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Vodafone deal: Tax dept. seeks over ₹ 32,000 cr from Hutchison

One of the most controversial economic issues in the last five years was the tax dispute between Vodafone and the tax department. The case originated after the revenue's (tax department) notice to Vodafone that the company has to pay a capital gains tax of nearly Rs 11000 crores from its purchase of Hutchison Essar Telecom Company from Hutch.

The entire dispute centered on the question that whether an indirect transfer of property located in India can be taxed under the relevant section 9(1) (i) of the Income-tax Act. The section instructs imposition of capital gains tax when the capital assets are transferred directly from one company to another.

Indirect transfer means when the shares of a company is transferred, the underlying asset is also transferred to the buyer.

At the final stage of the dispute, the Supreme Court verdict came that tax department doesn't have the right to tax the deal. This is because the relevant income tax Act (Section 9 (i) (i)) doesn't instruct tax authorities when capital asset (machinery building etc.) lying in India is transferred indirectly by transferring the shares by foreign companies abroad. Both Vodafone and Hutch were foreign companies and they made deal in another foreign company which held 67% of shares of Hutchison Essar India Limited. Hence Vodafone need not pay tax for the said deal.

- Issues:
  - Taxability over Capital Gains on an overseas transaction between 2 foreign companies (having nonresidential status in India) of sale of investments comprising of shares of an Indian Company;
  - Withholding Tax obligations of the Non Resident Buyer (Vodafone International Holdings BV) while making payment of lump sum consideration to Non Resident Seller (Hutchison International Holdings Ltd)
- Facts of the Case
  - Vodafone International Holdings BV, Netherlands ("VIH") entered into a Share Purchase Agreement with Hutchison Telecom, Cayman Islands for purchasing equity shares of its subsidiaries CGP, Cayman Islands
  - CGP in turn, directly and indirectly, owned ~52% share capital of Indian Company named as Hutchison Essar Limited ("HEL"). The acquisition meant VIH acquired control over CGP and subsidiaries, including HEL
  - **The Revenue Authorities held that the gains were taxable in India as there was transfer of controlling stake / business situated in India and**

accordingly alleged failure on part of VIH to withhold tax on gains arising to HTIL on the transfer of shares of CGP

- Vodafone judgment synopsis (by the Hon'ble SC of India) which set aside the Bombay HC order that WHT and interest and penalties of Rs 11,000 Cr are leviable on Vodafone International Holdings BV, Netherlands.
  - **The transaction for transfer of shares of a Foreign Company (though directly or indirectly holds shares of an Indian Company) between two non-residents on principal to principal basis abroad cannot be deemed as "Transfer of Capital Asset" situated in India and accordingly, cannot result into levy of capital gains tax in India.**
  - The provisions of Section 9 of Act will be attracted only when capital asset is located / situated in India.
  - The transaction should not be structured in a manner for avoidance of income tax. The investment structure should be examined and seen in a holistic manner.
  - The lump sum consideration for purchase of an entire investment cannot be allocated or dissected in order to calculate the value of specific rights and entitlements.
  - The withholding tax obligations in India would arise only when such income is taxable in India
- Vodafone judgment synopsis (by the Hon'ble HC of Bombay) which upheld the Revenue's contention that Vodafone was liable for tax deduction at source (TDS) under the Income Tax Act.
  - The submission of VIH BV that the transaction involves merely a sale of a share of a foreign company from one nonresident company to another cannot be accepted.
  - In the present case, the transaction in question had a significant nexus with India. The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The transaction between the parties covered within its sweep, diverse rights and entitlements. The Petitioner by the diverse agreements that it entered into has a nexus with Indian jurisdiction. In these circumstances, the proceedings which have been initiated by the Income Tax Authorities cannot be held to lack jurisdiction.
  - The issue of jurisdiction for the reasons already noted earlier, has been correctly decided.

