

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS



Open Access, Refereed Journal Multi Disciplinary
Peer Reviewed Edition :

www.ijlra.com

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Megha Middha, is working as an Assistant Professor of Law in Mody University of Science and Technology, Lakshmangarh, Sikar (Rajasthan). She has an experience in the teaching of almost 3 years. She has completed her graduation in BBA LL.B (H) from Amity University, Rajasthan (Gold Medalist) and did her post-graduation (LL.M in Business Laws) from NLSIU, Bengaluru. Currently, she is enrolled in a Ph.D. course in the Department of Law at Mohanlal Sukhadia University, Udaipur (Rajasthan). She wishes to excel in academics and research and contribute as much as she can to society. Through her interactions with the students, she tries to inculcate a sense of deep thinking power in her students and enlighten and guide them to the fact how they can bring a change to the society

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Mrs.S.Kalpana

Assistant professor of Law

Mrs.S.Kalpana, presently Assistant professor of Law, VelTech Rangarajan Dr. Sagunthala R & D Institute of Science and Technology, Avadi. Formerly Assistant professor of Law, Vels University in the year 2019 to 2020, Worked as Guest Faculty, Chennai Dr.Ambedkar Law College, Pudupakkam. Published one book. Published 8 Articles in various reputed Law Journals. Conducted 1 Moot court competition and participated in nearly 80 National and International seminars and webinars conducted on various subjects of Law. Did ML in Criminal Law and Criminal Justice Administration. 10 paper presentations in various National and International seminars. Attended more than 10 FDP programs. Ph.D. in Law pursuing.



Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC - NET examination and has been awarded ICSSR - Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and

learning.

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INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS

ISSN

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RETROSPECTIVITY IN TAXATION STATUTES – A CONSTITUTIONAL ANALYSIS

AUTHORED BY - ANJALI VISWANAATHAN

Abstract

Retrospectivity in taxation, often referred to as retrospective taxation or retroactive tax legislation, is a contentious and complex aspect of fiscal policy. It pertains to the government's ability to enact tax laws that apply to events or transactions that have already occurred in the past, potentially changing the tax liabilities of individuals, businesses, or entities retroactively. This concept raises important questions about fairness, legal certainty, and the balance between revenue generation and taxpayer rights.

This paper explores the key issues surrounding retrospectivity in taxation. It delves into the reasons governments may resort to retrospective tax legislation, such as closing perceived loopholes or addressing unintended consequences of prior laws. However, it also examines the potential negative consequences, including undermining taxpayer trust, distorting economic decisions, and triggering legal challenges.

This also explores the constitutional conflicts that retrospective taxation may trigger, including issues related to legislative authority, due process, equal protection, and the violation of established legal expectations. It discusses how these conflicts can lead to legal challenges and disputes between taxpayers and the government.

In conclusion, retrospective taxation poses significant constitutional challenges, as it runs counter to principles of fairness and legal predictability. A comprehensive constitutional analysis is vital to strike a balance between a government's revenue-raising needs and the protection of individual or corporate taxpayer rights within the constitutional framework. Such analysis is crucial for maintaining the rule of law and upholding the fundamental principles of a just taxation system.

Introduction

Retrospective taxation or backdated taxes, is a contentious fiscal practice in which a government creates or alters tax rules with the authority to influence financial transactions that occurred in the past. This approach allows the government to apply tax changes, such as rate hikes, deductions, or exemptions, to past tax years' transactions or revenue. The concept of retrospective taxes is both complex and contentious, with differing viewpoints on its benefits, drawbacks, and ethical implications.

Advocates of retrospective taxation believe that it is a valuable instrument for governments to use to close unforeseen tax loopholes or ambiguities that taxpayers may have exploited. The government can maintain justice in the tax system and the integrity of its revenue collection by correcting these concerns retroactively. Retroactive tax revisions can serve as a corrective tool, aligning tax rules with the original goals of the government.

