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Companies await India's Vodafone tax ruling

By James Crabtree in Mumbai

Despite encountering obstacles, Vodafone has invested $15bn in India so far

Several big western companies are nervously awaiting a ruling from India's Supreme Court which could saddle Vodafone with a $2.6bn tax bill and send further pessimistic signals about India's fast-deteriorating investment climate.

India's tax authorities are pursuing the UK-listed telecoms group for capital gains tax they claim is due on its $10.9bn acquisition of Hutchison Essar , an Indian mobile operator, four years ago. The ruling is due "any day now", according to one lawyer following the case, who asked not to be named.

Legal experts believe India's increasingly aggressive tax authorities will quickly bring similar proceedings against other western businesses, if chief justice S.H. Kapadia rules against Vodafone's current and final appeal.

Nishit Desai, a Mumbai-based international tax lawyer, said: "The tax bill for other international businesses could easily be in the tens of billions of dollars if Vodafone lose".

He estimates that India's tax department has already served at least 100 notices of potential future investigations.

The authorities do not publish records of such notices, but the estimation was corroborated by two other legal experts, who asked not be named. Attention is focusing in particular on some half a dozen mergers involving western companies, including AT&T, E*Trade, General Electric and SABMiller.

Mr Desai said: "The approach of the Indian tax authorities is highly unusual globally, so this case is being very closely watched. The judiciary in India is independent and Vodafone has good case, but it will have huge implications if the appeal is rejected."

The ruling comes as investors are increasingly concerned about the prospects for India's slowing economy, as well as its record of drifting policy, ingrained corruption and eccentric regulation.

Who next?

If Vodafone loses its case, who could be next? Legal experts point to a series of deals where India's tax men are eyeing a slice of he action **writes James Crabtree**.

None of the other cases features penalties as large as that facing Vodafone, but all involve he same basic pattern. Two unsuspecting parties, both based outside India, do a deal. Only later do they discover that a claim is being made, because one had a subsidiary in India.

Take General Electric, which in 2004 sold its 60 per cent stake in Genpact, the Indian outsourcing company, to two US-based private equity groups. The deal took place in the US, and no taxes were paid in India – at least not yet.

SABMiller, the world's second-largest brewer, faces a poten ial $35m retrospective bill, in a case relating to its 2006 purchase of the Indian division of he Foster's Australian drinks group.

AT&T and E*Trade also face possible tax issues: the former over a 2005 telecoms deal; he

On Wednesday, India's ruling Congress party completed a humiliating U-turn by shelving a reform to open the country's $450bn retail sector to foreign supermarket groups.

Hugh Young, managing director of Aberdeen Asset Management Asia, a fund manager with about $10bn in Indian equities, said: "The unpredictability of Indian authorities – be it over tax, or the recent decision and subsequent nonsensical indecision on retail investment – is most off-putting for foreign investors.

"If Vodafone loses, it will be a further blow to investor confidence."

The case has plodded through the upper echelons of India's slow-moving legal system since 2007. Vodafone has argued throughout that there is no legal basis on which to levy domestic tax on a transaction that occurred between two non-Indian companies in the Cayman Islands.

India's authorities claim tax is due because the transaction related to business activity located in India. Three legal experts, all of whom asked not to be named, said the result could go either way. All three agreed, however, that the law was substantially on Vodafone's side. One described the Indian government's case as "very weak indeed".

The result has particular implications for Vodafone, which has endured numerous problems in return for the $15bn it has invested in India so far. In addition to having to place $550m in escrow to cover part of the loss that may occur in this case, in 2010 it booked a $3.7bn impairment charge against a backdrop of a ferocious competition and widespread bickering with rival operators.

The UK company declined to comment on the current case, but Vittorio Colao, chief executive, visited India last week to lobby Manmohan Singh, prime minister, to improve the country's unpredictable telecoms regulation.

Mr Colao has previously expressed exasperation at his company's treatment, saying the planned IPO of part of his Indian business will only go ahead if the appeal is successful.

Ultimately Mr Colao's fate rests in the hands of Mr Kapadia, a judge widely respected for his honesty and latter over funds transferred between two companies based in Mauritius.

None of the companies involved in these cases was willing to comment. But Dinesh Kanabar the Mumbai-based chairman of KPMG India's tax practice says the Vodafone case itself gives clues to the decision's broader ramifications.

He says: "The length of the hearing was unprecedented in the history of Indian tax law, showing that the Supreme Court recognised how widely the effect of its decision may be felt".

He also notes that, if Vodafone loses, more deals could be considered liable, including cases such as Kraft's takeover of Cadbury, in which the latter has an Indian subsidiary. The only sure outcome would be "a huge amount of uncertainty."

An executive in a company involved in one such case agreed, saying that the tax authorities had played a big part in making India "without doubt one of the toughest regulatory environments in which we have to operate".

On he case facing his own company, however, the executive is resigned: "Whe her there is any end in sight from our point of view, I fear will remain rather unclear for some time."

independence.

But David Cornell, chief executive of Ocean Dial Asset Management of Mumbai, argues that the power of the chief justice's reasoning will be felt far outside his courtroom.

He says: "A reputation for making it difficult and risky to bring in foreign capital into a country, once earned, is extremely hard to lose.

"India may be about to test just how hard this will be."