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Indirect Transfers Taxation

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Indirect Transfers Taxation

An indirect transfer is the sale of shares of a foreign company whose value comes substantially from assets in India. India taxes such a sale because the shares are deemed to sit in India. This lesson covers the Vodafone case, the 2012 retrospective law, the arbitration awards and the 2021 reversal.

Must know: the definition

1 What is an indirect transfer? Picture a foreign holding company that owns an Indian business. A buyer purchases that holding company's shares abroad. No Indian asset is sold on paper. Yet the real value of the shares sits in India.

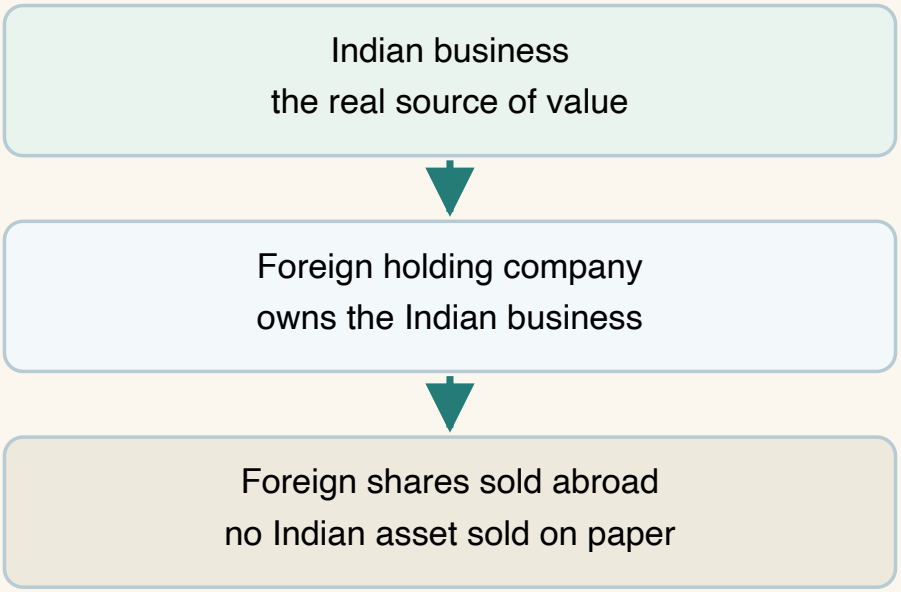
What makes a transfer “indirect”?

- A **direct transfer** sells an Indian asset, such as shares of an Indian company.
- An **indirect transfer** sells shares of a **foreign company** instead.
- The deal happens abroad, between two foreign parties.
- The tax question arises because the foreign company’s value comes **substantially from assets located in India**.

How do you remember it?

- Ask where the value sits, not where the paper is signed.
- Foreign shares plus Indian value equals an indirect transfer.

Quick check 1. An indirect transfer needs an Indian asset to be sold directly. *(True or False?)* See answer ↓



The sale is abroad, but the value sits in India. Original explanatory diagram.

Sources: elplaw.in; prsindia.org

2 Why does India tax a deal with no Indian asset sale? The answer lies in one section of the Income-tax Act, 1961.

What does the law say?

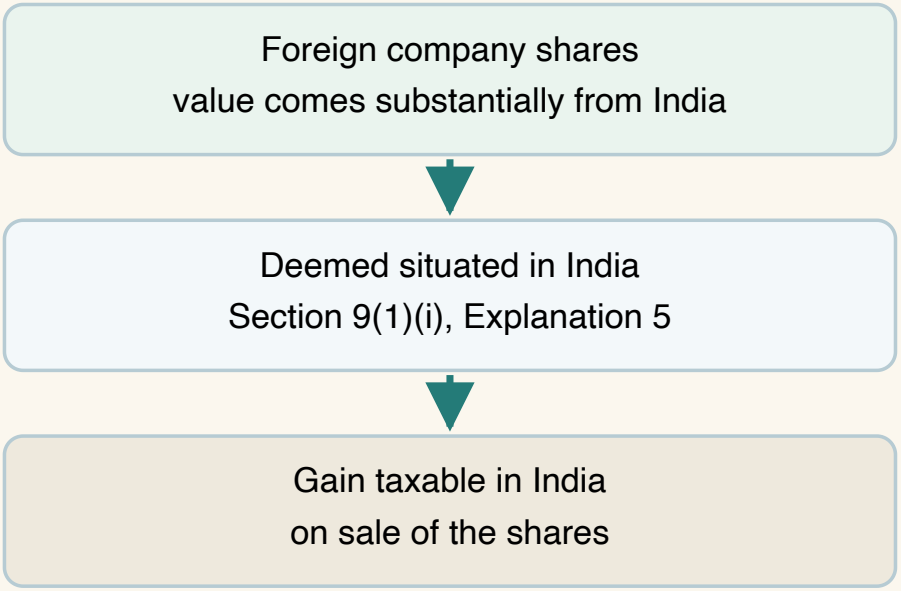
- **Section 9(1)(i)** deals with income that is deemed to accrue or arise in India.
- Explanation 5 to this clause was inserted by the Finance Act, 2012.

