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VODAFONE WINS ANOTHER BATTLE - INDIA'S RESPONSE AWAITED

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Recently, the Permanent Court of Arbitration at the Hague passed an award in favour of the telecom giant Vodafone, in an international arbitration initiated by Vodafone International Holdings BV (Vodafone) against the Republic of India under the 'Agreement for the Promotion and Protection of Investments' that India had entered into with the Kingdom of Netherlands (Agreement).

Background

The instant award is preceded by a long-drawn battle between Vodafone and the Indian tax authorities.

Vodafone, a company resident in the Netherlands, acquired in 2007 shares of CGP Investments (Holdings) Limited (CGP), an entity resident in the Cayman Islands from another Cayman Islands company, Hutchison Telecommunications International Limited (Hutchison). CGP through its subsidiaries held majority stake in an Indian company, Hutchison Essar Limited (HEL) (later Vodafone Essar Limited), thus resulting in a change in the ultimate shareholding of HEL upon conclusion of the said transaction.

The Indian tax authorities, in an unexpected move held the said transaction to be liable to capital gains tax in India and accordingly held Vodafone in breach of not fulfilling its withholding tax liabilities on payment of consideration to Hutchison. A notice was also issued to HEL in its capacity as a 'representative assessee'.

A writ petition filed before the Bombay High Court did not result in a favourable result for Vodafone which subsequently filed a special leave petition before the Supreme Court (SC). The SC, in its landmark decision in 2012, ruled in favour of Vodafone and held that the consideration paid by Vodafone to Hutchison was not liable to tax in India. Our analysis of the SC decision is available [here](#).

Soon after the SC decision, the Finance Act of 2012 was passed by the Indian Parliament which nullified the decision of the SC. A retrospective 'clarificatory' amendment was introduced vide an explanation to Section 9 of the Income-tax Act, 1961 which made certain indirect transfers taxable in India. This amendment was given retrospective effect from 1 April 1962. In essence, the effect of the amendment was that transfer of shares of an offshore entity which derived substantial value from Indian assets was taxable in India. Accordingly, Vodafone's acquisition of CGP was now a transaction liable to tax in India and retrospectively so since 1 April 1962.

Aggrieved by this, Vodafone initiated arbitration against India by invoking the relevant provisions of the Agreement.

Decision of the Arbitration Tribunal

From information available in the public domain, a three member Arbitral Tribunal has unanimously passed an award in favour of Vodafone.

India was held to have breached Article 4 (1) of the Agreement, which states that investors of each country must be accorded fair and equitable treatment and enjoy full protection and security in the territory of the other party, at all times. India's conduct in imposing the tax liability retrospectively on Vodafone, along with interest thereon and penalties, notwithstanding the 2012 Supreme Court decision was held to have fallen foul of its obligation under Article 4(1) of the Agreement.

The award further holds that, India is required to "cease the conduct in question" and any failure to comply with such obligation would "engage its international responsibility".

The Ministry of Finance has issued an official statement acknowledging the award, mentioning that the future course of action would be decided and has also hinted that such action could include "legal remedies before appropriate fora".

Comments

Interestingly, in the recently enacted and presently active tax dispute resolution scheme - Vivad se Vishwas Act, 2020 (whereunder tax payers have the option to settle their income tax disputes and get complete waiver of interest, penalty, and potential prosecution by paying only the disputed tax within the prescribed time), arbitrations under investment protection treaties entered into by India with other countries is also a specifically covered dispute eligible for settlement. Though never officially confirmed, it was widely believed that this provision had been introduced to cover arbitrations such as the one with Vodafone and Cairn.

With Vodafone having won this round of the battle, it now remains to be seen what India's next move would be. Options available include a potential appeal probably in Singapore Courts or contesting the enforcement of this award when Vodafone begins proceedings in an Indian court for enforcement of the order (in view of the legal requirement that all foreign awards need to be approved by Indian courts before they can be enforced). News reports suggest that India will contest the enforceability of this award when presented for enforcement in Indian courts.

The present ruling party had clearly expressed its position of being one that did not favour retrospective amendments in taxation laws and promised a steady and certain tax environment to the investors. Hence, it would be interesting to see how it deals with the situation resulting from this award. The economy has already taken a blow with the Covid-19 situation and the Indian government would be walking a tight rope between balancing investor sentiments, international obligations and loss of potential revenue.

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