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On the *Vodafone* Roller Coaster: India's Supreme Court Provides Multinationals a Short-Lived Solace

by Charles W. Cope, Esq., and Vikas Vasal, Esq.[*]
KPMG LLP
Washington, D.C., and India

INTRODUCTION

On January 20, 2012, the Supreme Court of India announced its judgment in favor of Vodafone International Holdings B.V. (''Vodafone'').[1] In February 2007 Vodafone acquired all of the shares (in fact a single share) of CGP (Holdings) Limited (''CGP''), a Cayman Islands company, for $11.1 billion from Hutchison Telecommunications International Limited (''HTIL''), a Cayman Islands company. CGP was a holding company that indirectly, through various Indian and Mauritian intermediary companies, held a 67% interest in Hutchison Essar Limited (''HEL''), an Indian telecommunications company.[2] The Indian Tax Authorities (the ''Indian Revenue'') subsequently asserted that this transaction was taxable in India and that Vodafone was liable to withhold Indian tax from the purchase price of $11.1 billion paid to HTIL and accordingly raised a demand of approximately $2.5 billion.

The *Vodafone* case is noteworthy for several reasons: Vodafone is one of a number of companies that the Indian Revenue has asserted is subject to tax in India as a result of the transfer of shares in a non-Indian holding company that indirectly owns shares in an Indian company. Therefore, the judgment, insofar as it has clarified Indian tax law as it holds today, should be of keen interest to companies with operations in India, particularly those having a similar tax dispute. However, as we discuss in the final section of this article, in March the Government of India proposed legislation that, if enacted by the Indian Parliament, would overturn the Supreme Court's judgment in *Vodafone*. Thus, whether Vodafone will ultimately be liable for tax in India remains uncertain, despite the company's victory in the courts.

The Union of India's effort to tax indirect share transfers is part of a trend among emerging econo-

[*] Charles W. Cope is a principal in the International Corporate Services group of the Washington National Tax (''WNT'') practice of KPMG LLP, based in Washington, D.C. Vikas Vasal is a tax partner with KPMG in India who is on rotation in the United States. The authors thank Josh Kaplan of WNT for his assistance in the preparation of this article. This article represents the views of the authors only, and does not necessarily represent the views or professional advice of KPMG LLP. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

[1] *Vodafone International Holdings B.V. v. Union of India & Anr.*, Civil Appeal No. 733 of 2012 (hereafter referred to as the ''Supreme Court Opinion''). The Supreme Court Opinion is available on the Supreme Court's website at: http://courtnic.nic.in/supremecourt/temp/sc%202652910p.txt.

[2] HEL is now known as Vodafone Esser Limited.

mies. How India ultimately resolves the issue of taxing indirect share transfers may influence others in the international community. In pursing Vodafone, the Indian Revenue advanced several legal arguments to support its case for imposition of the withholding tax. From a U.S. legal perspective, these arguments and the courts' response to them are of interest because of various parallels between the two countries' tax jurisprudence. More importantly, tax advisors of all jurisdictions may wish to place reliance on the learning in this case and plan future share transfers with these arguments in mind as some of them could very well be portable to other jurisdictions.

BACKGROUND

The Corporate Structure

The Hutchison Group, which is headquartered in Hong Kong, formed HEL in 1992 as a joint venture with the Essar Group, an Indian company.[3] At the time of the sale to Vodafone, the Hutchison Group effectively held a 67% interest[4] in HEL, and the Essar Group held the remaining 33% interest. The Hutchison Group directly and indirectly owned 52% of the shares of HEL through several Indian and Mauritian companies, which were in turn held through a chain of Mauritian, British Virgin Islands, and Cayman Islands holding companies.[5] The Hutchison Group — through CGP — also owned call options to acquire additional shares in two Indian companies that, if exercised, would give the Hutchison Group a further 15% indirect equity interest in HEL.[6]

