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# HC says Vodafone must pay tax on Hutch buy

MUMBAI: A decision by the Bombay High Court in the landmark Vodafone tax case has tipped the equation in favour of the Indian taxman, as the court has accepted its jurisdiction over Vodafone's India acquisition.

On Wednesday, the high court ruled that Vodafone must pay capital gains tax on its \$11-billion acquisition of a controlling stake in mobile phone operator Hutchison Essar that was completed in 2007. Estimates published prior to the judgement assign a \$2-billion tax liability on Vodafone.

Vodafone will appeal to the Supreme Court in the next two-to-four weeks, said senior lawyer Harish Salve, who is representing Vodafone.

The court has given the company eight weeks. "Vodafone remains confident that there is no tax to pay on the transaction," said a company statement.

The final outcome of the case may influence valuations and structuring of M&A transactions between offshore entities with underlying assets in India.

However, experts said the high court ruling raised a new debate on whether the court said only a part of the transaction was taxable, or the entire transaction. "The principle is understood, but the bifurcation of taxability remains a point of contention," said Sudhir Kapadia, partner at Ernst & Young.

The decision is being closely watched globally because it is the first of its kind and can affect other similar transactions in India.

Mr Kapadia said future transactions would be governed by the Direct Taxes Code, which has a clear stance on overseas transactions, so the decision will not affect them. Yet, "this judgement makes past transactions vulnerable".

The I-T department had issued a show-cause notice to Vodafone in 2007, saying it should have withheld tax when it cleared payments to Hutchison. The UK-based global telecom giant subsequently filed a petition against this in Mumbai.

The case was heard in 2008, and in December that year, the high court dismissed Vodafone's petition. The company then appealed this in the Supreme Court, which sent the matter back to the high court to establish whether the tax department had jurisdiction on the transaction.

The current Bombay High Court judgement identifies two parts to the transaction: one of a controlling interest that was through a share transfer in Cayman Islands comprising a maximum of 52% stake; the second related to contractual agreements, in the form of options that increased Vodafone's rights to 67%.

In its transaction, Vodafone acquired 52% from Hutchison in an overseas transaction while 15% was held by Analjit Singh and Asim Ghosh, who were in India.

The order then goes on to say parts of the transaction for which an Indian link is established can be taxed by the I-T department. The court has left that decision in the hands of the assessing officer, and at this point has not assigned a value to the tax liability.

"The Court was of the view that the transaction was a composite one and the department will have to assess the specific part of the income that had sufficient nexus with the territory of India. Therefore, the sale of shares of the offshore entity may not per se be taxable in India," said Nishith Desai of Nishith Desai Associates who was also acting on Vodafone's behalf.

The argument can work both ways. The taxman can say since the entire underlying asset is in India, it has jurisdiction on all of it. The company can say only 15% of stake acquired has links with India, therefore, only that portion is taxable.

"The stand of the income-tax department that we do have jurisdiction has been upheld, and we will take whatever steps that are required in the law," said revenue secretary Sunil Mitra. The Vodafone judgement also rejected the revenue department's claim that the Cayman Islands part of the transaction was a smoke screen in order to avoid tax.

CGP Investments, formed in 1998 in Cayman Islands, held Mauritian company Array Holdings, which further held 14 other Mauritian companies, cumulatively holding 52% in Hutchison Essar.

Cayman Islands-based Hutchison Telecommunications International sold its interests to Dutch company Vodafone International Holdings through sale of shares in CGP Investments.

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