VODAFONE INTERNATIONAL HOLDINGS B.V. VS. UNION OF INDIA

1. ABOUT HUTCHISION ESSAR LIMITED:

1. Hutchison Essar Limited (HEL) is an Indian Company which is the joint venture of Hutchison Telecommunication International Limited (HTIL) Group and Essar Group.
2. HEL is carrying on the business of providing telecommunication services in India.

2. ABOUT HUTCHISION TELECOMMUNICATION INTERNATIONAL LIMITED:

1. Hutchison Telecommunication International Limited is a foreign company, registered in Hong Kong

3. HOW VODAFONE ACUIRED CONTROL OVER HEL:

1. HTIL has a wholly owned subsidiary company CGP Investment Ltd. (CGP) which is also a foreign company registered in Cayman Islands, Mauritius.
2. The company CGP holds directly more than 50% shares in HEL.
3. Vodafone International Holdings B.V., registered in Netherland <u>with a view to acquire the controlling interest in HEL</u> purchased the 100% shares in CGP from HTIL.

GRAPHICAL REPRESENTAION

BALANCE SHEET OF HTIL				**VODAFONE INTERNATIONAL HOLDINGS B.V.**
Liabilities	**Assets**			
	Investment			
	100% Share of CGP	XXXX	1	Purchased share of CGP from HTIL for $11 billion in 2007
XXXXX		**XXXXX**		Thus acquired the business of CGP
BALANCE SHEET OF CGP				
Liabilities	**Assets**			
	Investment		2	Indirectly purchased >50% share of
	> 50% Share in HEL	XXXX		HEL
XXXXX		**XXXXX**		
BALANCE SHEET OF HEL				
Liabilities	**Assets**		3	Acquired the controlling interest in HEL
				Thus acquired the business in India

4. ISSUES INVOLVED

1. Whether HTIL by reason of instant transaction, had earned income liable for capital gain tax in India as this income was earned towards sale consideration of transfer of its business/ economic interests in India as a group in favour of Vodafone.

2. Whether, on payment made by the Vodafone to HTIL on such transaction, Vodafone was liable to deduct tax at source under Section 195 from the sale consideration paid to HTIL.

5. SHOW CASUE NOTICE UNDER SECTION 201

The Income tax department issued a show cause notice on September 19, 2007 under section 201 to Vodafone as to why it should not be treated as an assessee in default for not deducting TDS (amounting to $1.7 billion as capital gain tax) under section 195 on the payment made to HTIL which is taxable in India in hands of HTIL as capital gains.

6. WRITE PETITION BY VODAFONE

Vodafone filed a writ petition in Bombay High Court challenging the legal validity of the show cause notice inter-alia on the grounds that

a) The transaction being one for purchase of CGP between two non- residents there can be no question of any tax on capital gains
b) Even assuming the transaction is taxable, Vodafone is not an assessee in default as the provisions of section 201 do not apply to such a transaction,
c) The 2008 amendment to section 201 making amendment retrospective from 2002 is unconstitutional,
d) There is no transfer of any capital asset in India, and
e) Duty to deduct tax will only arise if the entity has presence in India.

7. FACTS PRODUCED BY REVENUE AUTORITY BEFOR HIGH COURT

1. The Vodafone made declaration to various authorities, including the SEC in USA, to the effect that the transaction is one for purchase of HTIL's interest in Indian companies.

2. Vodafone has not only become a successor-in- interest of HTIL in the joint venture between HTIL and Essar, it is now de facto a co- licensee with the Essar Group to operate mobile telephony in India.

3. Hutchison Essar was renamed as Vodafone Essar.

4. The profit resulting from the transaction was to HTIL as, after the transaction, the HTIL distributed the profit to its shareholders at the rate of HK$ 6.15 per share.

