INDIAN INSTITUTE OF MANAGEMENT KOZHIKODE

Case Study

IIMK/CS/195/HLA/2023/01

March 2023

Cairn Energy Tax - Arbitration Dispute: Legal Quagmire for India

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Abstract:

India's two Bilateral Investment Treaties (BITs) were challenged in the recent past before the highest arbitration body - Permanent Court of Arbitration (PCA) - by foreign investor instilling investor-state dispute settlement (ISDS) procedures against Republic of India. Ironically both these cases were relating to taxation matters in connection with indirect transfer of shares/offshore indirect transfer (OIT) of shares which lead to Indian Income Tax (IT) authorities imposing tax liability on these foreign assessee by way of 'source' principle. This process was reinstated by amending the domestic legislation and empowering IT authorities to impose retrospective taxation. One of the arbitration award and its subsequent enforcement proceedings paved way for withdrawal of retrospective taxation rule by the Indian legislature in 2021. The sovereign responsibility under the international investment law and processes involved in arbitration mechanism also gets reflected in this case. Any kind of policy or regulatory measure, which could hamper the Fair and Equitable treatment (FET) could lead to violation of the BIT. Whether the taxation policy and regulatory change could lead to a scenario of FET violation is an important question that arises in the case of Cairn v. India. This case study attempts to decipher the tax legislations contributing to shift in the approach of the Indian government as well as understanding the legal quagmire faced by Indian government due to mis-interpretation of BIT.

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