No clarity on how to deal with retro-taxes so far

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Though the President's address to the joint session of Parliament on Monday iterated the BJP manifesto's promise of a non-adversarial tax regime, the finance ministry has been unable to come up with a solution to deal with the problem. In which case, the Budget may not specifically deal with how the R2 lakh crore of transfer pricing adjustment orders — largely made on the basis of retrospective tax amendments — served on companies in the last few years are going to be dealt with (see graphic).

According to sources, one of the government's concerns is how rolling back the retrospective tax will go down with the Comptroller and Auditor General (CAG). Given previous CAG reports, a serious concern is that the CAG could argue that the government has effectively lost several tens of thousand crore rupees in potential tax revenues.

What is unclear, however, is why there should be any concern about the CAG since, if the law is changed by Parliament — which is also how it was introduced — the CAG has no locus standi as it cannot question policies made by Parliament. So while Parliament can roll back the tax, the worry is that the CAG may object to the tax demands already issued being withdrawn.

Not only will rolling back the retrospective tax affect existing cases like that of Vodafone where a R20,000-crore tax demand has been made — including the penalties and interest — it will also affect cases where such a demand has not been raised as yet. In which case, the total amount affected will be larger than the R2 lakh crore of transfer pricing adjustments being talked of.

In the case of Cairn Energy, for instance, the demand has not been finalised, but it has been told it cannot sell its shares of Cairn India till the case is finalised. Cairn India, in turn, has been told it cannot buy Cairn Energy's shares as part of its open offer. Though no formal order has been issued, tax department sources estimate the likely tax claim at around R25,000 crore.

In cases like Cairn, Shell and Vodafone India, incomes from share transfers were not considered as taxable income. A retrospective amendment in FY12, however, decreed that income earned from share transactions will also be considered as taxable under Section 92(1) of the Income Tax Act.

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