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Supreme Court of India Holds That Offshore Transaction Between Vodafone and Hutchison Is Not Liable to Taxation in India

On January 20, 2012, the Indian Supreme Court delivered its judgment in the landmark case of Vodafone International Holdings B.V. The case related to India's ability to tax capital gains arising to a non-Indian company on the sale of shares of another non-Indian company owning Indian assets. The Supreme Court held that the transaction was not taxable in India.

Background

In 2007, a Dutch subsidiary of UK-based telecommunications company, Vodafone plc, entered into an agreement with a Cayman Islands company in the Hong Kong-based Hutchison group. The agreement related to an acquisition by the Dutch company of the entire share capital of a second Cayman Islands company in the Hutchison group. That second Cayman Islands company owned a 67% interest in Hutchison Essar Limited, an Indian company engaged in the telecommunications business.

The Indian tax authorities asserted jurisdiction in respect of this transaction and sought to tax the capital gain arising from the sale of the shares of the second Cayman Islands company. They asserted this jurisdiction on the ground that the company held underlying Indian assets, namely the shares in Hutchison Essar Limited. The tax authorities claimed that the Dutch company should have deducted the tax from the consideration paid for the shares, and it sought payment of the tax due, together with penalties and interest. Vodafone's potential total liability was approximately US$ 2.2 billion.

Vodafone challenged the position of the Indian Tax Authorities before the Bombay High Court, but the High Court dismissed the challenge.

The Supreme Court decision

On appeal, the Supreme Court set aside the decision of the Bombay High Court and held that the transaction was not subject to tax in India.

One of the key questions for the Supreme Court was whether it would be possible to look through the non-Indian holding structure to the underlying Indian assets. It concluded, broadly speaking, that unless specifically provided otherwise in tax law and tax treaties, it is only possible for the Indian Tax Authorities to adopt a "substance over form" approach or, in a holding company structure, to "pierce the corporate veil" if it has first satisfied a burden of establishing that the transaction is a sham or establishing that there is abuse (for example, if a holding company were to be interposed as a device only to avoid tax and had no other commercial substance).

On the facts, looking at matters like duration of time the holding structure existed, the period of operations in India, the generation of taxable revenue in India during the period of business operations in India, the timing of the exit and the continuity of business on exit, the Supreme Court concluded that there was a bona fide foreign direct investment into India and that it was not therefore appropriate to look through the structure.

In a positive sign for overseas investors, the Court recognized, in reaching its decision, the importance to foreign investment of certainty within the Indian legal system. It emphasized that "*tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner*". The extent to which this case will in fact benefit overseas investors remains to be seen and may depend on whether the Indian government seeks to legislate to restrict its scope.

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If you have any questions, please feel free to contact any of your regular contacts at the firm.

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