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- Vodafone judgment – Retrospective Amendments in Finance Act 2012
  - **Explanation 4** has been inserted in section 9(1) (i), w.e.f. A.Y. 1962-63 to clarify that the expression 'through' (used in section 9(1) (i) in relation to any asset or source of income in India) shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of"
  - **Explanation 5** has been inserted in section 9(1) (i), w.r.e.f. A. Y. 1962-63 to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.
  - Consequent to insertion of above explanations, **the following explanations have also been added** to clarify the meaning of (a) "capital asset" given in section 2(14), (b) "transfer" given in section 2(47) and (c) to widen the scope of section 195(1).

Multinationals that own property situated in India pay taxes to the Indian government on a transfer of that property if such a transfer has resulted in a gain, termed a "capital gain".

The key factor here is that the property being transferred is situated in India; otherwise, the Indian government would have no jurisdiction to tax the transfer of property. Globally, countries do not tax capital gains unless there is some nexus with the country, such as the fact that the transferor is a resident of the taxing country or the fact that the property is situated in the taxing country.

What the Income Tax Act of 1961 did not make clear was the application of the capital gains rules to a situation where the foreign company did not sell any Indian property (i.e. property situated in India) directly. Instead, the foreign company sold Indian property indirectly by owning the Indian property though a foreign company and then transferring the shares of that foreign company. A foreign company is not considered as "situated" in India and, therefore, a transfer of the shares of a foreign company would not attract any Indian taxation.

This, simply put, was the issue in the Vodafone case. The buyer of the Indian property is usually indifferent to whether he will own the Indian property directly or indirectly through an acquisition of shares in a foreign company that owns the Indian property. Either way, the buyer is able to obtain economic control over the Indian property.

The Supreme Court decided that the Indian tax legislation did not tax indirect transfers of property. The Indian government disagreed and introduced a "clarificatory" amendment to the tax legislation that taxed the indirect transfer of property described above and had retrospective application from the inception of the Indian Income Tax Act, 1961.

The Modi government, however, refrained from making any such radical changes to the tax legislation, mindful, no doubt, of the fact that more than $2 billion in unpaid tax dues are at stake in the Vodafone case.

The explanation 5 to section 9(1) (i) has not defined clearly the meaning of "substantial" contained in the explanation. This is done by the following Delhi HC judgement that if the 50% of the value of the foreign company is derived from Indian assets, it is substantial.

Current Tax demand by the IT department on Hutchison Holdings Ltd:

The tax department has now asked Hong Kong-based Hutchison Holdings to pay up over ₹ 32,000 crore as capital gains tax, penalty and interest on the deal to sell its mobile business to Vodafone in 2007.

In a filing to the Hong Kong stock exchange, Hutchison Holdings Ltd said its unit, Hutchison Telecommunications International Ltd (HTIL), has been served with a tax demand of about ₹ 7,900 crore, an additional ₹ 16,430 crore of interest and another ₹ 7,900 crore in penalty. The demands were raised by the Indian tax department through two notices — on February 13 and August 9.

This is the first time the tax authorities have issued notices to the Hong Kong firm. Until now they had targeted Vodafone for failing to recover the tax at the time of the deal.

Arbitration proceedings under India-UK Bilateral Investment Protection Agreement (BIPA) and India-Netherlands BIPA

Mean a while, The Delhi High Court on Tuesday restrained Vodafone Group's arbitration proceeding against India, under a treaty with the United Kingdom, in connection with an Rs 11,000 crore tax demand raised against the company in relation to its $11 billion deal acquiring stake of Hutchinson Telecom.

The court noted that government was of the view that the $11 billion acquisition of stake of Hutchinson Telecommunications International Limited (HTIL) in Hutchinson Essar Limited (HEL) by Vodafone was liable for tax deduction at source (TDS) under the Income Tax Act.

Thereafter, the government made a retrospective amendment to the Income Tax Act which re-fastened the liability on Vodafone, the high court order noted.

Aggrieved by the imposition of tax, VIHBV invoked the arbitration clause under the BIPA between India and Netherlands through a notice of dispute of April 17, 2012 and notice of arbitration of April 17, 2014, the 10 page order said.

