



INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE AND MANAGEMENT

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VODAFONE TAX DISPUTE: A SAGA

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ABSTRACT

Nowadays, tax disputes are one of the most celebrated disputes, which hit the headlines of the print and television media. In a recent development, the telecom giant Vodafone International Inc. has been alleged to be involved in a tax evasion. The Authorities have asked the Vodafone International to pay a very heavy amount because of capital gain from the acquisition of Hutch Essar. The Author has also deeply discussed 1) the entire facts, right from the pre-acquisition times to the time after acquisition; 2) the contentions raised by both the parties; 3) the judgment of the Hon'ble High Court and 4) the latest development in the tax evasion incident.

KEYWORDS

Acquisition, Contention, Evasion, Vodafone.

INTRODUCTION

Mergersⁱ, Acquisitionsⁱⁱ and Takeoversⁱⁱⁱ have been a part of the business world for centuries. In today's dynamic economic environment, companies see themselves placed to face such a situation, where they need to take decisions concerning these actions - after all, the job of the management is to maximize the shareholder's value. Through mergers and acquisitions, a company can develop a competitive advantage and ultimately increase the shareholder's value.

Today, Mergers, Acquisitions, and Amalgamations^{iv} have now become significant news and hence, one can see, read, and discuss the issue of merger or amalgamation through the business column of the newspapers. Some of such classic examples are Mahindra & Mahindra's takeover of 90 percent stake in Schoneweiss, a family-owned German company^v; what hit the headlines early 2007 was Tata's takeover of Corus^{vi}. Tata again made itself available on the headlines in June 2008, when it declared about the complete acquisition of Jaguar-Land Rover, a British luxury marquee brand^{vii} and lastly, RSM Ambit's acquisition by PricewaterhouseCoopers.

Sometimes, such merger or amalgamation turns out to be mere news or a rumor, but now, there is news that in turn forms to be a major issue in relation to the aftermath of such a merger or amalgamation. Many at times, it has been observed that, one company is successful to take over the other company, but failed to run the company in which it was supposed to be done by the acquirer company.

However, now apart from all these matters, one more issue which stands tall is the taxation issue, in respect to the tax implications for the acquisition of the other company, wherein this has an entity working in India. The foreign established firms acquiring the foreign firms, which also have an established Indian arm, have now started to raise a major question of the applicability of the Indian tax implications on all of them.

The same issue created a divided opinion in the society of the tax applicability upon the global telecommunication company Vodafone International Holdings B.V. based in United Kingdom, which had acquired Hutchison Essar Limited in 2007. However, in regards to the arguments made by the petitioner (Vodafone), both the acquirer as well as acquired are the Overseas Corporate Bodies and therefore they should not be liable for the purpose of the payment of income tax to the Income Tax Authorities.

The Author would attempt to throw some light upon the same issue in the light of the Vodafone tax liability.

THE ACQUISITION

Vodafone International Holdings B.V.^{viii} (VIH), Netherlands decided to acquire the Indian arm i.e. Hutchison Essar Limited (HEL) of Hutchison Telecommunication International Ltd.^{ix} (HTIL) for a huge amount of \$ 11.076 billion (about Rs. 55,000 crore).

HTIL came to establish its network in India with an entity by the name of Hutchison Max Telecom Ltd. (HMTL) (the name got itself replaced with Hutchison Essar Limited- HEL in August 2005). Max Telecom Venture (an Indian Entity) had a 50% stake in the share capital, Hutchison Telecommunications (India) Ltd. Mauritius (HTM) kept a 49% stake of the share capital with itself, and another company held the remaining 1 %.

However, in 1998, MTV sold a 40% stake in HMTL to Telecom Investments India Ltd. (TII). In 2004, Essar purchased the 40% stake of Distacom in HTC which was then transferred to HTI BVI Holdings Ltd. HTM transferred its 19.6% of its holding in HMTL to the Essar Group. In 2006, Kotak Group sold its 51% stake in TII to ND Callus Info Services Pvt. Ltd. Simultaneously, Centrino Trading Co. Pvt. Ltd. subscribed to 23.97% stake in TII. In 2006, the Hinduja Group, which held a 5.11% stake in HEL, sold its stake to Hutchison Group.

