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Tax law clouds Indian finances

Anti-avoidance rules may open up a Pandora's box of uncertainty and litigation

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Image Credit: Reuters

Women shop at a supermarket in Mumbai. India gives foreign investors the guarantee that they will not be taxed doubly, but not that they will not have to pay tax in any country, finance minister Pranab Mukherjee said.

Mumbai: India has proposed changing laws so it can retrospectively tax capital gains by foreign companies, a move industry analysts say could have a negative impact on investment in the nation.

The government's had a "knee-jerk reaction" to this year's loss of a $2.2 billion tax case against Vodafone Group Plc, said Nishith M. Desai, managing partner at law firm Nishith Desai & Associates in Mumbai. The proposed change in law "will considerably erode India's standing in the eyes of investors and treaty partners," he said in an emailed statement yesterday.

Finance Minister Pranab Mukherjee, struggling to rein in the widest budget deficit among major emerging economies, wants the change to ensure the government gets as much as Rs400 billion (Dh29.6 billion) of tax payments that officials say is under litigation. The move may slow foreign direct investment into Asia's third-largest economy, according to KPMG.

India gives foreign investors the guarantee that they will not be taxed doubly, Mukherjee told Bloomberg UTV yesterday. "We do not give them the guarantee that they will not have to pay tax in any country. That way we'll simply encourage tax evasion and tax avoidance. That is not possible for any government."

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The Supreme Court in January dismissed the government's demand for Rs112.2 billion of taxes from Vodafone stemming from its 2007 purchase of Hutchison Whampoa Ltd.'s India mobile-phone operations. The new wording of India's Income Tax Act will apply retrospectively from 1962, according to Mukherjee's budget documents presented in parliament on Friday.

Transactions like Vodafone could now be reopened and "assuming that the law holds, the companies will be issued tax notices," said Uday Ved, a partner at the local unit of KPMG.

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"The highest court has given the verdict in favour of them, so naturally that is the highest court of appeal and beyond it cannot go," Mukherjee said yesterday. "The Supreme Court suggested that you clearly define your position, your intention, that we have done."

The proposed change will only be applicable to those cases that have already started or are "in the pipeline," the minister said. The government won't reopen cases that are more than six years old, he said.

"The budget proposes a number of regressive, retrograde and extraterritorial provisions that would significantly increase tax costs and alter the dynamics of cross-border transactions and M&As," Desai said.

Roadblock

The government's budget proposal to introduce general anti-avoidance rules, or GAAR, enabling the taxing of companies it believes are structuring deals in a manner to escape taxes could serve as a roadblock to companies' investments, he said.

"The ambiguously worded provisions capture most conventional structures for M&As [mergers and acquisitions] and investments into India," said Desai. "If implemented, GAAR will open up a Pandora's box of uncertainty and litigation, and investors may be forced to think twice," he said.

While budget amendments to counter Vodafone and similar transactions were anticipated, the retrospective aspect of the proposed laws is "surprising," said Pallavi Bakhru, practice leader for tax and regulatory services at Walker Chandiok & Co.