While the proceedings under the India-Netherlands BIPA was pending, Vodafone initiated arbitration under the India-UK BIPA on January 24 this year.

Questions that arise:

1. Hutchison HK has announced that it is discontinuing its telecom business in India
2. Vodafone International Holdings has submitted to FIPB of its intention to acquire telecom interests in India
3. Hutchison- Vodafone deal was structured based on Business value of Hutchison Essar Ltd (Indian telecommunication business) in India
4. The sale of one share in Cayman islands need not be structured with so many complexities unless the controlling Interest involved multiple entities in India
5. The arbitration award under **India-Netherlands BIPA** is still pending though the application under **India-UK Bilateral Investment Protection Agreement (BIPA)** was stalled by the Supreme Court. Will the award override the retrospective amendment to section 9(1) (i) of the IT Act, like the arbitration award of London in the DoCoMo case where the Delhi HC concluded that the Indian courts cannot sit in judgement over International arbitration awards?
6. Now that the Indian Government has chosen to proceed against the seller of shares in the deal, Hutchison Holdings, demanding Capital Gains Tax, interest and penalties, will the parallel claim against Vodafone under section 195 of the IT Act for failure to deduct withholding tax be maintainable?
   a. Tax experts said the move to issue notices to Hutchison could backfire. “This weakens the tax department’s case against Vodafone in the tribunal as you cannot ask two entities to pay the same tax. In effect, the tax department has conceded its case against Vodafone. Hutchison will contest this claim, and the legal arguments have to be heard all over again,” said a Mumbai-based tax lawyer.

Facts about the players:

Hutchison Asia Telecommunications Limited, formerly **Hutchison Telecommunications International Limited**, is a multinational telecommunications Services Company headquartered in Hong Kong and a wholly owned subsidiary of Hutchison Whampoa. It operates GSM mobile telecommunications services in Sri Lanka and Vietnam, and CDMA services in Indonesia under brands including *Hutch*, *3*and *Vietnamobile*.

Hutchison Telecom was formerly a listed company with a primary listing on the Hong Kong Stock Exchange (stock code: SEHK: 2332) and American Depositary Shares quoted on the New York Stock Exchange. In May 2010, Hutchison Telecom became a fully owned subsidiary of the Hong Kong-based Hutchison Whampoa Group and its shares were delisted.[1]

In early 2007, Hutchison Telecom made headlines by selling its 67% interest in the Indian mobile phone network Hutch Essar to Vodafone for US$13.1 billion (of which $2 billion was debt).

Hutchison India

Hutchison Essar Limited started operations under the brand name "Orange" in Mumbai. In other states it was marketed under "Hutch" brand. It was then changed to "Hutch" nationwide when they expanded rapidly to become the third largest mobile service provider in India and furthered its market share through the acquisition of BPL, Fascel, and Command & Aircel Digilink. On March 31, 2007 Hutch Essar sold its 67.1% stake to Vodafone.

Vodafone International Holdings BV

Vodafone International Holdings B.V. is a holding company that owns and operates telephone networks in The Netherlands. The company offers mobile communication networking, short message service (SMS), paging, and data communication services. The company is based in Capelle Aan Den Ijssel, the Netherlands. Vodafone International Holdings B.V. operates as a subsidiary of Vodafone Group Public Limited Company.

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MUMBAI, AUGUST 29: The tax department has asked Hong Kong-based Hutchison Holdings to pay up over ₹ 32,000 crore as capital gains tax, penalty and interest on the deal to sell its mobile business to Vodafone in 2007.

In a filing to the Hong Kong stock exchange, Hutchison Holdings Ltd said its unit, Hutchison Telecommunications International Ltd (HTIL), has been served with a tax demand of about ₹ 7,900 crore, an additional ₹ 16,430 crore of interest and another ₹ 7,900 crore in penalty. The demands were raised by the Indian tax department through two notices — on February 13 and August 9.