Another advantage of retrospective taxes is the possibility for increased budgetary stability for governments. In times of unexpected budgetary issues or crises, the ability to enact retroactive tax changes might help stabilize government revenue sources. This adaptability can be critical in maintaining public finances, especially during economic downturns or unusual events.

Retrospective taxation can also be used to discourage aggressive tax avoidance and evasion. Taxpayers may be more careful in their financial planning and less inclined to participate in activities meant to minimize their tax payments if they are aware of the government's power to make tax adjustments that apply to past periods. As a result, the tax system can function as intended, with taxpayers paying their fair amount.

However, retroactive taxation has serious drawbacks and raises various ethical difficulties. One of the most significant disadvantages is the uncertainty it causes for organizations, individuals, and investors. When tax regulations can change after the fact, taxpayers find it difficult to confidently manage their finances, make investments, or engage in commercial activities. This uncertainty can stifle economic growth and hinder the normal functioning of markets.

Furthermore, retrospective taxes has the potential to damage investor trust. Domestic and foreign

investors are frequently wary of locations where the government can change tax rules retroactively. This lack of certainty might discourage investment and stifle economic growth. It can also lead to disagreements and court battles, tarnishing a country's reputation as a stable and appealing place to invest.

From an ethical standpoint, retrospective taxes involve issues of fairness and due process. Taxpayers anticipate that the regulations controlling their tax responsibilities will not alter after the fact. When governments implement retroactive tax changes, it can be interpreted as a violation of these fundamental principles of tax justice. As a result, people may lose faith in the government. This, in turn, can lead to a loss of trust in the government's ability to administer taxes fairly.

There have been notable cases of retrospective taxation in numerous countries, each of which has sparked controversy and debate. The Vodafone case¹ in India is a well-known example. The Indian government revised tax regulations with retroactive effect in 2012, with the goal of taxing Vodafone's acquisition of Hutchison's Indian businesses. This action generated a lengthy court battle as well as condemnation from international investors.

To counteract tax avoidance tactics, the United Kingdom has implemented retrospective tax measures. While the goal is to close tax loopholes, the impact on legitimate tax planning has been criticized.

To counteract corporate tax inversions, in which corporations shift their headquarters to lower tax jurisdictions, the US government adopted retrospective laws. These rules have had an impact on a number of high-profile mergers and acquisitions.

Retrospective laws and their Legislative Competence

The Constitution of India places two restrictions on the legislative authority of Parliament or State legislatures. Firstly, it delineates legislative competence by categorizing subjects into three lists, granting exclusive power to Parliament for List I, to States for List II, and concurrent power for List III. Secondly, Part III of the Constitution, akin to a bill of rights, imposes limitations on laws.

¹ Vodafone International Holdings B.V. v. UOI (2012) 341 ITR 1/204.

Tax laws can be challenged for being discriminatory (breaching equality before the law) or excessively burdensome, thereby unreasonably restricting the right to conduct business.

The 1951 amendment imposing a duty on manufactured tobacco, which was implemented retroactively—that is, starting on the day the bill was introduced rather than the day the law went into effect—was the first significant challenge to the retrospective changes that had been made.

Two grounds led to legal challenges to this Act. First, there was insufficient legislative competence on the part of the State Assembly to pass a sales tax bill that would take effect retroactively. It was argued that sales tax was fundamentally an indirect tax, with the ability to transfer its costs to the customer being one of its key characteristics. Since the consumer could not be made to bear the cost of the past when it was imposed retroactively, it ceased to be an indirect tax and was therefore illegal.²

The Supreme Court acknowledged that Part III of the Constitution applied to tax laws. The Indian Supreme Court, however, decided to adopt the American precedents that had rejected the argument that a tax law's simple retroactivity would make it arbitrary and capricious.

Although the Court did, in principle, hold tax laws to the fundamental rights to own and dispose of property as well as to conduct business, in actuality the Court only struck down laws on a very few number of cases when the tax was blatantly discriminatory. There is no known instance in which the court determined that the law imposing the tax violated the constitution due to its retrospective nature.