Overview of the Transaction

During 2006, HTIL received several offers from potential buyers interested in acquiring its interest in HEL. On February 11, 2007, Vodafone and HTIL entered into a sale and purchase agreement (the ''SPA'') in which HTIL agreed to sell to Vodafone the single share of CGP for $11.1 billion.[7] On February 20, 2007, Vodafone applied to India's Foreign Investment Promotion Board (''FIPB'') — the agency that regulates foreign direct investment (FDI) in India — for approval to acquire a 52% indirect controlling interest in HEL through the acquisition of CGP.[8] The FIPB thereafter sent a letter to Vodafone inquiring why it agreed to pay $11.1 billion — representing 67% of the enterprise value of HEL — if Vodafone was acquiring only a 52% equity interest in HEL.[9] Vodafone explained in response that in addition to the acquisition of HTIL's 52% equity interest in HEL, the $11.1 billion purchase price included: a control premium; use and rights to the Hutch brand in India; a non-compete agreement with the Hutchison Group; the value of non-convertible preference shares in two indirect Indian shareholders of HEL; the assumption of $630 million of liabilities of CGP's subsidiaries; and the right to acquire an additional 15% of the shares of HEL.[10] Vodafone represented that these elements together amounted to 67% of the economic value of HEL.[11]

On March 15, 2007, HTIL entered into a settlement agreement with the Essar Group that provided, *inter alia*, that HTIL would pay the Essar Group $415 million in exchange for the Essar Group's acceptance of the SPA and for waiving its rights or claims with respect to the management and conduct of HEL.[12] The settlement agreement also describes HTIL's agreement to sell Vodafone its direct and indirect equity, loan, and other interests and rights in and related to HEL.[13] On that same day, Vodafone also entered into an agreement with the Essar Group (the ''Term Sheet Agreement'') to regulate the affairs of HEL and the relationship between Vodafone and the Essar Group as shareholders of HEL. The Term Sheet Agreement provides that Vodafone would have operational control over HEL, and the Essar Group would have rights consistent with its minority interest.[14]

The SPA

The SPA governed the terms of the CGP stock sale. The SPA provided that ''[HTIL] has agreed to procure the sale of, and [Vodafone] has agreed to purchase, the entire issued share capital of CGP on the terms

[3] Technically, the Hutchison Group acquired an interest in Hutchison Max Telecom Limited, the predecessor entity to HEL.

[4] As discussed below, the quantum of the interest that Vodafone acquired was at issue in the litigation.

[5] Members of the Hutchison Group under CGP directly owned 42% of the stock of HEL. CGP also owned 37% of the stock of Telecom Investments India Private Limited (''TII''), an Indian company that owned 20% of the stock of HEL, and 38% of the stock of Omega Telecom Holdings Private Limited (''Omega''), an Indian company that owned 5% of the stock of HEL. Together, the TII and Omega stock gave CGP a 10% indirect interest in HEL. *See* Supreme Court Opinion at 15.

[6] CGP held call options to acquire a further 63% of the stock of TII and a further 54% of the stock of Omega. Together, the additional TII and Omega stock would give CGP a further 15% indirect equity interest in HEL. *See* Supreme Court Opinion at 20–21.

[7] Supreme Court Opinion at 9.

[8] Supreme Court Opinion at 11.

[9] Supreme Court Opinion at 19.

[10] Supreme Court Opinion at 20.

[11] *Id.*

[12] Supreme Court Opinion at 16.

[13] *Id.*

[14] Supreme Court Opinion at 18.

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and conditions set out in this Agreement. [HTIL] has further agreed to procure the assignment of, and [Vodafone] has agreed to accept an assignment of, the Loans on the terms and conditions set out in this Agreement and the Loan Assignments.''[15] The loans at issue involved certain loan obligations of CGP and its wholly owned Mauritian subsidiary to other members of the Hutchison Group.[16]

The SPA states that the transaction was contingent on Vodafone obtaining FIPB approval for the acquisition of the CGP stock.[17] The SPA also conferred certain rights and obligations on Vodafone and HTIL. For example, the SPA required Vodafone to make an offer to the Essar Group for the acquisition of its entire equity interest in HEL.[18] For its part, HTIL was required — amongst other things — to ensure the execution of the terms of the transaction documents by certain Indian shareholders of HEL.[19] The SPA also incorporated a non-compete agreement, restraining HTIL and its affiliates from carrying on telecommunications activities in India.[20]

The Relevant Tax Statutes

Under Indian tax law, a person who is a nonresident of India is subject to tax on only certain types of income. Section 5(2) of the Indian Income-tax Act, 1961 (the ''ITA'') provides that the total income of a nonresident person for a taxable year includes all income from whatever source derived that: (1) is received or is deemed to be received in India by or on behalf of such person during the year; or (2) accrues or arises or is deemed to accrue or arise in India during the year.

