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India promises investors a fair deal on tax

Arun Jaitley

The government must end damaging retroactive demands as a priority, writes Arun Jaitley



Prime minister Narendra Modi

The administration that took office in New Delhi last year pledged to end the previous Indian government's record of "tax terrorism". Rule of law and the sanctity of contract are the essential underpinnings of a market economy, but they had been called into question, most damagingly by a bill on retrospective taxation passed in 2011. We intend to repudiate this past.

Consider what we have done. When we came to power, we declared that there would be no more retroactive tax actions in India. Taxpayers would henceforth be treated as partners, not hostages or victims. We have ensured fair treatment of certain kinds of contentious transactions. We clarified rules on transfer pricing. We introduced procedures, such as safe harbour provisions, to provide extra comfort to investors. We instructed tax officials not to file frivolous appeals.

In this year's budget, we have not implemented anti-avoidance tax measures that could be construed as unfriendly to investors. There would be no more "minimum taxes" for foreign portfolio investors. And perhaps most significantly, when the courts decided in favour of Vodafone and Shell in their long-running multibillion tax disputes with the Indian government, we did not challenge their verdicts.

Yet, to be frank, we have not been entirely successful in convincing investors of the fairness of our tax system. New cases of unexpected tax demands have cropped up, the most recent one being the minimum alternative tax (MAT). This has long been imposed on domestic companies. The tax authorities have started claiming payments from foreign portfolio investors, too.

It is ironic, and to my government disappointing, that tax issues are damaging our reform credentials precisely when we are on the cusp of modernising and rationalising our tax policies. In the current parliamentary session we will amend the constitution, to allow us to implement a historic reform of indirect taxes in the form of a value added tax (the so-called goods and services tax) to be implemented at the centre and the states.

The political consensus needed to implement this reform had eluded the country for more than a decade. We secured it within months of coming into power. Similarly, we have announced major changes in the corporate tax regime to reduce rates to internationally competitive levels, eliminate exemptions, and give companies a bigger incentive to comply.

But on tax administration, our situation today recalls William Faulkner's lament that "the past is never dead. It is not even past." All of the disputes now attracting attention are legacy cases: tax demands arising from actions that the tax authorities and the judiciary took before we came to power.

The decision to levy MAT on foreign portfolio investors, for example, was taken not by the government but by quasi-judicial bodies. These were created — well before the present government came to power — to reassure investors that the tax system would be free of political interference. But some of the rulings went against foreign investors (others have gone in their favour).

We have had little choice but to respect these decisions. The rule of law cuts both ways. We cannot say it is undermined when we take retroactive actions, and at the same time seek to override, retroactively, the decisions of our institutions. However, we have made clear that these rulings can be contested in higher courts, which will respect due process and have the power to quash faulty decisions. We also made clear that our international tax treaties cannot be overridden by these rulings.

Even though it is only the legacy issues that haunt us, we recognise that we must put a quick end to them.

I am considering a high-level committee to explore what can be done to resolve the past, and move beyond it in a way that would provide real predictability and certainty to investors. This committee will be instructed to report back expeditiously so that early actions can be taken. We have fashioned tax policies for the 21st century. Our tax administration cannot afford to lag behind. We will not let it.

The writer is the Indian finance minister

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