vedanta to be liable to pay the corresponding taxes. The government therefore froze payment of dividend by CIL to Cairn Energy.

The tax notices issued by the IT Department led to court proceedings which, as in the case of Vodaphone, culminated in arbitration proceedings before the PCA. Thus, there arose two sets of arbitration proceedings, one relating to the Cairn Group and another relating to the Vedanta Group. The PCA delivered its arbitral order in the Cairn case on December 21, 2020, upholding Cairn's contention that the group is entitled to investment protection under the India-UK BIPA, which in effect meant that BIPA provisions should prevail over India's sovereign right to amend the Income Tax Act retrospectively.

India has since chosen to contest the arbitral order in the case of Vodaphone and is likely to question the Cairn order on similar grounds.

There are three public concerns that emerge from the arbitral order in the Cairn case. They are as follows.

i. Paras 135-140 of the arbitral order reproduced the relevant extracts of BJP's 2014 election manifesto and the first Budget Speech of the NDA government in 2014 which literally questioned the rationale of retrospective taxation. Apart from making such statements which in effect weakened India's stand before the PCA that BIPA provisions cannot override its sovereign right to amend its tax laws, the NDA government which is constantly harping on its ultranationalistic posture could never translate its avowed stand on "tax terrorism" by revoking the retrospective tax amendment. In such matters, to walk the talk is not easy!

ii. Taxation is never a pleasant task, especially when it comes to taxing the large corporate businesses with whom most political parties in India have a cosy relationship. In the words of Edmund Burke, the 18th Century British statesman, "To tax and to please, no more than to love and to be wise, is not given to men." At the same time, maximising tax revenues is a necessity for political parties that promise expensive populist schemes for which they need to find additional funds. The political parties thus face a dilemma that often results in adversely affecting the public interest.

iii. The BIPA scheme in itself raises serious concerns about its legality in relation to the domestic laws. The scheme therefore needs to be reviewed. Stable domestic economic policies strengthened by corruption-free, hazzle-free governance is what is needed for attracting investments of the benign kind.

FCRA amendments:

In a Parliamentary democracy like ours, it is important that the political parties have the opportunity to contest on a level playing ground and there is little scope for money power to influence the elections. Unfortunately, over the last seven decades, a cosy relationship has developed between the political parties and the large business houses. This in turn has resulted in electioneering to become more and more

extravagant, which in turn has rendered the political parties more and more dependent on their business cohorts. While domestic corporate donations to the political parties are bad enough, the entry of foreign funds could pose a serious threat to the integrity of the electoral system and the security of the nation. This was the background against which the 1976 FCRA was enacted by the Parliament. It was replaced later by its 2010 counterpart, which strengthened the prohibitive clauses further. Despite prohibition on foreign donations, several political parties had resorted to accepting foreign donations in outright violation of the FCRA provisions. It was the civil society that sought judicial intervention on the legality of such foreign donations and had been able to secure favourable orders from the courts. Instead of respecting the court directions, the present NDA government, as already pointed out, resorted to amending both the 1976 and the 2010 FCRAs. Coupled with the corresponding amendments to the Companies Act and the introduction of a highly non-transparent Electoral Bond scheme, these FCRA amendments paved the way for unfettered inflow of foreign funds into India's electoral system through opaque instruments and with little public accountability. Instead of reducing the electoral expenditure of the political parties, these legislative changes have encouraged profligacy in expenses, detrimental to the integrity of the electoral processes. These are highly regressive measures that have distorted the level playing ground for the political parties further and bestowed a greater leverage on the corporate houses to influence the government policies to their advantage. For example, during 2018-19, the party in power i.e. BJP received 80% of the total corporate donations as a result of these questionable measures. In the long run, such reforms will weaken our democracy and erode the well being of the nation.

These two retrospective legislative amendments raise the following serious public concerns.

i. In its anxiety to attract foreign investments, India had signed BIPAs in the past with several countries without providing the necessary safeguards to prevent abridgement of the State's right to legislate on important aspects of investment such as taxation, environmental conservation etc. BIPAs and other bilateral

agreements tend to restrict competition and inhibit satisfactory price discovery. There is therefore an urgent need to move away from this concept altogether.

ii. Globalisation has opened up many new areas of investment routes and tax avoidance opportunities through tax havens easily accessible to digital financial systems. India needs to be vigilant and update its laws on a continuing basis to address this concern.

iii. The Vodaphone and the other arbitration matters show how the political executive is caught between its anxiety to be friendly with the corporate entities and, at the same time, maintain its ultranationalist posture that has provided it considerable mileage in the elections. It reminds one of the often quoted line from Shakespeare's Hamlet, “I must be cruel only to be kind”. For the Indian political parties, it perhaps implies, “I must be *outwardly* cruel only to be *inwardly* kind”. The political parties play to the gallery by putting up a facade of being stern with their corporate friends but, in their heart of hearts, they quietly grant undue benefits to them, as it is the corporates that fund their elections and provide the support facilities. Unless there is a concerted civil society movement against this nexus, the integrity of the electoral system in the country will further get eroded.

iv. The FCRA amendments have clearly highlighted that there is a conflict of interest in the party in power manipulating the laws to further its own interests. There is need for a wider public debate on this.