Section 9 of the ITA provides rules for determining whether income is deemed to accrue or arise in India. Section 9(1)(i) determines when income is deemed to accrue or arise in India:

> 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.

Thus, under §5 read with §9 of the ITA, a nonresident person is subject to Indian income tax on gain from the transfer of a capital asset (e.g., shares of stock) only if the capital asset is situated in India. The income arising from such transfer of a capital asset by a nonresident person also may be subject to Indian withholding tax.

Section 195(1) of the ITA generally requires a person to withhold Indian tax on payments made to a nonresident person in connection with a transaction that is subject to tax in India. Any person that purchases a capital asset from a nonresident seller is generally required to withhold tax under §195 of the ITA to the extent that the transfer of the capital asset is taxable to the seller in India.

The Judicial System of India

India is a federation of seven union territories and 28 states. India has an integrated judiciary system that administers both Union and state laws. The Supreme Court is the highest court in India, and has original, appellate, and advisory jurisdiction.[21] The current Chief Justice is Hon. S. H. Kapadia. The *Vodafone* case was heard by a three-justice panel that included the Chief Justice.

Below the Supreme Court are 21 High Courts, which serve as the highest courts within each state (or in some instances a group of states).[22] The High Courts have original jurisdiction in certain circumstances, and they have appellate jurisdiction over the lower-level District and Sessions courts within each state. The High Court of Bombay has appellate jurisdiction over the states of Maharashtra and Goa, and the territories of Daman and Diu, and Dadra and Nagar Haveli.[23]

THE CASE'S PROCEDURAL HISTORY

The *Vodafone* case began on September 19, 2007, when the Indian Revenue issued a show-cause notice to Vodafone to explain why it should not be treated as a taxpayer-in-default for not withholding tax on payments made by it to HTIL for the CGP share.[24] In October 2008, Vodafone filed a writ petition in the Bombay High Court (the ''High Court'') arguing that the show-cause notice was invalid because the Indian Revenue did not have jurisdiction over the sale. The High Court responded on December 3, 2008, by dismissing Vodafone's petition and finding that the Indian Revenue had jurisdiction over the transaction because the Indian Revenue had made a *prima facie*

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[15] High Court Opinion at 157–58.

[16] High Court Opinion at 158.

[17] *Id.*

[18] High Court Opinion at 159.

[19] High Court Opinion at 161.

[20] High Court Opinion at 162.

[21] Supreme Court of India, Jurisdiction of the Supreme Court, http://supremecourtofindia.nic.in/jurisdiction.htm.

[22] *See* http://indiancourts.nic.in.

[23] High Court of Bombay, History, http://bombayhighcourt.nic.in/history.php#.

[24] Supreme Court Opinion at 122.

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case that the transaction constituted a transfer of a capital asset situated in India.[25]

Vodafone appealed the High Court order to the Supreme Court, and on January 23, 2009, the Supreme Court directed the Indian Revenue to determine the preliminary issue of whether the High Court had jurisdiction over the transaction.[26] The Supreme Court also permitted Vodafone to challenge the preliminary jurisdictional issue before the High Court in the event that the Indian Revenue decided against Vodafone.[27]

On October 30, 2009, the Indian Revenue issued a second show-cause notice to Vodafone, and on January 28, 2010, Vodafone filed its response with the Indian Revenue contesting the second show-cause notice.[28] On May 31, 2010, the Indian Revenue affirmed its jurisdiction to tax the transaction and issued a new show-cause notice to Vodafone to explain why Vodafone should not be required to withhold tax on the transaction as an agent/representative assessee of HTIL.[29]

In June 2010, Vodafone filed a writ petition in the High Court challenging the May 2010 show-cause notice. In a lengthy judgment issued on September 8, 2010, discussed below, the High Court dismissed Vodafone's challenge and upheld the Indian Revenue's jurisdiction over the transaction.[30] That same month, Vodafone filed a special leave petition with the Supreme Court.