- It says shares of a company registered abroad are deemed to be situated in India.
- This applies if the shares derive their value **substantially from assets located in India**.
- The shares are deemed to be in India, so the gain on selling them is taxable in India.

Is this the same as transfer pricing?

- No. Transfer pricing is about the price charged between related firms.
- Indirect transfer taxation is about **where** a share sale is deemed to take place.

> **Quick check 2.** Explanation 5 deems foreign shares to be situated in India if their value comes substantially from Indian assets. *(True or False?)* See answer ↓



Explanation 5 turns foreign shares into Indian-situated shares for tax. Original explanatory diagram.

Sources: elplaw.in; prsindia.org

Good to know: the Vodafone case and the 2012 law

3 How did the Vodafone case start this? One deal in 2007 made the question famous.

What was the deal?

- In 2007 a Netherlands company, Vodafone International Holdings, bought a stake in Hutchison Essar.
- Hutchison Essar was an Indian telecom company.

- The seller was a Hong Kong based entity that held the stake through a chain of subsidiaries.
- The deal was done offshore, between foreign parties.

What did India do?

- The Indian tax department demanded tax from Vodafone under the Income-tax Act, 1961.
- Vodafone did not pay. The matter went to court.

What did the Supreme Court decide?

- In 2012 the Supreme Court ruled in Vodafone's favour.
- It held that gains from an indirect transfer of Indian assets were **not taxable** under the law as it then stood.

> **Quick check 3.** In 2012 the Supreme Court ruled against Vodafone in the Hutchison deal. *(True or False?)* See answer ↓

Sources: scconline.com; prsindia.org

4 Why was the 2012 amendment so controversial? Parliament did not accept the court's reading. It changed the law, and it did so backwards in time.

What did the Finance Act, 2012 do?

- It inserted Explanation 5 into Section 9(1)(i).
- It gave the change **retrospective effect from 1 April 1962**.
- It also validated tax demands in cases of indirect transfers.

- The Bill's own statement says the court's verdict was inconsistent with legislative intent.

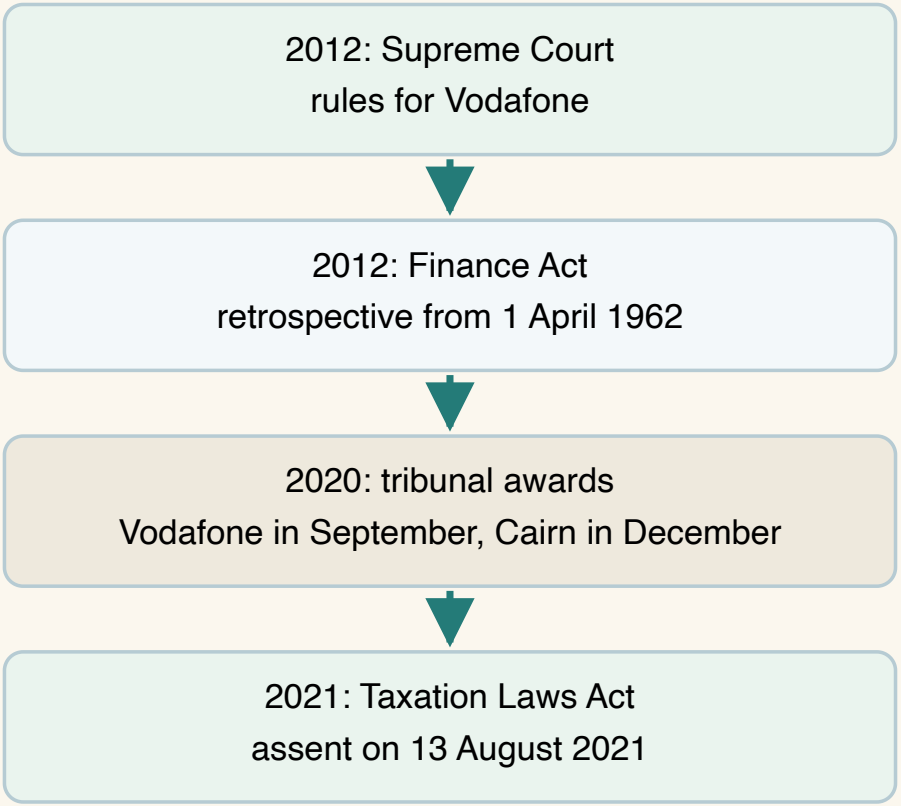


The Supreme Court of India, New Delhi. It ruled for Vodafone in 2012, and Parliament then amended the tax law. Photo: Pinakpani, CC BY-SA 4.0, via Wikimedia Commons.