This is the first time the tax authorities have issued notices to the Hong Kong firm. Until now they had targeted Vodafone for failing to recover the tax at the time of the deal. Vodafone had challenged the tax, saying it did not make any gains on the deal. The British telecom major also argued that since the transaction was not between Indian entities, there was no tax liable to be paid in India.

Tax authorities argued that Vodafone should have recovered the tax on Hutchison's before concluding the deal, and that though the transaction was between two foreign entities, since the underlying assets are in India, there was a tax liability.

The dispute came before the Supreme Court in January 2012; it ruled that the company was not liable to pay any tax over the acquisition of assets in India from Hutchison. But in May 2012, the Centre amended the tax laws with retrospective effect and again claimed taxes. Vodafone then filed a complaint with the international arbitration panel. The panel is yet to give its ruling; Indian tax authorities have now issued the notices to Hutchison.

The Hong Kong-based company, in its filing to the exchange, said the taxes cannot be validly imposed on it as the Supreme Court had, in January 2012, ruled that the 2007 deal was not taxable in India. It said the tax demand violates the principles of international law.

Hutchison may contest

Tax experts said the move to issue notices to Hutchison could backfire. "This weakens the tax department's case against Vodafone in the tribunal as you cannot ask two entities to pay the same tax. In effect, the tax department has conceded its case against Vodafone. Hutchison will contest this claim, and the legal arguments have to be heard all over again," said a Mumbai-based tax lawyer.

Vodafone, challenging the tax bill over its $11 billion deal to buy Hutchison Whampoa Ltd's Indian mobile business in 2007, had appealed to the Supreme Court after losing the case in the Bombay High Court in 2010.

"The government has no jurisdiction over Vodafone's purchase of mobile assets in India as the transaction took place in Cayman Islands between HTIL & Vodafone," Chief Justice S.H. Kapadia said.

He said for the stability of investors should know where they stand.

He said Hutch Essar, whose Indian operations were acquired by Vodafone, was not a fly-by-night operator and was in India since 1994 and had contributed Rs 20,242 crore by way of direct and indirect taxes.

Justice Kapadia delivered the majority judgment alone with Justice Swatanter Kumar. However, Justice K.S. Radhakrishnan differed with the judgment.

The judgement of Bombay HC that upheld the Revenue's contention that the underlying asset is the controlling interest in Hutchison Enterprises Limited in India and held that the taxable provisions of Income deemed to accrue or arise in India under section 9(1)(i), Capital Gains u/s 45, Withholding tax provisions under s195 are applicable

The judgement of the Hon'ble SC that the underlying asset is not in India and hence none of the above will be applicable.

Vodafone-Tax-judgment-Bombay-High-

SC -Vodafone_Internati

The word substantial in the explanation 5 defined:

- **DIT (IT) v. Copal Research Limited, Mauritius and Ors, W.P. (C) 2033, 2470, 2590, 2597/ 2013 dated 14/8/2014 (Delhi HC)**
    - Explanation 5 to section 9(1)(i) of the Income-tax Act, 1961 ("the Act") introduced by the Finance Act 2012 is no longer *res integra* in view of the pronouncement by the Delhi High Court.
    - In its recent judgement in the case of DIT vs. Copal Research Limited And Ors.: W.P. 2033/2013, the Delhi High Court has held that gains arising from sale of shares of a company incorporated overseas, which derives **less than 50%** of its value from assets situated in India would not be taxable under section 9(1) (i) of the Act.

Retrospective amendment to section 9(1) (i) of the IT Act, 1961 to cover indirect transfer of property located in India:

The SC judgement resulted in the amendment of section 9(1) (i) of the IT Act 1961 which provided that

9. (1) the following incomes shall be deemed to accrue or arise in India:—

(*i*) All income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or

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from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India:

Section - 9, Income-tax Act, 1961-2017

Income deemed to accrue or arise in India.