On October 22, 2010, the Indian Revenue issued a demand for payment to Vodafone for approximately $2.5 billion of tax and interest.[31] On November 15, 2010, the Supreme Court asked Vodafone to deposit approximately $500 million with the Supreme Court and to provide a guarantee of approximately $1.9 billion pending final adjudication of the case.[32] The Supreme Court announced its judgment in favor of Vodafone on January 20, 2012.

We first discuss the High Court's judgment, because its reasoning is necessary to understand the reasoning of the Supreme Court. We then discuss the judgment of the Supreme Court.

THE HIGH COURT'S JUDGMENT

The principal issue before the High Court was whether the Indian Revenue had jurisdiction under the ITA to tax a foreign corporation on gain from the sale of stock of a foreign holding company that indirectly held an equity interest in an Indian company. If the Indian Revenue does not have jurisdiction to tax HTIL's gain on the sale of the CGP stock, then the Indian Revenue likewise would not have jurisdiction to require Vodafone to withhold Indian tax on its payments to HTIL for the CGP stock.

Whether the Sale Was Subject to Indian Tax

The High Court began its analysis by examining the parties' understanding of the transaction. The court found that Vodafone's real intent in purchasing CGP was to acquire HTIL's controlling interest in HEL's Indian telecommunications business. Similarly, the court found that HTIL's motivation for selling CGP was to discontinue its operations in India. Thus, although the transaction took the form of a share sale, the court found that ''[t]he commercial understanding of the parties was that the transaction related to the transfer of a controlling interest in HEL from HTIL to [Vodafone].''[33] The court explained, however, that ''[t]he transfer of control was not relatable merely to the transfer of the CGP share.''[34] Rather, the court found that ''[i]nextricably woven with the transfer of control were other rights and entitlements which HTIL and/or its subsidiaries had assumed in pursuance of contractual arrangements with its Indian partners and the benefit of which would now stand transferred to [Vodafone].''[35]

The High Court was of the opinion that the amount that Vodafone paid to HTIL for the CGP stock was at least in part attributable to ''diverse rights and entitlements'' that HTIL transferred to Vodafone.[36] Thus, the High Court laid emphasis on the rights and entitlements embodied in the share of CGP and looked through the share transfer.

The High Court also stated that many of the enumerated rights and entitlements transferred to Vodafone were independent of the transfer of the share of CGP stock, including: a control premium; use and rights to the Hutch brand in India; a non-compete agreement with the Hutchison Group; the value of certain preference shares; various loan obligations;

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[25] The High Court's decision is available at [2008] 175 TAXMAN 339 (BOM.).

[26] The Supreme Court's decision is available at [2009] 179 TAXMAN 129 (SC).

[27] *Id.*

[28] Supreme Court Opinion at 123.

[29] Supreme Court Opinion at 23.

[30] *Vodafone International Holdings B.V. v. Union of India & Anr.*, Writ Petition No. 1325 of 2010 (hereafter referred to as the ''High Court Opinion''). The High Court Opinion is available on the High Court's website at http://bombayhighcourt.nic.in/data/judgements/2010/OSWP130810.pdf.

[31] Vodafone Group Plc, 2011 Annual Report 122 (2011), available at http://www.vodafone.com/content/annualreport/annual_report11/downloads/vf_ar2011_full_report.pdf.

[32] Vodafone 2011 Annual Report at 122.

[33] High Court Opinion at 162–63.

[34] High Court Opinion at 163.

[35] *Id.*

[36] High Court Opinion at 179.

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and the right to acquire a further 15% interest in HEL.[37] The court then concluded:

> The submission of [Vodafone] that the transaction involves merely a sale of a share of a foreign company from one nonresident company to another cannot be accepted. The edifice of the submission has been built around the theory that the share of CGP, a company situated in the Cayman Islands, was a capital asset situated outside India and all that was transferred was that which was attached to and emanated from the solitary share. It was on this hypothesis that it was urged that the rights and entitlements which flow out of the holding of a share cannot be dissected from the ownership of the share. The purpose of the discussion earlier has been to establish the fallacy in the submission. The transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and [Vodafone]. 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.[38]