Why did people object?

- Critics said retrospective changes break the principle of **tax certainty**.
- They said it damaged India's image as an attractive place to invest.
- The Government itself later called the demand "a sore point" for investors.
- Demands were raised in **17 cases**.

> **Quick check 4.** The Finance Act, 2012 gave its indirect transfer rule retrospective effect from 1 April 1962. *(True or False?)* See answer ↓



Four steps from the court ruling to the reversal. Original explanatory diagram.

Sources: prsindia.org; elplaw.in

Great to know: arbitration and the 2021 reversal

5 How did Vodafone and Cairn fight back? Both firms looked beyond Indian courts. They used investment treaties.

What happened to Vodafone?

- Vodafone began arbitration in 2014 under the **India-Netherlands** investment treaty.
- On **25 September 2020** the Permanent Court of Arbitration passed its award.
- The tribunal found India's retrospective demand breached the fair and equitable treatment standard.

What happened to Cairn?

- Cairn Energy, a British firm, used the **India-UK** investment treaty.
- In **December 2020** its tribunal also ruled against India.
- It awarded about **$1.2 billion**, plus interest and costs.
- India's authorities had seized dividends and shares and withheld tax refunds to recover the dues.

How many cases reached arbitration?

- Of the 17 cases, arbitration under the UK and Netherlands treaties was invoked in **four**.
- In **two** of them the tribunal ruled for the taxpayer.

Quick check 5. Vodafone used the India-UK treaty and Cairn used the India-Netherlands treaty. *(True or False?)* See answer ↓

Sources: scconline.com; atblegal.com; prsindia.org

6 What changed in 2021? India chose to end the dispute. It did so by law.

What did Parliament pass?

- The **Taxation Laws (Amendment) Bill, 2021** was introduced on 5 August 2021.
- Lok Sabha passed it on 6 August and Rajya Sabha on 9 August.
- The President gave assent on **13 August 2021**.

What does the Act say?

- No tax demand is raised on the 2012 amendment for an indirect transfer made **before 28 May 2012**.
- Earlier demands are treated as **never made**, but only if the taxpayer meets set conditions.
- Any amount paid is refunded **without interest**.

What conditions must the taxpayer meet?

- Withdraw pending appeals and writ petitions.
- Withdraw arbitration, conciliation or mediation claims.
- Give an undertaking waiving any further claim on the same income.



Relief comes only after the taxpayer meets the conditions. Original explanatory diagram.

Sources: prsindia.org; pib.gov.in

7 What does the rule look like today? The 2021 Act did not abolish the tax. It cut the retrospective part.

What stays and what goes?

- The 28 May 2012 date is the day the Finance Bill, 2012 got the President's assent.
- Transfers **before** that date are no longer taxed on the basis of the 2012 amendment.
- The deemed-situs idea in Explanation 5 is still the rule for later transfers.

Which wrong ideas should you clear?

- **Myth:** the 2021 Act scrapped indirect transfer tax. **Fact:** it only withdrew the retrospective reach.
- **Myth:** every taxpayer got relief automatically. **Fact:** relief needed the conditions, such as withdrawing litigation.
- **Myth:** the Supreme Court upheld the retrospective law. **Fact:** the 2012 ruling went for Vodafone, and Parliament then amended the law.

Sources: pib.gov.in; elplaw.in

8 How did UPSC test it in 2022? This was Question 8 in the 2022 Civil Services Preliminary Examination (General Studies Paper I, Series A). It asked: "Which one of the following situations best reflects "Indirect Transfers" often talked about in media recently with reference to India?"

The options were:

- (a) “An Indian company investing in a foreign enterprise and paying taxes to the foreign country on the profits arising out of its investment”
- (b) “A foreign company investing in India and paying taxes to the country of its base on the profits arising out of its investment”
- (c) “An Indian company purchases tangible assets in a foreign country and sells such assets after their value increases and transfers the proceeds to India”
- (d) “A foreign company transfers shares and such shares derive their substantial value from assets located in India”

The answer is **(d)**.

