

Mixed verdict on Vodafone tax case

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Mumbai/New Delhi: The Bombay high court's verdict on Wednesday on the dispute between telecom firm Vodafone International Holdings BV and the income-tax (I-T) department partially upheld positions of both sides and said tax authorities could unbundle different rights conferred through shareholding to tax aspects relevant to India.

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"This will create a lot of difficulties for cross-border mergers and acquisitions," Nishith Desai, legal adviser to Vodafone, said. "The number of transactions that are being done overseas between two foreign companies of shares outside India would have a lot of impact and that it will be important for India to clarify its position as to how it wants to go about it."

The Direct Taxes Code (DTC) Bill, tabled in Parliament on 30 August, clearly identifies situations in which transactions of the Vodafone kind can be taxed.

"The scenario from 1 April 2012 (when DTC is likely to be introduced) will be completely different," Mukesh Butani, partner at BMR Advisors, said. "For now, it would be about Vodafone and all past transactions of similar nature."

Tax experts who *Mint* spoke to were unable to indicate the number of disputes that could be affected by the outcome of the Vodafone case or the amounts involved.

Wednesday's verdict upheld the jurisdiction of the Indian authorities to tax the transaction. The verdict also said: "We are not inclined to stay the operation of the judgement so we direct while the proceeding before the I-T department may continue, no final orders shall be passed by the tax authority for a period of eight weeks from today."

Vodafone indicated that it might approach the Supreme Court. A statement mailed by the company after the verdict said: "Following an initial review of the order, the legal advice received indicates that Vodafone's contention that the transfer of shareholding of CGP was a valid transaction (i.e., not a sham structure) and therefore not liable to be taxed in India, has been upheld in the judgment."

"However, the judgement holds that certain other contractual rights with the Indian parties were also a part of the transaction and this has 'nexus' with India. The judgement indicates this gives jurisdiction to the tax office to levy a tax on that part of the transaction. Vodafone is seeking legal advice to challenge this part of the judgement," the company's statement added.

In May 2007, Vodafone bought Hutchison Telecommunications International Ltd's 66.98% stake in Indian telecom company Hutch Essar Ltd for \$11.2 billion (around `52,300 crore today). Hutchison controlled its Indian telecom subsidiary through a Cayman Island company called CGP. CGP's shares were sold to Vodafone, which consequently became majority owner of the Indian telecom firm.

Vodafone's contention all along has been that existing Indian law does not give Indian tax authorities jurisdiction over an overseas transfer of the kind it did. The tax authorities dispute the contention and say Vodafone should have deducted tax at source before paying Hutchison.

"The court (verdict) seems to suggest a bifurcation between a bouquet of assets, suggesting that the entire amount is not subject to tax in India," said Sudhir Kapadia, partner at audit and consulting firm **Ernst and Young**. "The tax department has a right over assets located in India alone and not transfer of shares of a foreign company."

Tax consultants and lawyers are also not sure how tax authorities can unbundle the value of assets of a company arising from shareholding.

Earlier, tax authorities had told *Mint* that the bundle of rights, which Vodafone got by buying CGP included an Indian telecom licence, use of rights to the Hutch brand in India, goodwill and equity interest, among others.

The likely disputes which could appear at the next stage were summarized by Pranay Bhatia, associate partner at law firm Economic Laws Practice, who, in an emailed statement, said: "It is notable that under the proposed DTC, a specific provision together with the basis of taxation has been made to deem transfer of shares of an offshore company to tax in India. Since similar provisions are absent under the (current) Act, taxability of the income on transfer of shares of an offshore company is still not clear. If there is no taxability of the transfer of shares, the withholding provisions may also fail."

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