The court went on to consider whether HTIL's gain on the sale of CGP was subject to tax under §9 of the ITA. The court explained that under §9(1) of the ITA, when an asset or source of income is situated in India, all of the income that accrues or arises directly or indirectly through or from it shall be treated as income that is deemed to accrue or arise in India (and therefore is subject to tax).[39] In this case, however, the court found that the real taxable event was not HTIL's sale of the single share of CGP. Rather, the real taxable event was HTIL's divestment of its interests in India, which included the transfer of certain rights and entitlements to Vodafone.[40] As discussed above, the court concluded that these rights and entitlements constituted capital assets independent of the share of CGP stock. Thus — to the extent that HTIL's gain on the sale of the share of CGP was attributable to profits generated or assets located in India — that gain should be subject to Indian tax under §9(1) of the ITA. The court instructed the Indian Revenue to determine the proper allocation of the sales proceeds between Indian and non-Indian sources.

[37] High Court Opinion at 182–83.

[38] High Court Opinion at 181.

[39] High Court Opinion at 182.

[40] High Court Opinion at 188.

Whether Vodafone Was Required to Withhold Tax

Having decided that the transaction was subject to at least partial taxation in India, the next question for the court was whether Vodafone was required under §195 of the ITA to withhold tax on its payment to HTIL. Section 195 of the ITA generally requires an Indian resident to withhold tax on a sum paid to a nonresident to the extent that the sum is subject to tax in India. The court stated that a nonresident payor also may be required to withhold tax under §195 of the ITA if there is a sufficient territorial connection or nexus between the nonresident payor and India. Here, the court determined that the rights and entitlements that Vodafone acquired in connection with the transaction created a direct nexus with India. The court therefore concluded that the Indian Revenue had jurisdiction to require Vodafone to withhold tax on the amount that it paid to HTIL for the CGP stock.

THE SUPREME COURT'S JUDGMENT

Introduction

In finding for Vodafone, the Supreme Court discussed three principal technical arguments as to whether the transaction was taxable in India.[41] The first, from a U.S. perspective, was a substance-over-form or sham argument, i.e., CGP lacked substance and a business purpose and should be ignored.[42] The second was an argument based on statutory construction, i.e., the scope of §9(1) of the ITA encompassed the indirect transfer of shares. The final argument was the one embraced by the High Court that, in fact, Vodafone acquired not a single share of a Cayman Islands company, but a bundle of rights and entitlements, which *inter alia* are assets located in India. The Supreme Court refers to this as ''a transfer of property rights by extinguishment.'' In addition, the Supreme Court addresses whether Vodafone was liable to withhold tax on the sale, if indeed tax was due.

The Policy Rationale for the Judgment

Besides interpreting the provisions under the present tax law on technical grounds, the Supreme

[41] As noted above, the *Vodafone* case was heard by a three-member panel of Supreme Court justices. Chief Justice Kapadia delivered the court's opinion, which was joined by Justice Kumar. Justice Radhakrishnan wrote a lengthy concurring opinion, which we do not discuss as its precedential value is unclear. References to the Supreme Court Opinion are to the Chief Justice's opinion.

[42] The sham or substance-over-form argument is closely related to the extinguishment theory adopted by the High Court and argued by the Indian Revenue before the Supreme Court. Based on the structure of the Supreme Court Opinion, the Indian Revenue may not have separately argued for sham treatment. However, from a U.S. perspective, the sham discussion is of interest, so we have discussed it separately.

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Court concludes with some observations from the larger macroeconomic perspective on Indian tax policy and its implementation.

The policy discussion begins by observing a basic economic truth:

> FDI flows towards location with a strong governance infrastructure which includes enactment of laws and how well the legal system works. Certainty is integral to the rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner.[43]

The Supreme Court also observed that legal doctrines like ''look through'' are matters of policy, and it is up to the government (i.e., the Parliament of India) to incorporate these into the country's laws in order to avoid ''conflicting views.'' The Supreme Court is of the view that there should be certainty and clarity in the tax laws and that if the intent of the legislature is to tax these kinds of transactions, then it should be expressly provided for, thereby removing any uncertainty from the minds of foreign investors.

The Technical Arguments

We first consider the statutory construction argument. Next, we review the substance-over-form or sham argument because it is closely related to the Indian Revenue's extinguishment of rights argument that was persuasive to the High Court. We conclude with a discussion of the extinguishment argument, i.e., that the transaction was a transfer of property rights, at least some of which were located in India, rather than a share sale.