9. DECISION OF BOMABY HIGH COURT ON 03.12.2008

The facts produced by the revenue weighted heavily with the High Court while holding that <u>prima facie there is a transfer of capital asset situated in India</u>. The Bombay High Court, on dismissing writ, held as under:

<u>Against ground no-a)</u>

1. The transfer of CGP by HTIL to Vodafone <u>amounts to transfer</u> to controlling interest in Indian Company HEL to Vodafone. The dominant purpose of sale of shares of CGP was to transfer the controlling interest of Indian Company.
2. <u>Applicability of Section 9:</u> Vodafone has acquired a source of income in India; HTIL by reason of this transaction has earned capital gains taxable in India as the income was earned towards sale consideration of transfer to Vodafone of its Indian business/ economic interest as a group. It was held that the income of HTIL was deemed to have accrued or arise in India and therefore, it squarely fell within the ambit of section 9 and hence, chargeable to Income Tax under the head capital gains.

<u>Against ground no-d)</u>

3. In the instant case, the subject matter of transfer as contacted between the parties is not actually the shares of a Cayman Island Company, but the assets situated in India.

(Issue 1. Resolved through 1, 2, 3 above)

Further on the other grounds of Vodafone order of High court is silent:

But we can analyze them as follow:

Ground no-e)

4. For the applicability of Section 195, presence of person, responsible to deduct tax, in India, is not required. For the applicability of this section following conditions are required to be satisfied:-
1. Payment is made by any person,
2. Payment is made to a NRI or foreign company
3. Payment is in the nature of Interest or sum (other than salaries) chargeable to tax in India

Since Vodafone PRIMA FACIE had satisfied all the above conditions, it was liable to deduct tax on the payment made to HTIL.

Ground –b)

5. As per the amended Section 201, where a person

Who is required to deduct any amount in accordance with the provisions of Income tax Act -

1. Does not deduct , or
2. After so deducting
   - Fails to pay
   - Does not pay the whole or any part of the tax, as required by or under the Income tax Act, he shall be deemed to an assessee in default under section 201.

Ground –c)

6. Making retrospective amendment is constitutionally valid.

(Issue 2 resolved through 4,5,and 6 above)

DECISION IN SHORT:

Bombay High Court dismissed the Writ Petition of Vodafone, challenging the notice issued by the income tax department, calling upon Vodafone to show cause why it should not be declared as assessee in default for not deducting the consideration paid to HTIL. The dominant purpose of the transaction was to acquire controlling interest which one foreign company held in the Indian company. This transaction would certainly be subject to municipal laws of India, including the Income Tax Act.

10.SPECIAL LEAVE PETITION WITH SUPREM COURT

Vodafone filed a Special Leave petition with the Supreme Court challenging the order of Bombay High Court which upheld the Show Cause notice issued by the Income tax department.

11.DECISION OF HONERABLE SUPREME COURT ON 23.01.2009

1. The supra court dismissed the Special leave petition of Vodafone.

2. While dismissing the SLP Supreme Court directed Vodafone to go back to the assessing officer, furnish all the necessary documents including the agreement (which had not been submitted earlier before the AO or the High Court), for deciding the issue of jurisdiction of the Indian authorities and other issue.

As per the law laid down in **Management of Express Newspapers vs. Workers** AIR 1963 SC 569, the High Court should ordinarily not embark upon deciding questions of fact which require appreciation of evidence, the question in regard to “the jurisdictional issue” should be decided by the AO as a “preliminary issue” and the assessee shall be entitled to question the decision of the AO on that preliminary issue before the High Court. The question of law “to that extent” remains open.

12.Comment on above judgment

1. In favour:
   This ruling will generate significant revenue for the government
2. In Against:

   - At a time when companies worldwide are rethinking their strategies and risk aversion is growing, the judgment sends powerful signals which may adversely affect the flow of foreign direct investment into India.

   - Although the ruling will generate significant revenue for the government, this will be in the short term only. In the long term it will act as a restraint for investors that view India as a good business prospect (particularly in the current market conditions), resulting in a significant slowdown of investment into the country in the form of both foreign direct investment and foreign institutional investment.

   - Such an interpretation of Indian tax law and the use of retrospective changes in law expose many previous buyers and sellers of shares outside India to significant amounts of tax and create significant uncertainty for such transactions going forward. Companies will undoubtedly face underlying issues regarding this taxation on two levels: in India and in the holding company's jurisdiction. In many cases tax treaties will provide no protection from such a double tax liability.

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CA finalist (with one group)