9. (1) the following incomes shall be deemed to accrue or arise in India:—

[29](*i*) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1.—for the purposes of this clause—

(*a*) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

(*b*) In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;

(*c*) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India ;

(*d*) In the case of a non-resident, being—

(*1*) An individual who is not a citizen of India; or

(*2*) A firm which does not have any partner who is a citizen of India or who is resident in India; or

(*3*) A company which does not have any shareholder who is a citizen of India or who is resident in India,

No income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India;

[30][(*e*) in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to the display of uncut and unsorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf.]

Explanation 2.—for the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

(*a*) Has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

(*b*) Has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(*c*) Habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business:

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

Explanation 3.—where a business is carried on in India through a person referred to in clause (*a*) or clause (*b*) or clause (*c*) of *Explanation 2*, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India:

[31] **[Provided** *that nothing contained in this* Explanation *shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in a Foreign Institutional Investor as referred to in clause* (a) *of the* Explanation *to* *section 115AD* *for an assessment year commencing on or after the 1st day of April, 2012 but before the 1st day of April, 2015:*]

[32]**[Provided further** *that nothing contained in this* Explanation *shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992).*]

[33][*Explanation 6.*—for the purposes of this clause, it is hereby declared that—

(*a*) The share or interest, referred to in *Explanation 5*, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if, on the specified date, the value of such assets—

(*i*) Exceeds the amount of ten crore rupees; and

(*ii*) represents at least fifty per cent of the value of all the assets owned by the company or entity, as the case may be;

(*b*) the value of an asset shall be the fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in such manner as may be prescribed;

(*c*) "Accounting period" means each period of twelve months ending with the 31st day of March:

Provided that where a company or an entity, referred to in *Explanation 5*, regularly adopts a period of twelve months ending on a day other than the 31st day of March for the purpose of—

(*i*) Complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or

(*ii*) Reporting to persons holding the share or interest,

Then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:

Provided further that the first accounting period of the company or, as the case may be, the entity shall begin from the date of its registration or incorporation and end with the 31st day of March or such other day, as the case may be, following the date of such registration or incorporation, and the later accounting period shall be the successive periods of twelve months:

Provided also that if the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist;

(*d*) "Specified date" means the—

(*i*) date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest; or

(*ii*) date of transfer, if the book value of the assets of the company or, as the case may be, the entity on the date of transfer exceeds the book value of the assets as on the date referred to in sub-clause (*i*), by fifteen per cent.

Explanation 7. — For the purposes of this clause,—

(*a*) no income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the *Explanation 5*,

(*i*) if such company or entity directly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, neither holds the right of management or control in relation to such company or entity, nor holds voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, of such company or entity; or

(*ii*) if such company or entity indirectly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, neither holds the right of management or control in relation to such company or entity, nor holds any right in, or in relation to, such company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India, nor holds such percentage of voting power or share capital or interest in such company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

(*b*) in a case where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity referred to in the *Explanation 5,* are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed;

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(*c*) "Associated enterprise" shall have the meaning assigned to it in section 92A;]

(*ii*) Income which falls under the head "Salaries", if it is earned in India.

Explanation.—for the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—

(*a*) Service rendered in India; and

(*b*) The rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment,

Shall be regarded as income earned in India;

(*iii*) Income chargeable under the head "Salaries" payable by the Government to a citizen of India for service outside India;

(*iv*) A dividend paid by an Indian company outside India;

(*v*) Income by way of interest payable by—

(*a*) The Government; or

(*b*) a person who is a resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(*c*) a person who is a non-resident, where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India ;

[34][*Explanation.*—for the purposes of this clause,—

(*a*) it is hereby declared that in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment in India of such non-resident to the head office or any permanent establishment or any other part of such non-resident outside India shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the permanent establishment in India and the permanent establishment in India shall be deemed to be a person separate and independent of the non-resident person of which it is a permanent establishment and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly;

(*b*) "Permanent establishment" shall have the meaning assigned to it in clause (*iiia*) of section 92F;]

(*vi*) Income by way of royalty payable by—

(*a*) The Government; or

(*b*) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(*c*) A person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government :

Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.