The Statutory Construction Argument

The Indian Revenue argued — apparently as a secondary argument, its primary argument being extinguishment — that §9(1)(i) of the ITA permitted the Indian Revenue to look through CGP. Section 9(1)(i) provides that:

> 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 from any asset or source of income in India, or *through* the transfer of a capital asset situate in India. [Emphasis supplied.]

The Indian Revenue argued that the statute contemplated taxing the income arising from the indirect transfer of shares in an Indian company that occurs when shares in a non-Indian holding company are transferred because ''through'' (i.e., in consequence of) the transfer of the holding company shares there is a transfer of a capital asset situate in India (i.e., the assets of an Indian business), and such income is derived ''indirectly'' from such transfer.

The Supreme Court observes that nonresidents are subject to tax only if they receive income in India or when income accrues or arises in India. The Supreme Court states that the second test for taxation of nonresidents (that found in §9(1) of the ITA) is simply intended to avoid arguments by a nonresident vendor that profits on the sale of property arises outside India because the sales contract was executed outside of India.

The Supreme Court goes on to say:

> The legislature has not used the words **indirect transfer** in section 9(1)(i). If the word **indirect** is read into section 9(1)(i), it would render the express statutory requirement of the fourth sub-clause in section 9(1)(i) nugatory. . . If [the] indirect transfer of a capital asset is read into section 9(1)(i) then the words **capital asset situate in India** would be rendered nugatory.[44]

The Supreme Court continues with other reasons why the Indian Revenue's argument is unconvincing. The asset transferred ''should be an asset in respect of which it is possible to compute capital gain in accordance with the provisions of the Act.''[45] Finally, the Supreme Court observes that the Direct Taxes Code Bill, 2010 (the ''DTC Bill,'' or the proposed revision of India's income tax law) proposes to amend the statute to bring in its ambit the indirect transfer of a capital asset situate in India. Had the Parliament of India intended to tax such indirect transfers under the ITA, such a change in the law would not have been necessary.[46]

The Sham Argument

The sham argument, i.e., that CGP had no substance and should be ignored, may be either a stand-

[43] Supreme Court Opinion at 94.

[44] Supreme Court Opinion at 46.

[45] *Id.*

[46] The Indian Revenue apparently has not adopted the position of the U.S. Treasury that new legislation may ''clarify'' existing law, and so preserve the government's litigating position under prior law.

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alone argument or a supporting argument to the Indian Revenue's extinguishment argument. The argument is central to understanding the Supreme Court's opinion and should be of interest to U.S. tax advisors.

Early in its opinion, the Supreme Court observes that ''in this case, we are concerned with the concept of GAAR [general anti-avoidance rule].''[47] It also observes that India, like many other jurisdictions, has an anti-avoidance rule. The rule has its roots in various United Kingdom judicial decisions, which the Supreme Court discusses in its decision.[48]

The court then considers the role of holding companies in corporate legal structures. It first affirms the separate entity principal, i.e., that a company is treated as a separate person. It then notes that ''the Indian Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies and other entities subject to income-tax.''[49] The Supreme Court also observes that ''it is a common practice in international law, which is the basis of international taxation, for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as Cayman Islands or Mauritius-based company for both tax and business purposes'' and that ''Special-Purpose Vehicles (SPVs) and Holding Companies have a place in legal structures in India . . . even under the income tax law.''[50]

Having established the general legitimacy of holding companies under Indian tax law, the Supreme Court then states that ''the Revenue may invoke the 'substance over form' principal or 'piercing the corporate veil' test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidance.''[51] In making this determination, Indian Revenue must ''**look at** the entire transaction as a whole and not . . . adopt a dissecting approach.''[52] The ''look at'' principal is referenced several times in the course of the opinion and is relied upon in addressing the extinguishment argument.

