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Vodafone's India tax battle to resume

By James Crabtree in Mumbai



Earlier this month Vodafone's Italian chief executive Vittorio Colao journeyed to New Delhi in a last-ditch attempt to win a change of heart from India's government.

His request was simple. Pranab Mukherjee, finance minister, should reconsider plans to change India's tax laws in an attempt to recoup about \$2.6bn of tax from the UK-based telecoms company.

After the meeting both men were tight-lipped about their discussions, but on Monday Mr Colao got his answer: no.

Speaking in parliament, Mr Mukherjee delayed or altered a variety of proposed tax changes that had incensed international investors and prompted an exodus of foreign capital from Asia's third-largest economy. But on his plans to reopen a dispute that had dragged through India's courts since Vodafone's purchase of Indian mobile group Hutchison Essar five years ago, the finance minister offered no hint of compromise.

Any lingering doubts that the long-running tax battle will now resume were unambiguously removed on Wednesday, when a senior official from India's finance ministry confirmed on television that the tax department was likely to send out a fresh demand as soon as the legislation passed parliament.

That bill could now be as much as Rs200bn (\$3.7bn), a figure that includes the original tax demand along with an additional fine of the same amount and five years of interest charges.

In a terse statement on Wednesday, Vodafone noted its disappointment at the developments, saying: "It would be grossly unjust if, on the basis of legislation passed five years after the event, Vodafone were to be charged tax on a gain made by someone else [Hutchison]."

The likely resumption of its battle with the revenue department is a significant setback for India's third-largest mobile group by subscribers, which had thought it had laid the matter finally to rest after a ruling in its favour by India's Supreme Court in January.

The decision will also come as a disappointment to a range of international trade bodies that had lobbied on Vodafone's behalf, along with political leaders including George Osborne, UK chancellor, and Tim Geithner, US Treasury secretary.

"There are two places it now looks likely this can end up," says Bobby Parikh, a founder of BMR Advisors, a Mumbai-based tax consultancy. "Either it will go back to the Supreme Court or there will be some kind of settlement negotiated."

On the latter option, Vodafone said in April that it wanted "an amicable outcome to this issue", a signal that its management would at least consider any deal they could sell to the company's shareholders, although there have been few conciliatory signals in return.

Analysts remain divided on Mr Mukherjee's motivation for pressing ahead. Some cite the simple need for money, as India tries to reduce its stubbornly high budget deficit. Others see an even more basic motive: "This is also being driven by a sense of grievance against Vodafone by the tax department, which lost face when the Supreme Court decision went against them earlier this year," says Nishit Desai, a Mumbai-based lawyer.

Much uncertainty still remains over the path forward, but legal analysts think a return to court is now highly likely, while Vodafone has already signalled its intention to seek international arbitration under a bilateral treaty between India and the Netherlands, where one of its holding companies is based.

"The tax authorities think they can recover a lot of money, but ultimately I believe that there will be good grounds for a constitutional challenge against this measure in the Supreme Court and under bilateral treaties," Mr Desai says.

Whatever happens, the re-emergence of the case has further dented India's image in the eyes of investors, while raising concerns among domestic business leaders and international experts over respect for the rule of law.

Raghuram Rajan, an Indian-born economist at the University of Chicago and adviser to Manmohan Singh, prime minister, highlighted Vodafone's predicament in a recent speech in Hyderabad.

“A government that changes the law retrospectively at will to fit its interpretation introduces tremendous uncertainty into business decisions, and it sets itself outside the law,” he said. “India has missed a golden opportunity to show its respect for the rule of law even if it believes the law is poorly written. That is far more damaging than any tax revenues it could obtain by being capricious.”

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