Hutchison, after obtaining the license for Mumbai Circle in November 1994, was successful in acquiring the license by Department of Telecommunication (DOT) to enter into the Delhi, Gujarat and Kolkata Circles way back in 1994, 1995 and 1997 respectively; however, the company actually established the network in December 1999, September 2000, and July 2000 respectively.

In December 2006, HTIL, in its press statements, revealed about some interest shown by the potential buyers for a sale of its Indian arm (HEL) of the telecom company. On December 22'06, Vodafone made an offer for a sum of US \$ 11.055 billion (being originally valued at US \$ 16.5 billion), in cash to HTIL for its share in HEL. On February 9'07, Vodafone then submitted a revised offer to HTIL for US \$10.708 billion (being valued at US \$ 18.250 billion). Finally, on February 10'07, Vodafone placed a final binding offer of US \$ 11.076 billion for the purchase of HEL.

The entire proceedings of the acquisition took place at the Cayman Islands^x. Now, the primary point to consider and ponder is that, after the acquisition of Hutchison Essar in 2007, the acquirer company took the charge of the Indian arm of the acquired company, which was having a considerable stake in the telecom market in India.

On February 20'07, Vodafone (VIH) wrote an application addressing (Foreign Investment Promotion Board) FIPB^{xi} stating its direct and indirect acquisition in Bharti Airtel and HEL and requested FIPB to take the note of the same and grant the approval of its 52 % stake in HEL.

HTIL, on the other hand, on February 22'07, informed Hong-Kong Stock Exchange about the declaration of a special dividend to its shareholders^{xii} and utilizing sale proceeds^{xiii} in reducing the debt and the remaining amount be utilized for the telecommunication business.

On February 28'07, FIPB wrote a letter to HEL, regarding to the foreign holdings also including the Indian holdings^{xiv} in the same. However, on March 14'07, FIPB wrote a letter addressing the Vodafone as well as HTIL about the clarification in the actual holding of the Vodafone in HEL.

In a clarifying letter written by HEL, the true picture of the complete holdings was displayed, by stating the contrast in the holding was due to the difference in the declarations given by the US and Indian GAAP^{xv,xvi} and therefore, FIPB was able to access such a difference in the holding of the Vodafone. In addition, in a separate letter to FIPB, Vodafone explained in detail about their holding in HEL according to the Indian GAAP.

On March 15'07, the Joint Director of Income Tax (International Taxation) issued a notice to HEL u/s 133 (6)^{xvii} of the Income Tax Act, 1961 (hereinafter referred as IT Act). The notice issued was about the seeking of the information of the sale of stake by HTIL in HEL to Vodafone, including the Shareholder Agreements and the details of the acquisition of the share capital of CGP.

On March 19'07, FIPB wrote a letter to Vodafone seeking the information about the circumstances under which the company had acquired HEL for US \$11.08 billion. FIPB was addressed the answer on the very same day in regards to the above stated letter. On March 22'07, HEL replied to the letter issued by FIPB on March 15'07. On March 22'07 only, FIPB addressed a letter to Vodafone seeking the break-up valuation of the entire amount along with the relevant documents. On March 23'07, in a letter addressed to HEL by the Joint Director of Income Tax (International Taxation), was asked to pay the tax on the Capital Gains (by HTIL), else there would be a cessation of its operations in India. On March 27'07, Vodafone in its letter gave detailed information of its stake in CGP along with the Non-Compete Agreement with HTIL.

Finally, on April 9'07, HTIL filed all the agreement papers pertaining to the transactions with FIPB and on May 7'07, FIPB conveyed its approval of the transactions to the Vodafone Group.