How do you check it?

- Options (a) and (b) are about taxes on profits from investment. That is not a share transfer.
- Option (c) sells tangible assets abroad. No foreign company shares are sold.
- Only option (d) has foreign shares whose value comes from Indian assets.

Sources: upsc.gov.in; mcqquestion.com

Review the feedback after each answer. The understanding-check score lasts for this page session.

Reset the checks when you want another attempt. This score is separate from the Native Practice score below.

Questions to think through

Why did Vodafone win in the Supreme Court but still face a tax bill?

The court read the law as it stood and ruled for Vodafone. Parliament then changed the law in 2012 and made the change retrospective. So the demand came back.

Why did the arbitration awards matter if India has its own courts?

The firms said the retrospective demand breached investment treaties. A treaty tribunal can judge that, even when Indian courts have spoken.

Why did the 2021 Act ask taxpayers to withdraw their cases?

The Act gave relief in return for ending all disputes on the same income. Taxpayers had to withdraw litigation and waive further claims.

Why is 28 May 2012 the key date?

It is the date the Finance Bill, 2012 got the President’s assent. The 2021 Act protects transfers made before it.

Practice MCQs

1. Which one of the following situations best reflects "Indirect Transfers" often talked about in media recently with reference to India? (UPSC CSP 2022, GS Paper I)

A. An Indian company investing in a foreign enterprise and paying taxes to the foreign country on the profits arising out of its investment

B. A foreign company investing in India and paying taxes to the country of its base on the profits arising out of its investment

C. An Indian company purchases tangible assets in a foreign country and sells such assets after their value increases and transfers the proceeds to India

D. A foreign company transfers shares and such shares derive their substantial value from assets located in India

See answer ↓

2. The retrospective amendment to India's indirect transfer tax law, introduced by the Finance Act, 2012, applied Section 9 of the Income Tax Act retrospectively from which date?

A. 1 April 1962

B. 1 April 1991

C. 28 May 2012

D. 1 April 2013

See answer ↓

3. Which two companies were most affected by India's retrospective indirect transfer tax amendment of 2012?

A. Vodafone and Cairn Energy

B. Tata and Reliance

C. Google and Amazon

D. Infosys and Wipro

See answer ↓

4. The Taxation Laws (Amendment) Act, 2021 changed India's indirect transfer tax rule by:

A. Extending the retrospective effect further back to 1950

B. Making the tax apply only prospectively, from 28 May 2012 onward

C. Abolishing indirect transfer tax entirely

D. Doubling the tax rate on indirect transfers

See answer ↓

5. Under the Taxation Laws (Amendment) Act, 2021, how is any amount that becomes refundable paid to a taxpayer who meets the conditions?

A. It is not refunded at all

B. Only as government bonds

C. With interest under Section 244A

D. Without any interest

See answer ↓

Answer Key

1. **D.** The correct answer is (d). In an indirect transfer, shares of a foreign company are sold. Those shares derive their value substantially from assets in India, so India deems them to be situated in India. Options (a), (b) and (c) describe taxes on profits or sales of tangible assets, not a transfer of foreign shares. ↑ Q1
2. **A.** The Finance Act, 2012 gave the amendment retrospective effect from 1 April 1962. The date 28 May 2012 is different. It is the date the Finance Bill, 2012 got assent, and the 2021 Act protects transfers made before it. ↑ Q2
3. **A.** Vodafone and Cairn Energy are the two best-known cases. Vodafone used the India-Netherlands treaty and won its award on 25 September 2020. Cairn used the India-UK treaty and won an award of about $1.2 billion in December 2020. ↑ Q3
4. **B.** The 2021 Act withdrew the retrospective reach. No demand is raised for indirect transfers made before 28 May 2012. Earlier demands are nullified if conditions are met, such as withdrawing pending litigation. Refunds carry no interest. ↑ Q4
5. **D.** The Act says such an amount shall be refunded, but no interest under Section 244A is paid on it. The refund follows only when the taxpayer meets the conditions, such as withdrawing pending litigation. ↑ Q5

Quick-check answers

1. **False.** this is false. The shares of a foreign company are sold, and their value comes from Indian assets. ↑ 1
2. **True.** That deeming rule is the basis of the tax. ↑ 2
3. **False.** this is false. The court ruled for Vodafone, and Parliament then changed the law. ↑ 3
4. **True.** That reach back to 1962 caused the controversy. ↑ 4
5. **False.** this is false. It was the other way round. ↑ 5

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