The Supreme Court then provides some additional detail as to how the test should be applied and comments that foreign direct investments in India should be viewed ''in a holistic manner.'' It observes that, besides others, the following parameters should be considered when applying the test:

> The concept of participation in investment; the duration of time during which the holding structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on such exit.[53]

In a section titled ''Role of CGP in the Transaction,'' the Supreme Court further discusses corporate legal structures and various business reasons for the use of holding companies and subsidiaries. Examining the role of CGP, the court finds that: ''the sole purpose of CGP was not only to hold shares in subsidiary companies but also to enable a smooth transition of business, which is the basis of the SPA. Therefore, it cannot be said that the intervened entity (CGP) had no business or commercial purpose.''[54]

While identifying a sufficient business purpose for the participation of CGP in the transaction refutes the sham argument, finding a business purpose for CGP is also significant in refuting the extinguishment argument adopted by the High Court.

The Extinguishment Argument

The Indian Revenue argued that: (1) the SPA, when viewed in a commercial context, extinguished (i.e., transferred) HTIL's control and management over its Indian business assets to Vodafone; and (2) control and management are property rights that are capital assets situated in India. The Indian Revenue also pointed to the Shareholders/Framework Agreements and the Term Sheet Agreement in support of this theory.

Central to the extinguishment argument is that the transfer of management control of the Indian subsidiaries was effected by various clauses of the SPA (and other agreements) and not by the transfer of the single share of CGP. The Indian Revenue made various technical arguments to support its position; however, probably the most persuasive bit of evidence put forth was Vodafone's statement to the FIPB that the $11.1 billion purchase price was paid for various items of value other than the single share in CGP (i.e., a control premium; use and rights to the Hutch brand in India; a non-compete agreement, etc.).

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[47] Supreme Court Opinion at 39.

[48] The Supreme Court reviews various U.K. judicial decisions involving tax avoidance transactions, including *IRC v. Duke of Westminster* (1936) AC 1 (HL); *McDowell and Company Limited v. Commercial Tax Officer* (1985) 3 SCC 230; *W. T. Ramsay v. IRC* (1982) AC 300 (HL); *Furniss v. Dawson* (1984) 1 All ER 530; and an Indian case, *Union of India v. Azadi Bachao Andolan and Another* (2004) 10 SCC 1.

[49] Supreme Court Opinion at 35.

[50] Supreme Court Opinion at 38–39.

[51] Supreme Court Opinion at 39–40.

[52] Supreme Court Opinion at 40 (bold emphasis in original).

[53] Supreme Court Opinion at 41.

[54] Supreme Court Opinion at 71. The Supreme Court also says, when discussing extinguishment, that ''it cannot be said that the structure was created or used as a sham or tax avoidant.'' Supreme Court Opinion at 52.

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Indian Revenue's technical arguments included: (1) that HTIL itself disregarded the corporate structure that it had created, which supported looking through CGP; (2) that the SPA gave effect to the 2003 Term Sheet with the Essar Group, which was an integral part of the transaction; and (3) that the execution of a new Framework Agreement in 2007 assigned certain benefits to Vodafone.

In rejecting the extinguishment argument, the Supreme Court makes several points. First, it lays emphasis on the use of the ''look at'' test, i.e., to consider the entire transaction holistically, rather than dissecting the transaction into various elements. Applying the ''look at'' test involves analyzing various factors enumerated above (e.g., duration of the holding company structure, duration of business operations in India, etc.). The Supreme Court concludes that the transaction was a share sale, not an asset sale, and that ''it cannot be said that the structure was created or used as a sham or tax avoidant.''[55] The Supreme Court observed:

> In a case like the present one, where the structure has existed for a considerable length of time generating taxable revenues right from 1994 and where the court is satisfied that the transaction satisfies all the parameters of ''participation in investment'' then in such a case the court need not go into the questions such as de facto control vs. legal control, legal rights vs. practical rights, etc.[56]

The Supreme Court concludes that ''extinguishment took place because of the transfer of the CGP share and not by virtue of various clauses of [the] SPA.''[57]

Although the Supreme Court rejected the ''dissecting approach'' of the Indian Revenue, the court apparently felt compelled to analyze the various arguments that had been put to it, perhaps to settle the long-going controversy with respect to indirect share transfers. In the context of control, there is a discussion of the distinction between a shareholder having power to control corporate assets rather than simply being in a ''persuasive position.'' The Supreme Court concludes that HTIL had a persuasive position, rather than actual power, over the lower-tier Indian subsidiaries.[58] In addition, the Supreme Court analyzes and rejects the significance of the execution of a new Framework Agreement and the clause of the SPA giving effect to the Term Sheet. The Supreme Court also discusses how to properly measure the equity interest in HEL that Vodafone acquired — i.e., whether it was 67% or 52% — and concludes that differences between Indian and U.S. Generally Accepted Accounting Principles explain the difference. Finally, the opinion includes a separate discussion as to how the overall facts have to be considered, thereby dissenting from the High Court's opinion.