On August 6, FIPB issued a show-cause notice to VEL u/s 163^{xviii} of the IT Act pertaining to any of the objection by VEL for treating the same as a representative assessee of the Vodafone Group. FIPB, on September 19, issued a notice to the Vodafone Group u/s 201 (1)^{xx} and 201 (1A)^{xx} of the IT Act of not treating the Vodafone Group as assessee-in-default for the failure of withhold tax.^{xxi,xxii}

In a Special Leave Petition^{xxiii}, the Hon'ble Supreme Court on January 23'09 directed the Respondents to determine the jurisdictional challenge raised by the Petitioner.^{xxiv} Subsequently, in the second show-cause notice addressed to the Petitioner on October 30'09, the Petitioner filed a reply on January 28'10. On May 31'10, the Respondent passed an order upholding the jurisdictional power of the same. On the very same day, the Petitioner was addressed another show-cause notice u/s 163 of the IT Act for a reason as to not to treat them as an agent assessee of HTIL.

CONTENTIONS

PETITIONER'S CONTENTIONS

In the Hon'ble Bombay High Court, the Petitioner contended that:

1. The shares acquired by them of the Mauritian Companies would be devoid of the capital tax because of the 'Double Tax Treaty' entered into by India and Mauritius;
2. Secondly, the gain, which ultimately arises upon the transfer of the asset to them, cannot be a subject to tax, because the asset is not in India and thus Section 195^{xxv} of the IT Act would not apply.

The Petitioner in its submission thus primarily stated that:

1. There was an acquisition of 65% of the shares of HEL by them and which, has been accepted by FIPB;
2. The imposition of the tax can only be done, in case when the income either is received in India or accrues or arises in India or is deemed to accrue or arise in India;
3. Capital Gain arises, when there is a transfer of asset situated in India, but CGP is entirely situated outside India;
4. Moreover, if there is any acquisition of the shares of an Indian Company being held by any Mauritian Company, due to Indo-Mauritius Tax Treaty, Capital Gain tax liability would automatically vanish;
5. There is no requirement to obtain a permission before the transfer of share, but only a reporting to FIPB is required to be done;
6. Moreover, Section 195 of the IT Act, applies only when the assessee is having some or the other nexus with India and thus, a foreign entity having no office in India is not obliged to pay the tax to the Indian authorities.

RESPONDENT'S CONTENTIONS

In the contentions stated by the Respondents, they stated that:

1. Sale Purchase Agreement (SPA) and other relevant documents establish the fact that there was not only the acquisition of the CGP shares that took place at the Cayman Islands but there was also a transfer of the rights from HTIL in HEL to the Petitioner. Therefore, it establishes a clear-cut territorial nexus between the Petitioners with India and thus, needs to pay the tax on the Capital Gain.

The Respondents in its submission thus primarily stated that:

1. The acquisition of the shares of CGP was only a part of the whole transaction. Out of the acquired 67% stake in HEL; 52% is a direct and indirect acquisition in HEL and through the Call Option, a further of 15% stake in the companies held by Asim Ghosh, Analjit Singh and IDFC;
2. HTIL also transferred the Framework Agreement, Management Rights in HEL, the Hutch brand etc. Therefore, the entire sum paid, is not only for the share of CGP, but also for in lieu of all these transfers by HTIL in HEL;
3. There would have been no need to take the approval from FIPB had it been only the acquisition of shares of CGP, but the Petitioner floated an offer of US \$ 6 billion to acquire a 33% stake in Essar's interest in HEL. The Petitioner would have operational control of HEL while Essar would have rights consistent with its shareholding, including a proportionate Board representation;
4. HTIL and the Petitioner entered into the agreement in relation to the interest held by eight Mauritian companies in HEL, interest held in TII, Omega, Asim Ghosh and Analjit Singh's companies. Also, some of the other things included the availability of the telecom licenses held by Hutch in India, the Hutch brand and the right to appoint/remove directors in the board of HEL;
5. HEL is an Indian company, having a fully established business in India, it also have telecom licenses granted to its name. The transfer of shares of CGP by HTIL to the Petitioner would attribute to be a Capital Gain, thus liable to pay tax on such gain^{xxvi}.
6. The divestment of the shares by HTIL to the Petitioner would result in the acquisition of capital asset in India and thus would attract Section 195 of the IT Act.
7. The mode of the transfer is not to be looked upon the transferred shares of CGP to the Petitioner in themselves are the assets.
8. The primary subject matter is the acquisition of assets in India and therefore, Section 195 of the IT Act would apply. In the definition of "Person", it is not only the Indian Resident, but it also includes the Non-Resident too.
9. The transfer of asset from HTIL to the Petitioner entirely lies in India and this is evident from the requirement of the permission from FIPB. The acquisition took place, just to increase the network business by the Vodafone Group.