Explanation 1.—For the purposes of the first proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date; so, however, that, where the recipient of the income by way of royalty is a foreign company, the agreement shall not be deemed to have been made before that date unless, before the expiry of the time allowed under sub-section (1) or sub-section (2) of section 139 (whether fixed originally or on extension) for furnishing the return of income for the assessment year commencing on the 1st day of April, 1977, or the assessment year in respect of which such income first becomes chargeable to tax under this Act, whichever assessment year is later, the company exercises an option by furnishing a declaration in writing to the Assessing Officer (such option being final for that assessment year and for every subsequent assessment year) that the agreement may be regarded as an agreement made before the 1st day of April, 1976.

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(*i*) The transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(*ii*) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*iii*) The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(*iv*) The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(*iva*) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(*v*) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(*vi*) The rendering of any services in connection with the activities referred to in sub-clauses (*i*) to (*iv*), (*iva*) and (*v*).

Explanation 3.—for the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(*a*) The possession or control of such right, property or information is with the payer;

(*b*) Such right, property or information is used directly by the payer;

(*c*) The location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;

(*vii*) Income by way of fees for technical services payable by—

(*a*) The Government; or

(*b*) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(*c*) A person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.

Explanation 1.—for the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Explanation 2.—For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

(2) Notwithstanding anything contained in sub-section (1), any pension payable outside India to a person residing permanently outside India shall not be deemed to accrue or arise in India, if the pension is payable to a person referred to in article 314 of the Constitution or to a person who, having been appointed before the 15th day of August, 1947, to be a Judge of the Federal Court or of a High Court within the meaning of the Government of India Act, 1935, continues to serve on or after the commencement of the Constitution as a Judge in India.

Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (*v*) or clause (*vi*) or clause (*vii*) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—

(*i*) The non-resident has a residence or place of business or business connection in India; or

(*ii*) The non-resident has rendered services in India.

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Before the Bombay HC – Vodafone International Holdings' petition questioning the IT Dept.'s jurisdiction to levy Tax demand and interest was dismissed and the HC upheld the Revenue department's jurisdiction to levy tax for non-compliance of the provisions of withholding tax under section 195

- On 10 February 2007, Vodafone Group Plc made a final binding offer of US $ 11.076 billion, based on an enterprise value of US $ 18.800 billion of HEL

- The VIH BV requested the FIPB to take note and grant approval under Press Note 1 to the indirect acquisition of a 51.96% stake in HEL through an overseas acquisition of the entire share capital of CGP from HTIL.

- On 23 March 2007, the Additional Director of Income Tax (International Taxation) Range 2, Mumbai, issued a letter to HEL intimating that both Vodafone Group Plc and Hutchison Telecom group announcements evidenced that HTIL had made substantial gains. HEL was consequently requested to impress upon HTIL/Hutchison Telecom group to discharge tax liability on gains, before they cease operations in India. Additionally, the attention of HEL was drawn to Sections 195 and 197 of the Act. The letter seemed to proceed on the basis that the shares of HEL were being sold and that hence HEL would be in a position to get the requisite information.

- The OECD Model is illustrative of the manner in which a value driven deeming nexus may be created by legislation. Thus, capital gains derived from an alienation of shares which derives more than fifty per cent of their value from immovable property situated in another Contracting State may be taxed in that State. Hence, where the underlying asset is land situated in the source State and where a transfer of shares in a foreign company or other entity owning the land results in an effective transfer of ownership of the land the source State may by legislation impose the tax.

- Counsel for VIH BV has stated before the Court that if and when the put agreements are enforced, there would be an acquisition of the shares of an Indian company upon which capital gains would be liable to be taxed under Indian tax legislation.

- Section 195 The Supreme Court held that “the assessee was not bound to deduct tax at source once Explanation 2 to Section 10(15) (iv) (c) stood inserted as TDS arises only if the tax is assessable in India”. Since tax was not assessable in India, there was no question of TDS being deducted by the assessee

- The equity value of HTIL’s 100% stake in CGP was computed on the basis of HELs enterprise value of US $ 18,250 million and by computing 66.9848% of equity value. The entire value that was ascribed to HTIL’s stake in CGP was computed only on the basis of the enterprise value of HEL.