The Harvard Law Review article that stated that *"it is necessary that the legislature should be able to cure inadvertent defects in statutes oh their administration by making what has been aptly called small repairs"* was cited by the Supreme Court in a later case decided in 1969³.

The Court was obviously thinking of situations in which the State would lose money and a taxpayer would benefit equally due to improper wording or the addition of a feature that rendered

² Chhotabhai v Union 1962 Supp 2 SCR 1.

³ Buckingham and Carnatic Mills case, 1953 AIR 47.

the tax code unconstitutional. The legislature could lawfully amend the law retroactively and add a validating clause in such a case.

Can taxing statutes be retrospective?

The notion that taxing statutes cannot be retroactive was rejected by the Supreme Court from the beginning of the Constitution. In truth, most retrospective legislations in our country are just taxation statutes. However, for a variety of reasons, many jurists link taxing statutes with penal statutes. Herein lies the significance of the question, "Can Taxing Statutes Be Retroactive?"

Of course, the wordings in Art.20(1)⁴ of our Constitution are no impediment to any government implementing a retrospective taxing statute, as the phrases "offence," "Charge," and so on make it plain that it only applies to pure criminal instances.

However, the spirit and intent of the law is that no one shall be punished for an act that is not an offence at the time it is undertaken, and it is arbitrary to hold anyone legally accountable for any act that is innocent or permissible while he or she is performing it. Then, how can you support a law that invalidates someone's tax planning, which he consciously devised in accordance with the law in effect at the time he devised the plan? Citizens have the right to understand their responsibilities as taxpayers. This was emphasized by Blackstone. In a society that respects the rule of law, one cannot be punished for arranging tax responsibility in a way that is later changed. The Supreme Court concluded that a retrospective taxing statute can be acceptable if it is in the public interest under Art. 19, clause (6)⁵. As a result, the Apex Court believes that a retrospective taxing provision is not inherently irrational because it is retroactive. The court will sometimes justify it on the basis of public interest. Of course, whatever objective standards the courts may establish for establishing reasonableness on an ultimate analysis, "reasonableness" is subjective, abstract, and wholly under the discretion of the ultimate deciding authority.

"A clear trend has been identified in relation to the interpretation of statutes from a strict or literal approach towards a more purposive approach" ⁶ notes Tobias Lonnquist. This has even been the case for revenue law, which was previously seen as a penal statute. This pattern can be

⁴ Article 20 of the Indian Constitution, 1950.

⁵ Article 19 of the Indian Constitution, 1950.

⁶ The Trend Towards Purposive Statutory Interpretation: Human Rights At Stake.

seen in numerous tax countries, including civil and common law. After weighing the many reasons for and against the purposeful approach, it was determined that the observed shift in taxes policy should not be welcomed. Such an approach jeopardizes the separation of powers, as the judicial branch would be empowered to insert terms into legislation as they saw fit.

Worse is the threat to human rights, which is the power of taxpayers to preserve what is properly theirs. Many private international law jurists saw taxing statutes as penal statutes. Foreign income rules were frequently not executed in common law countries by characterizing them as penal statutes. A dicta in *Wisconsin v. Pelican Ins. Co.*⁷ was frequently quoted in U.S.A. to support the affirmative of this argument.

The view that taxing statute is penal statute is rejected in State of *Maryland v. Turner*,⁸ as well as *Moore v. Mitchell*⁹. In U.S.A Supreme Court held that where a retrospective tax law is challenged on constitutional grounds, it is necessary to consider the nature and the circumstances in which it is laid to find out whether its retroactive operation is harsh and oppressive enough to break the constitutional bonds. The contention that the retroactive application of the Revenue Acts is a denial of the due process guaranteed by the Fifth Amendment of U.S Constitution was not accepted by the Hon'ble U.S. Supreme Court in *Stockdale v. Insurance Companies*¹⁰; *RailroadCo. v. Rose*¹¹; *Billings v. United States*¹²; *Brushaber v. Union Pacific R. Co*¹³. In *MC Cray v. U.S.A*¹⁴ Supreme Court opined that the Constitution is not self-destructive. Constitution won't meant to take away by one provision powers conferred by another The Fifth Amendment's due process clause, in particular, has no bearing on the express authority to tax. Nor are subsequent provisions or amendments. Wisconsin's courts have upheld the legislature's similar practice.

