# THE DOWNFALL OF RETROSPECTIVE TAXATION: ANALYSIS OF CAIRN ENERGY DISPUTE

**Sai Nandan K***

## ABSTRACT

Retrospective application of laws has always been contentious as it violates the principles of natural justice and is generally considered unfair, unreasonable, and devoid of logic. The retrospective application of laws is contrary to the general principle of prospective effect in bringing about a new legislation. The judiciary has flip-flopped on the matter of retrospective application of laws. Cairn Energy dispute originated from the introduction of retrospective taxation on indirect transfers of downstream assets in India by amending the Income Tax Act, 1961. Cairn Energy's dispute against the Government of India lead to the scrapping of the Retrospective taxation law, which was introduced in 2012 and the refund of all the money seized under the same.

**Keywords:** Retrospective taxation, dispute, judiciary, arbitration

## INTRODUCTION

Retrospective taxation has been a contentious issue not only in India but throughout the global economic system. This particular article aims to examine the subject of retrospective taxation and its subsequent downfall with the analysis of Cairn Energy dispute against the Government of India.

## CONCEPT OF RETROSPECTIVE TAXATION

Retrospective tax is levied on a transaction or a dealing which happened in the past. Hence tax can be levied on a particular transaction even though at the time of the transaction taking place, there was no obligation to pay taxes. Retrospective application of laws has been mostly used in the area of taxation. Retrospective taxation can lead to an obligation appearing out of thin air, even though all legal procedures have been complied with at the time of the transaction.

*BBA LLB, FOURTH YEAR, K.L.E SOCIETY'S LAW COLLEGE, BENGALURU.

## WHY IS IT CONTENTIOUS?

The retrospective application of laws is contrary to the general principle of prospective effect in bringing about a new legislation. Laws have an obligation arising from the time of their enactment and not before. Retrospective laws lead to people being prejudiced by laws which were not even in existence at the time of the commission of a 'wrong". Similarly, retrospective taxation has been vehemently opposed by several sections of the country since it is unjust, unreasonable and devoid of fairness. In general, retrospective laws have been criticized as unfair, unjust and violative of natural justice.

## JUDICIAL VIEW

The first instance regarding the validity of retrospective taxation before the Judiciary came up in the case of Chhotabhai Jethabhai Patel vs Union of India[1] wherein the Supreme court had to decide whether retrospective application of taxation is permissible under the Constitution. The Supreme court in the case held that there was no clear restriction against retrospective laws. This decision led to the Parliament abusing its power and went about making unreasonable retrospective applications and corrections of statutes.

The Supreme Court in the case of Maneka Gandhi vs Union of India[2] has held that the legislature indeed has the power to legislate retrospectively subject to the restrictions of Fundamental Rights. Multiple cases have differed in the retrospective application of laws. Established rules of interpretation were that unless explicitly stated, a piece of legislation is presumed not to have retrospective operation. Retrospective legislation was contrary to the general principle that 'legislation introduced for the first time need not change the character of past transactions carried out upon the faith of the then existing law and thus must be only clarificatory in nature or meet a very high threshold of need. The obvious basis of the principle against retrospectivity was the principle of 'fairness' which is one of the cornerstones of law and must be considered at all times when looking at a particular statute[3]

[1] 1962 AIR 1006
[2] 1978 AIR 597
[3] Karthikeyan, Prathik, Retrospectivity in Taxation in India: A Judicial & Constitutional Analysis (January 10, 2019). Available at SSRN: https://ssrn.com/abstract=3782726 or http://dx.doi.org/10.2139/ssrn.3782726

## BACKGROUND OF CAIRN ENERGY DISPUTE

The dispute between Cairn Energy and the Indian government started in 2014 when the Indian tax officials started enquiring about the corporate reorganization which took place from 2006-2007. Cairns UK had transferred shares of Cairn India holdings to its counterpart, Cairn India. In January 2014, Cairns received a notice from the Income Tax department regarding its tax liability amounting to ₹.10,247 crore on capital gains it made upon the reorganization in 2006.

## FINANCE ACT, 2012

The Finance Act of 2012 introduced retrospective taxation on indirect transfers of downstream assets in India by amending the Income Tax Act, 1961. Hence the transfer of shares that takes place outside of India can be taxed if the value of the shares is based on assets in India. The introduction of this retrospective tax resulted in enormous tax liability on Cairn Energy even though it complied with all tax laws at the time of transfer and subsequent corporate reorganization.

## APPEAL BY CAIRN

Upon receiving the notice from the Income Tax department, the company appealed before the Income Tax Appellate Tribunal. But the appellate tribunal rejected the company's arguments and ruled in the favour of the Income Tax department. Aggrieved by this, the company decided to take up arbitration before the Permanent Court of Arbitration.



## THE DECISION OF THE PERMANENT COURT OF ARBITRATION

Cairn initiated arbitration in order to resolve the dispute under the 1994 India-Britain Bilateral Investment Treaty (BIT) contending violation of the same. During the proceedings, shares of Cairn Energy which had been seized were sold by the Income Tax department. In December 2020, the Permanent court of arbitration ruled in the favour of Cairn Energy and awarded damages amounting to almost 1.2 billion dollars.

## ATTEMPT TO SEIZE INDIAN ASSETS

The Indian government refused to recognize the decision of the Permanent Court of Arbitration. Hence Cairn Energy decided to enforce the arbitration award by filing suits in multiple countries requesting the seizure of sovereign assets of India. Cairn resorted to suing Air India in New York and the Tribunal judiciaire de Paris agreed to the seizure of Indianowned assets in Paris in order to enforce the arbitration award. The mounting pressure and the issue of national prestige led to the Government's decision to scrap the retrospective taxation law and subsequently refunded the tax money collected by the Income Tax department.

## SETTLEMENT OF THE DISPUTE

The dispute was finally when the Government decided to refund the money seized in return for Cairn Energy withdrawing all the cases against India. The government refunded ₹.7,900 crore to Cairn Energy and scrapped the retrospective taxation law. In order to repair the damage caused by the dispute and the subsequent decision, India decided to refund all the tax money seized under the 2012 retrospective tax law.

## CONCLUSION

The Cairn energy dispute led to the realization that retrospective taxation laws inherently punished many companies and had an adverse impact on the country's image as a budding investor-friendly destination. The lessons learnt by this long-running dispute is that India must strive to balance its interest in touting itself as an investor-friendly country and effective enforcement of its domestic tax laws. One would hope that this dispute would force the Government to reconsider its stance on the retrospective application of laws.