- The crux of the submission is that the entire transaction in the case is subsumed in the transfer of a share of an upstream overseas company which exercised control over Mauritian companies. As we have noted earlier, it is simplistic to assume that all that the transaction involved was the transfer of one share of an upstream overseas company which was in a position to exercise control over a Mauritian company. The transaction between VIH BV and HTIL was a composite transaction which covered a complex web of structures and arrangements, not referable to the transfer of one share of an upstream overseas company alone. The transfer of that one share alone would not have been sufficient to consummate the transaction. The transaction documents are adequate in themselves to establish the untenability of the Petitioner's submissions.

- The transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH BV. Intrinsic to the transaction was a transfer of other rights and entitlements. These rights and entitlements constitute in themselves capital assets within the meaning of Section 2(14) which expression is defined to mean property of any kind held by an assessee.

- In the present case, the transaction in question had a significant nexus with India. The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The transaction between the parties covered within its sweep, diverse rights and entitlements. The Petitioner by the diverse agreements that it entered into has a nexus with Indian jurisdiction. In these circumstances, the proceedings which have been initiated by the Income Tax Authorities cannot be held to lack jurisdiction.

- The issue of jurisdiction for the reasons already noted earlier, has been correctly decided.
- For the reasons which we have indicated, we do not find any merit in the petition. The petition is dismissed

1. Transnational law recognizes that the jurisdiction of a State to tax non-residents is based on the existence of a nexus of the person sought to be taxed or his activities with the taxing jurisdiction. Such nexus may exist either as a result of physical presence or, in relation to the source rule, where the income earned by the non-resident has a source in the taxing jurisdiction.
2. Counsel for VIH BV has stated before the Court that if and when the put agreements are enforced, there would be an acquisition of the shares of an Indian company upon which capital gains would be liable to be taxed under Indian tax legislation.
3. For HTIL the transaction represented a discontinuation of its operations in India upon which it had generated a profit of H.K. $ 70,502 million. From the proceeds of the transaction, HTIL declared a transaction special dividend to its shareholders. From HTIL's perspective it had carried on "Indian mobile telecommunications operations" which were being discontinued as a result of the transaction.

4. On 22 December 2006, Vodafone in its announcement stated that the mobile market in India has great potential and that it was considering the acquisition of a controlling interest in Hutch Essar which would be consistent with its strategy of seeking selective acquisition opportunities in developing markets.
5. The equity value of HTIL's 100% stake in CGP was computed on the basis of HELs enterprise value of US $ 18,250 million and by computing 66.9848% of equity value. The entire value that was ascribed to HTIL's stake in CGP was computed only on the basis of the enterprise value of HEL.
6. A Sale Purchase Agreement ("SPA") was entered into on 11 February 2007 between Hutchison Telecommunications International Limited (HTIL) and Vodafone International Holdings B.V. The Agreement contains the following two recitals:
    a. "(A) CGP is an indirect wholly owned subsidiary of the Vendor. CGP owns, directly or indirectly, companies which control the Company Interests,
    b. (B) The Vendor has agreed to procure the sale of, and the Purchaser has agreed to purchase, the entire issued share capital of CGP on the terms and conditions set out in this Agreement. The Vendor has further agreed to procure the assignment of, and the Purchaser has agreed to accept an assignment of, the Loans on the terms and conditions set out in this Agreement and the Loan Assignments."

    'Company interests' are defined to be the aggregate interests in 66.9848 % of the issued share capital of Hutchison Essar Limited (HEL).