Liability to Withhold

Under §195 of the ITA, a person making payments to a nonresident has an obligation to withhold tax at source only when such payments are chargeable to tax. Having concluded that the transaction was not taxable in India, the Supreme Court concludes that Vodafone had no withholding tax liability.

The Petition for Review

Despite the comprehensive opinion of the Supreme Court, Indian Revenue did not give up its fight to tax this transaction and others of this type that are pending in the courts.

On February 16, 2012, the Indian Revenue filed a petition with the Supreme Court requesting a review of the judgment on the grounds (based on media reports) that the judgment suffers from errors, fails to consider its submissions, and certain provisions in the income-tax law have not been correctly interpreted.

On March 20, the Supreme Court rejected the review petition, upholding its judgment.

THE ROAD AHEAD FOR INDIRECT SHARE TRANSFERS

India is in the process of developing a new DTC (a new tax law to replace the existing ITA). Under the new DTC, the transfer of shares in a non-Indian company is proposed to be taxable when at least 50% of the fair market value of all assets owned by the company, either directly or indirectly, consists of assets in India. The test would be applied during the 12-month period prior to the transfer. Only the portion of the value of the shares of the holding company that is attributable to capital assets in India would be subject to tax in India.

The new DTC was proposed to be made effective from April 2012. However, at this stage it appears that implementation of the new DTC is likely to be extended.

On March 16, the Government of India presented the Union Budget 2012 to the Indian Parliament. The

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[55] Supreme Court Opinion at 52.

[56] *Id.*

[57] *Id.*

[58] The opinion states, ''We hold that HTIL, as a group holding company, had no legal right to direct its downstream companies in the matter of voting, nomination of directors and management rights.'' Supreme Court Opinion at 58.

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budget includes a provision that would make a retrospective amendment, with effect from April 1, 1962, in the present tax law to tax the indirect transfer of shares in an Indian company and thus overturn the decision of the Supreme Court in *Vodafone*. In fact, the tax law is proposed to be amended to overturn most of the points on which relief was granted to Vodafone by the Supreme Court.

The scope of income deemed to accrue or arise in India to non-residents directly or indirectly through the transfer of a capital asset situated in India is proposed to be expanded retrospectively, to tax indirect transfer of shares in an Indian company. Shares or an interest in an overseas company is "clarified" to be situated in India if it directly or indirectly derives value substantially from assets located in India.

Interestingly, the term "property" is clarified to include rights in or in relation to an Indian company, including rights of management or control or any other such rights. Also, the ambit of "transfer" in such cases would be widened to include the disposition of shares of a company registered/incorporated outside of India when it relates to such "property"

Finally, the scope of withholding tax obligation on payment of income to non-resident is proposed to be expressly extended to all persons including non-residents irrespective of them having a residence or place of business in India.

The share transfer tax would yield to income tax treaties. However, the Union Budget 2012 also proposes to include a statutory GAAR, which would override treaties, in specified situations and circumstances. The precise relationship between the share transfer tax, income tax treaties, and the statutory GAAR remains to be developed, and it is bound to lead to further disputes and litigation.

As this article goes to press, the Union Budget 2012 has been presented before the Parliament and will undergo a debate in the days ahead. If the Budget is passed by the Parliament as it is, then it will become the new law, with retrospective effect.

Such changes in tax law with retrospective effect might be challenged before the courts on account of their constitutional validity or as being unjust and causing undue hardship. Therefore, we may very well witness another round of legal debate before the Indian courts. Nevertheless, the intent of the government is quite clear: Indirect transfers of shares in Indian companies should be subject to tax in India.

Thus, while the Supreme Court has offered multinationals some solace, that solace appears to be short-lived. Today, the trend appears to be to tax indirect share transfers. Future casebooks on the history of tax policy may refer to the Supreme Court's opinion in *Vodafone* as an important milestone, albeit followed by a quick turnaround of events wherein such transactions are brought within the tax net.

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