However Section 16 of Article 1 of Constitution of North Carolina Provides as follows

“Retrospective laws, punishing acts committed before the existence of such laws and by them only

⁷ Court held that rule against application foreign criminal is applicable to revenue laws.

⁸ 75 Misc. 9, 132 N.Y.S. 173 (1911).

⁹ 281 U.S. 18 (1930).

¹⁰ 20 Wall.323.331.

¹¹ 95 U.S.78, 80.

¹² 232 U.S. 261,282.

¹³ 240 U.S.1, 20.

¹⁴ 195 U.S. 27; 24 S. Ct. 769.

*declared criminal, are oppressive, unjust, and incompatible with liberty, and therefore no ex post facto law shall be enacted. No law taxing retrospectively sales, purchases, or other acts previously done shall be enacted.”*¹⁵

In Unemployment Compensation Commission of North Carolina v. Wachovia Bank & Trust Co.Ltd¹⁶, the Supreme Court of North Carolina held Taxes levied for the year 1936 under the Unemployment Compensation Act, ., as void as violating this section.

In the contemporary times, both indirect as well as direct tax laws have seen a wave of retroactive changes. Throughout the 1980s and early 1990s, the majority of these changes had one thing in common: they either fixed a flaw or made a change that, in all fairness, could not be denounced as a change of law per se; rather, it was more a case of parliamentary intent missing fire. Recently, there has been a noticeable shift in the trend.

Since 2000, the trend has unmistakably shifted. Furthermore, this is evident in the field of direct tax law. This may be because, in the modern era, following the rationalization of indirect taxes (partially due to WTO commitments), direct taxes, in particular corporate tax, have become the largest source of revenue.

The Indian Constitution states that a law does not become unconstitutional just because it operates beyond Indian borders. However, there is still debate over whether Parliament can pass a law that explicitly attempts to tax income that is not connected to India.

The Supreme Court agreed in a 2007 ruling¹⁷ that statutes must be interpreted in accordance with the idea that income that is not geographically related to India should not be subject to the fallacy of the notion that "income deemed to accrue arise in India.

Several amendments have been proposed to retroactively modify this decision by modifying provisions where the presumption against extraterritoriality would be applicable. The Indian courts have not yet rendered a decision on the question of whether or not some of these provisions

¹⁵ Section 16, Article 1 of the North Carolina Constitution,1971.

¹⁶ 215 N.C. 491; 2 S.E.2d 592

¹⁷ Ishikawajimas' Case 2007 3 SCC 481.

are still valid.

Foreign direct investment has grown exponentially in India in recent years. Before the USSR broke up, India and the USSR had very close economic ties, facilitated by the rupee-ruble exchange. As a result of this unique relationship, India was able to finance a large amount of its major imports, including arms and oil.

The collapse of the USSR coincided with the lowest point in Indian economic history. The country's foreign exchange had reached a point where it was necessary to pledge massive amounts of its gold reserves in order to raise additional loans in order to avoid falling behind on loan repayment obligations.

Therefore, 1991 can be considered the year of the economic reform wave that started India's transition to a market economy. Foreign investment became necessary as a result of this shift. Foreign direct investment (FDI) increased dramatically during this time, not only in India but in many other developing economies as well; by the middle of the 1990s, FDI inflows had surpassed official development assistance inflows. The influx of MNCs coincided with rising FDI. Almost 36% of foreign direct investment flows originated in developing nations by 2005. Foreign investment has come to India in reasonable amounts. As a result, the Indian service sector has experienced exponential growth, much of which can be attributed to the arrival of foreign investment and the existence of multinational corporations in India.

The provisions for taxing non-residents' offshore income in India [based on some connection to India] and the enactment of transfer pricing determination provisions have undergone significant changes. The former allows associated enterprises operating in India and abroad to transact, and the latter allows the fair amount of income attributable to India to be subject to tax under Indian tax law.

