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The Vodafone decision: insights, perspectives and disconnects

EXPERT VIEW

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The Bombay high court has affirmed the tax department's jurisdiction to proceed against **Vodafone Group Plc**. However, it has not determined whether any part of the payment made by Vodafone is actually chargeable to tax in India. The court had granted a stay on the department from raising a tax demand to allow time for an appeal to be filed by Vodafone before the Supreme Court, which has now been made.

The decision accepts the principle that income earned by a non-resident from an offshore transaction cannot be taxed in India unless the assets transferred have sufficient nexus with the territory of India. With respect to transfer of capital assets by a non-resident, it is necessary that the legal situs (a legal term meaning site) of the assets is in India. Considering that the transaction between Vodafone and Hutchison only involved the transfer of specific non-India based assets such as shares of a foreign company and certain loan entitlements, it should ordinarily not give rise to any income that is taxable in India.

To briefly summarize the facts, in February 2007, a sale and purchase agreement was entered into between **Vodafone International Holdings BV**, Netherlands, and **Hutchison Telecommunications International Ltd** (HTIL), Cayman Islands, for acquisition of the entire share capital of **CGP Investments (Holdings) Ltd**, another company based in the Cayman Islands. CGP Investments directly and indirectly held offshore companies that owned a 67% interest in the Indian operating company, **Hutch Essar Ltd** (HEL). The agreement between Vodafone and HTIL also involved assignment of certain inter-company loans which were owed by CGP Investments and its Mauritian subsidiary to various Hutchison group companies.

Based on various transaction documents, Foreign Investment Promotion Board (FIPB) disclosures and due diligence reports, the tax department has tried to argue that the subject matter of the transaction was a transfer of 67% interest in the Indian operating company, HEL, and a number of other rights such as its Indian telecom licence, the right to use the Hutch brand, management rights in the Indian company, joint venture interests and inter-company loan obligations. According to the department, this creates sufficient nexus for it to exercise jurisdiction to proceed against Vodafone.

While accepting the tax department's jurisdiction to initiate proceedings, the Bombay high court noted that the acquisition of the offshore Cayman entity by Vodafone was a composite transaction and the numerous agreements between the various parties captured certain rights and entitlements in relation to the Indian operating company. On this basis, the court held that the department would have to apportion that part of the payment made by Vodafone which related to assets that were situated in India.

The high court has also emphasized that, for tax purposes, one should only look at the form of the transaction and not its substance as long as it is not a sham or a colorable device. This principle was laid down by the Supreme Court in the Azadi Bachao Andolan case. The high court clarified that taxpayers can legitimately plan their economic affairs within the four corners of law even if the object was to lawfully mitigate the incidence of tax.

The high court also reiterated the common law principle that a share is a distinct capital asset in its own right. The business and assets of a corporation are not the business and assets of its shareholders and the acquisition of shares of a parent company would not lead to any transfer of interests in its underlying subsidiary companies. The court observed in very clear terms that a controlling interest which a shareholder acquires is incidental to the holding of shares and does not have a separate existence distinct from the shareholding.

On applying these principles to Vodafone's facts, it is difficult to understand how the high court accepted the tax department's jurisdiction to initiate proceedings in relation to an offshore transaction of this nature. Even if such jurisdiction does exist, it is likely that little or no part of the consideration paid by Vodafone may be considered taxable in India.

The form of the transaction only contemplated transfer of certain offshore loan entitlements and shareholding in the Cayman entity which is legally distinct from the underlying controlling interest in the Indian operating company. The other rights and interests vested with various downstream subsidiary companies and it may not be possible to suggest that these were transferred in law. Another issue is that it would be very difficult to quantify the cost of acquisition of the various rights identified by the tax department.

Further, under principles of private international law, the legal situs of many of these rights cannot be said to lie in India and, hence, there may not be sufficient nexus for the transaction to be taxed in India. These legal aspects are likely to have a crucial bearing on the final outcome of the case.

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The author is an international tax and corporate counsel. He is also special counsel to Vodafone International Holdings BV in this case. These are his personal views.