

India Tax Potent on Global M&A The Vodafone Case Update



A High-Level Discussion Note

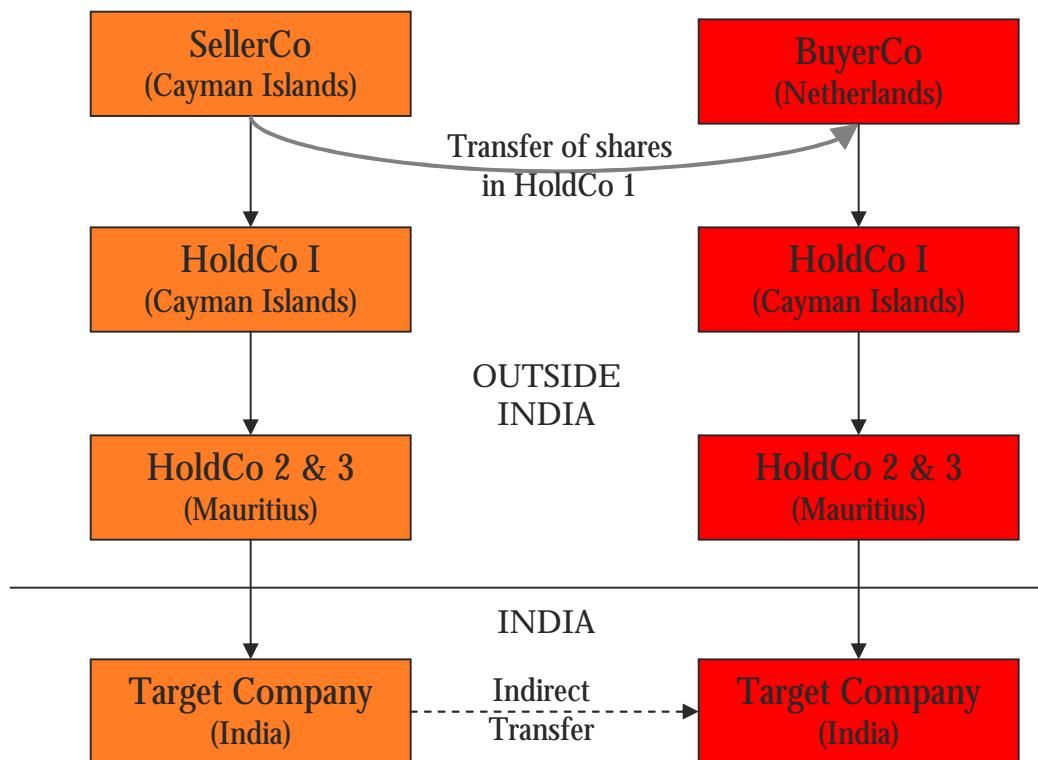
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Overview

Pre acquisition structure
the **Hutch** days...

Post acquisition structure
the **Vodafone** days...



- ▶ Non-resident BuyerCo got controlling interest in TargetCo in India on account of share acquisition of HoldCo 1 (situated outside India) from a non-resident SellerCo.
- ▶ Is Buyer Co liable to comply with Indian withholding tax provisions on Indian capital gains tax liability of SellerCo?
- ▶ The Court ruled that the Indian Revenue was well within its jurisdiction to examine the taxability of offshore transactions that enabled a foreign company to acquire control in an Indian telecom business. While the decision has not specifically ruled on the chargeability to tax, the Court's observations are significant to note.

Facts of the Case

- ▶ Vodafone Holdings International (“Vodafone”), a Dutch company, purchased shares of a Cayman Company – CGP Investments (Holdings) Ltd from another foreign company (Hutchinson Telecommunications International Limited - HTIL)
- ▶ CGP Investments in turn held 67% stake of an Indian Telecom company (Hutch Essar) through intermediate companies situated in Mauritius
- ▶ Revenue issued a notice asking Vodafone why it should not be treated as an “assessee in default” for failure to deduct tax at source?
- ▶ Vodafone filed a writ petition against the same in the Mumbai High Court