The Supreme Court in its 1967 judgment of *CIT v. Motors and General Stores (P) Ltd*,^{xxvii} held that the true principle of the taxing statute is that it needs to be applied in accordance with the legal rights of the parties to the transaction. The ordinary rules of construction should be applicable in case where the meaning of the words used in the language is to be construed.

In *Mathuram Agrawal v. State of Madhya Pradesh*^{xxviii}, the Supreme Court stated that where the language is plain and unambiguous, the intention of the Legislature should be gathered from the language itself.

DOUBLE TAX AVOIDANCE AGREEMENT

India entered into the Double Tax Avoidance Agreement with several countries in order to increase mutual trade and investment.^{xxix} A person is supposed to pay the tax in the resident country and need not to pay the same in the source country.

The source country can also ask for the tax, but that needs to be the same, which is prescribed in the agreement. The tax is to be levied on the gross receipt without the deduction of the expenses. India entered into the Double Tax Avoidance Agreement with Mauritius in 1983-84.^{xxx}

In an article written by Prof. Michael J. Graetz of Yale Law School, "Foundations of International Income Taxation"^{xxxi}, he said that only the source or a residential country is having the right to implement the tax. The double taxation (i.e. both by the residential as well as the source country) would indeed be unfair and would create substantial trade barriers between the two nations.

Explanation 2 of Section 9 of IT Act states about the concept of "Business Connection". A Business Connection is such, wherein on behalf of a Non-Resident, the agent complies the business in India or maintains the stock of goods and merchandise on his behalf etc.

The Bombay High Court, thus passed an order, in which they stated that the Petitioner has acquired an asset in India and therefore, is required to pay a sum of Rs. 12,000 crore (US \$ 1.7 billion) as a tax on the Capital Gain.

The Petitioner then filed an appeal in the apex Court of India i.e. the Supreme Court. However, the Supreme Court as of now^{xxxii} has adjourned the hearing of the said celebrated tax dispute. Further, the Supreme Court has asked the Petitioner to deposit Rs. 2,500 crore (US \$ 0.5 billion)^{xxxiii} and has been asked to furnish another Rs. 8,500 crore (US \$ 1.75 billion)^{xxxiv} as a bank guarantee before proceeding with the appeal challenging the order given by the Income Tax department^{xxxv}.

CONCLUSION

In the end, the author would like to say that, since the ball is on the court of the Supreme Court and the proceedings along with the judgment is awaited by all. It would be interesting to know the stand, which the apex court takes after the proceedings, and averments are completed. One has to wait and follow-up the entire matter.

However, strong reasons has been provided to by the Bombay High Court while giving the judgment, therefore will the Supreme Court follow the same reasons or will it go to the other side of the road, all the answered would be complete after the judgment of the Supreme Court.

ⁱ A Merger is a full or a complete joining of the two separate companies by drawing out a third new entity by dissolving rest of the two entities.

ⁱⁱ An Acquisition is taking over the possession of another business.

ⁱⁱⁱ A Takeover is the other name given to Acquisition.

^{iv} Amalgamation is a combination of two or more firms into one firm.

^v It was a deal worth US \$ 0.3 billion.

^{vi} It was a deal worth US \$ 10 billion.

^{vii} It was a deal worth US \$ 2.3 billion.

