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DSK Legal Knowledge Center

Updates on
• Tax

TAX: Vodafone

A. Transaction Background

Hutchinson Telecommunication International Limited (“Hutch”) sold the shares of Cayman based CGP Investments (“CGP”) to Netherlands based Vodafone International Holdings BV (“Vodafone”). CGP through its underlying subsidiaries in the British Virgin Islands and Mauritius held/controlled 67% (approx) stake in Hutchinson Essar Limited in India. The Indian tax authorities proceeded against Vodafone to recover tax amounting to USD 2.1 billion, on the transaction worth USD 11.076 billion, for failing to withhold tax in India at the time of making such payment to Hutch.

The Department contended that such a transaction would be taxable in India as it is an indirect transfer of a controlling interest in Indian operating company.

The matter after reaching the High court and the Supreme Court was finally remanded back to the tax authorities to decide if they have jurisdiction to proceed against Vodafone.

The tax authorities after passing the order, establishing that they have valid jurisdiction over the matter, confirmed that the transaction in question involves transfer of a bundle of rights in India rather than a transfer of a single share of CGP. Vodafone then filed a writ petition before the Bombay High court challenging the jurisdiction of the tax authorities and the tax liability.

B. Judgment of the Bombay High Court

Elaborate submissions were put forth and Vodafone explained the commercial basis of structuring the deal in such a complex manner. It was further provided that there was no intention to avoid any taxes and such structuring is a widely followed practice in the cross border transactions. Therefore, the transfer of shares between two non residents based out of India should not give rise to any tax liability in India.

The High Court noted that the transaction apart from the transfer of a share also involved a number of other rights and entitlements. Such is evidenced by the fact that mere transfer of the single CGP share would not have led to the consummation of the entire transaction. Intrinsic to the transaction was the transfer of other rights and entitlements. Also the existence of the term sheet which spells out the rights and obligations of the successor and the ways in which the Indian company has to be operated clearly indicates that it was not just a transfer of single share but also rights and entitlements in India.

The court provided that these rights and entitlements, defined within the meaning of section 2(14) of the Income Tax Act 1961 as 'Capital Asset', have sufficient nexus with the territory of India and fall within the jurisdiction of the Indian Revenue Department.

The Court further accepted that the company has a separate legal entity and the ownership of shares of a company does not imply a direct ownership of the assets of that company. The court further provided that for asset to be taxed in India there should be sufficient nexus between the asset transferred and the territory of India. It is necessary that the legal situs of the asset is situated in India. However, where the legal situs of the asset can be traced in India such a transaction even if happening outside India will be liable to tax in India and maybe subject to withholding taxes. The court split the term Capital Asset in two categories (a) Shares (b) Underlying rights and entitlements. Based on such segregation the court has directed the tax authorities to apportion the income for Shares (transferred outside India) and other assets (Rights and Entitlements in India) and determine and charge tax in case of the Rights and Entitlements transferred in India.

DSK Comment:

The Court while concluding the issue in this case provides that if the legal situs of the assets can be traced in India only in such cases, the transaction shall be liable to Indian tax. Therefore, it can be safely inferred that all the transactions involving the transfer of shares, of an offshore holding company, between non residents would not always be taxed in India.

News Alert

The Supreme Court in a recent case involving GE, Samsung Electronics, Hewlett-Packard, Sonata Software and other firms has rejected the view taken by the Karnataka High Court where it had held that the companies based in India are liable to withhold tax when they make any payment overseas, including the payments made against purchase of shrink- wrapped software. The Supreme Court has made it clear that withholding tax has to be made only if the non resident's income is chargeable to tax in India. Therefore, this judgment has put to rest all the controversies arising out of the Karnataka High Court's judgment in relation to the withholding tax liability in case consideration is paid by Indian buyer to foreign supplier.

DSK Legal Knowledge Center

Contact Details: dsklegal.knowledgecenter@dsklegal.com

Mumbai Office
4th Floor, Express Towers,
Nariman Point,
Mumbai 400 021
India
Tel: (91 - 22) 6658 8000
Fax: (91 - 22) 6658 8001

Delhi Office
46, Aradhana, Chanakyapuri,
New Delhi 110 066
India
Phone: (91 - 11) 2687 1122; 2687 1133;
2687 1144
Fax: (91 - 11) 2687 1155

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