Vodafone plea to the High Court

- ▶ Vodafone filed a writ petition before the Mumbai High Court to challenge the validity of the notice
 - > the provisions were not applicable to the current case and the primary obligation to discharge the tax was with the payee (HTIL). Unless the payee had defaulted in making payment of taxes, on demand by the Revenue authorities, tax could not be recovered from the payer
 - > the withholding tax provisions cannot have extra-territorial application i.e. cannot apply in an offshore transaction involving two non residents in respect of a capital asset (i.e. shares) and payment outside India
 - > the transaction is not chargeable to tax in India since it involves transfer of shares of a non-resident company by one non-resident to another and is not a transfer of a capital asset situated in India

The High Court

Holds that the notice is legally tenable and thus dismisses the writ petition

However, it should be noted that the Court has not ruled on the chargeability of tax

- ▶ Court observes that Revenue has made out a strong prima facie case that the transaction entered into by the Petitioner amounts to transfer of a capital asset
 - > Income was earned towards consideration for transfer of its business/economic interests as a group;
 - > The subject matter of the present transaction is nothing but transfer of interests, tangible and intangible in Indian companies and not an innocuous acquisition of shares of a shell Cayman Islands Company;
 - > The interest in Telecom License is jointly held with the Essar Group along with the use of Brand & Goodwill and noncompete rights given by HTIL. There is a right to enter into Telecom Business in India, with a premium for the controlling interest;
 - > As there was admittedly a transfer of controlling interest in the Indian company, there was an “extinguishment of rights” and “relinquishment” by the transferor in the shares of the Indian company which constituted a “transfer”
 - > The shares in the Cayman company were merely the mode or the vehicle to transfer the assets situated in India. The choice of the assessee in selecting a particular mode of transfer of such assets will not alter or determine the nature or character of the asset

The High Court

- ▶ As the assessee (Vodafone) had wilfully failed to produce the primary/original agreement and other prior and subsequent agreements/documents it was impossible to appreciate the true nature of the transaction and the constitutional validity of Income-tax provisions could not be gone into;
- ▶ The assessee has not been able to demonstrate the notice to be non-est in the eyes of law for absolute want of jurisdiction in the assessing officer.
 - > It is settled law that a writ cannot be entertained against a mere show-cause notice unless the Court is satisfied that the show cause notice was totally non est in the eye of law for absolute want of jurisdiction of the authority to even investigate into facts.

A Look Beyond...

- ▶ Chargeability to tax of an offshore transaction between non-residents
 - > The Court has not made any observation on the chargeability of the said transaction to tax. However it appears to acknowledge a distinction between the shares *per se* (held outside India) and the underlying rights/interests/assets (based in India). It observes that the share transfer could be treated as mere mode for transfer of underlying assets. This appears to navigate against the accepted jurisprudence and seeks to lift the corporate veil, having far-reaching implications on transactions domestically and internationally.
 - > If the value is created significantly in India, there are merits in the Revenue's perspective; However prior to seeking a levy of tax on such transactions, the legislature should first make appropriate provisions in the tax laws (moreover, these can be only prospective)
- ▶ While, the position of the Courts on the chargeability of tax is yet to be decided, this judgment indicates the direction in which the legislature could move.
 - > Media reports suggest that notices to several companies are in the pipeline
 - > The revenue department is embroiled in a legal battle with US-based General Electric for its 60% stake sale in Genpact. Stakes was sold for \$500 million in 2007.
 - > In yet another transaction, telecom major AT & T stake sale in Idea Cellular to the Tata Industries in 2005 has also been sent a tax notice.
 - > Internationally, US private equity fund Lone Star has faced tax hurdles in Seoul, Korea over its planned sale of Korea Exchange Bank to HSBC.

A Look Beyond...



- ▶ As part of the corporate tax strategy, appropriate attention should be provided to:
 - > Use of jurisdictions with good treaty networks for implementing global investment structures
 - > Clarity and consistency in disclosures and filings under other regulations and with regulatory authorities
 - > Review of shareholder agreements to understand the references to key business rights, its' situs and its transferability
 - > Use of an indemnification clause for recourse to seller in case of tax liability
 - > Hygiene in corporate communications (particularly external media)

“An organization’s ability to learn, and translate that learning into action rapidly, is the ultimate competitive advantage”

- Jack Welch



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