7. By and as a result of the SPA, HTIL was relinquishing its interest in the telecommunications business in India and VIH BV was acquiring the interest which was held earlier by HTIL.
8. Clause 28.7 provided that the term sheet would be governed by and in accordance with the laws of India.
9. By a letter dated 19 March 2007 VIH BV informed the FIPB that the price of US $ 11.08 Billion "includes a control premium, use and rights to the Hutch brand in India, a non-compete agreement with the Hutch group, the value of nonvoting non-convertible preference shares, various loan obligations and the entitlement to acquire, subject to Indian foreign investment rules, a further 15 % indirect interest in Hutch Essar".
10. The facts clearly establish that it would be simplistic to assume that the entire transaction between HTIL and VIH BV was fulfilled merely upon the transfer of a single share of CGP in the Cayman Islands. The commercial and business understanding between the parties postulated that what was being transferred from HTIL to VIH BV was the controlling interest in HEL
11. The due diligence report by Ernst & Young emphasizes that the object and intent of the parties was to achieve the transfer of control over HEL and the transfer of the solitary share of CGP, a Cayman Islands company was put into place at the behest of HTIL, subsequently as a mode of effectuating the goal.

12. The transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH BV. Intrinsic to the transaction was a transfer of other rights and entitlements. These rights and entitlements constitute in themselves capital assets within the meaning of Section 2(14) which expression is defined to mean property of any kind held by an assessee.
13. VIH BVs disclosure to the FIPB is indicative of the fact that the consideration that was paid to HTIL in the amount of US $ 11.01 Billion was for the acquisition of a panoply of entitlements including a control premium, use and rights to the Hutch brand in India, a non-compete agreement with the Hutch group, the value of nonvoting non-convertible preference shares, various loan obligations and the entitlement to acquire subject to Indian foreign investment rules, a further 15% indirect interest in HEL. From the perspective of Income Tax Law what is relevant is the place from which or the source from which the profits or gains have generated or have accrued or arisen to the seller. The income accrued and arose and was derived as a consequence of the divestment of HTIL's interest in India. If there was no divestment or relinquishment of its interest in India, there was no occasion for the income to arise. The real taxable event is the divestment of HTIL's interests which comprises in itself various facets or components which include a transfer of interests in different group entities.
14. As to the obligation to deduct tax under Section 195, in the present case, the transaction in question had a significant nexus with India. The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The transaction between the parties covered within its sweep, diverse rights and entitlements. The Petitioner by the diverse agreements that it entered into has a nexus with Indian jurisdiction. In these circumstances, the proceedings which have been initiated by the Income Tax Authorities cannot be held to lack jurisdiction.
15. The liability to levy of penalty can be fastened only on the person who does not have good and sufficient reason for not deducting the tax" the burden being on the person to prove the existence of good and sufficient reasons.

RELEVANT PROVISIONS OF INCOME-TAX ACT TO BE COMPLIED WITH BY NON-RESIDENTS PLANNING TO SET UP BUSINESS IN INDIA; AND RESIDENTS DEALING WITH NON-RESIDENTS

S. No.	Section	Particulars

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3.	5	Scope of total income.
4.	6	Residence in India.
5.	7	Income deemed to be received in India
6.	9	Income deemed to accrue or arise in India.
7.	9A	Certain activities not to constitute business connection in India
8.	10	Incomes not included in total income
9.	28	Profits and gains of business or profession
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11.	40(a)(iii)	Salary payable outside India or to a non-resident not deductible in case of TDS default
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14.	44BBA	Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents.
15.	44BBB	Special provision for computing profits and gains of foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects.
16.	44C	Deduction of head office expenditure in the case of non-residents
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20.	47	Transactions not regarded as transfer
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43.	97	Arrangement to lack commercial substance
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47.	101	Framing of guidelines.
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51.	115A	Tax on dividends, royalty and technical service fees in the case of foreign companies.
52.	115AB	Tax on income from units purchased in foreign currency or capital gains arising from their transfer
53.	115AC	Tax on income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer.
54.	115ACA	Tax on income from Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer
55.	115AD	Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer
56.	115BBA	Tax on non-resident sportsmen or sports associations.
57.	115BBD	Tax on certain dividends received from foreign companies
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62.	115G	Return of income not to be filed in certain cases.
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