However, it is imperative that laws not be changed frequently due to the need for stability and certainty as well as the need to foster public confidence in the dispute resolution process. It is not necessary to amend the law to reflect the intent of the assessing officers every time the income tax department misinterprets the law. Unless the situation clearly justifies Parliamentary

intervention, there is no harm in acknowledging that the Courts are better arbiters of Parliamentary intention, and if they conclude that the Assessing Officer misinterpreted the law, certainty and stability would require that the law not be changed without cause.

Acknowledging the necessity for definiteness, the income tax legislation has been modified to incorporate mechanisms that enable non-resident assesseees to acquire preliminary decisions regarding prospective transactions. The purpose of this kind of mechanism is to provide clarity prior to any transactions being made. A regular tampering with the interpretation of laws by advance ruling authorities undermines public trust in the prescribed procedure and undermines the basic goal for which they were created.

Impact of retroactive law on matters that have already been resolved

A judicial or quasi-judicial decision cannot be completely overturned by a retrospective law. Any such decision will therefore be final and binding on the parties unless it is changed by an appeal, revision, review, or other suitable procedure, even after the retrospective statute has taken effect.⁽²⁸⁾ The intriguing thing about retrospective taxing statutes is that an assessee who has no open cases with income tax authorities or courts will not be held liable for a retrospective tax if reopening of assessment is prohibited by statute. In the case of *Union of India v. National Agricultural Cooperative Marketing Federation of India Limited*¹⁸ Judge Ruma Pal ruled that a retrospective amendment could not be interpreted to give the Revenue authorities permission to reopen assessments when doing so would already be prohibited by statute.

The Act's statute of limitations is not intended to be addressed by the amendment. It is impossible to understand how the legislature intended to allow the Income-tax Officers to begin proceedings that were started prior to the new Act going into effect, regardless of any limitations, in the absence of any such explicit language or obvious implication. Finance Act 2009 added an explanation to Section 80IA of the Income Tax Act, which became effective on April 1, 2000.¹⁹ In *Doshion Ltd. v. ITO*²⁰, The Gujarat High Court ruled that a retroactive amendment could not

¹⁸ Appeal (civil) 6170 of 2001.

¹⁹ Sec.147 of Income Tax Act.

²⁰ SPECIAL CIVIL APPLICATION No. 18574 of 2011 (16/01/2011).

reopen assessments that had already been completed more than four years ago.³² The Finance Act of 2012, Section 113, nullifies the effect of judgments, invalidating the notices issued by the Income Tax authorities and validating them retroactively.

Nonetheless, the Supreme Court ruled in *PUCL v. Union of India*²¹ that the Legislature could not order the state's agencies to disregard a court's ruling. The legislature can only overturn a court decision's foundation.

The Supreme Court citing *Smt. Indra Nehru Gandhi v. Raj Narain*²² held that a legislature could only alter the foundation of a judgment and could not declare a court judgment to be null and void or not binding,. The Supreme Court viewed it as a violation of the fundamental division of powers and an intrusion on judicial authority.

According to the Supreme Court's recent ruling in *State of Tamilnadu v. K.Shyam Sunder & Ors*²³, "*passing the Act 2011, amounts to nullifying the effect of the High Court and this Court's judgments and such an act simply tantamounts to subversive of law.*"

Conclusion

To summarize, retrospective taxation is a difficult and diverse fiscal practice with both benefits and drawbacks. While it can assist in correcting tax anomalies, providing fiscal stability, and discouraging tax avoidance, it also causes uncertainty, erodes investor trust, and raises ethical concerns. Governments must carefully assess the consequences of enacting retroactive tax adjustments in order to strike a balance between resolving fiscal concerns and establishing a stable and predictable economic environment. Finally, the use of retrospective taxation should be addressed with caution, taking into account the long-term economic and ethical ramifications.

²¹ (2003) 4 SCC 399.

²² 1976 2 SCR 347.

²³ AIR 2011 SC 3470.