^{viii} A global telecommunication giant, which has a controlling stake with Vodafone Group Plc. based at United Kingdom, having a market capitalization of a whopping amount of £92 billion (US \$ 123 billion) and around 332 million mobile subscribers all over the world.

^{ix} Another telecommunication company based in Hong-Kong

^x Cayman Islands are the British Overseas Territory located in the Western Caribbean Sea.

^{xi} FIPB is a government body, which allows a single window clearance for the Foreign Direct Investment.

^{xii} The company had declared a special dividend of HK \$ 6.75 (US \$ 0.87) per share to its shareholders.

^{xiii} HK \$ 13.9 billion (US \$ 1.79 billion) to be utilized for the purpose of reducing the debt by HTIL

^{xiv} On March 2 and 5'07, Asim Ghosh and Analjit Singh (respectively) addressed their letters disclosing the complete holdings in HEL.

^{xv} Generally Accepted Accounting Principles (GAAP) or simply Accounting Standards includes the standards, conventions, and rules that the accountants follow in recording and summarizing transactions and in the preparation of financial statements. India, in particular follows a little different Accounting Standard as compared to that of U.S.

^{xvi} HEL gave the clarification in its letter to FIPB. US GAAP declaration displayed around 62 % stake of Vodafone in HEL, whereas according to the declaration by Indian GAAP, this came up to be around 52 %. However, Indian GAAP brings out and reflects accurately the true equity ownership and control position.

^{xvii} Section 133 (6) states about the power to call for information; which can be exercised by the Director-General, the Chief Commissioner, the Director or the Commissioner

^{xviii} Section 163 states that for a Non-Resident person, "Agent" is any person in India who is either employed or has a business connection or is a recipient of income directly or indirectly

^{xix} Section 201 (1) states that, if a person or a company fails to pay the tax to the department without any sufficient reason, he would be deemed to be an assessee in default and the penalty would only be charged u/s221, if the Assessing Officer is satisfied of his default.

^{xx} Section 201 (1A) of the Income Tax Act, 1963 states that such defaulter shall also be liable to pay interest @ 18% p.a. being applicable from the due date to the date of its actual payment.

^{xxi} Withholding tax is a government requirement for the assessee to withhold or deduct tax from the payment, and pay that tax to the Government.

^{xxii} The Income Tax Tribunal had thereafter, passed an order which required the Vodafone Group to pay Rs. 12,000 crore (US \$ 1.7 billion) as a tax

^{xxiii} The Supreme Court registered the SLP because of the decline to exercise its power u/a 226 in a petition filed for challenging the show-cause notice.

^{xxiv} The Petitioner had raised the issue regarding the jurisdictional aspect of the Director of Income Tax (International Taxation) for dealing with the issue.

^{xxv} Section 195 applies only when the assessee has some nexus with India. It is thus, not applicable in case of offshore company acquiring another offshore company, which does not even has an office situated in India.

^{xxvi} Section 2 (47) of the IT Act explains 'Transfer' and is wide enough to include any method of transfer.

^{xxvii} 1967 (66) ITR 692

^{xxviii} 1999 (8) SCC 667

^{xxix} Section 90 of the IT Act empowers the Government to enter into such agreement with various countries.

^{xxx} http://www.incometaxindia.gov.in/publications/9_income_tax_for_nri/chapter012.asp; last visited on 18th January 2011

^{xxxi} Foundation Press 2003

^{xxxii} <http://timesofindia.indiatimes.com/business/india-business/Vodafone-approaches-SC-challenges-Bombay-HC-order-on-Rs12000cr-tax/articleshow/6554041.cms>; last visited on 10th January 2011

^{xxxiii} Vodafone Group is required to submit the same within 3 weeks

^{xxxiv} Vodafone Group is required to submit the same within 8 weeks

^{xxxv} http://www.domain-b.com/companies/companies_v/Vodafone/20101115_tax_case.html; last visited on 10th January 2011

REQUEST FOR FEEDBACK

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