The Vodafone Case: A Critical Analysis

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Abstract

The Indian Constitution provides that no tax will be exacted or gathered except by the authority of law.[1] Any necessary exaction of money by Government results in imposition of tax which is not allowed except by or under the authority of statutory provisions. The adequacy of tax related statues relies upon the methods through which understanding is embraced as it open to legal interpretations where the technicalities are not an easy breakthrough.

The Vodafone case had been covered in ambiguity till 2012. Thereafter, a new development after some point prompted the fight in court between the Indian Income Tax Department on the one side and Vodafone on the other for the cosmic figure of Rs. 12,000 Crores which caused a stir of numerous business in India.

The present article talks about the significance and source of 'Capital Gains Tax' and its pertinence to Vodafone. Furthermore, the article compares the different provisions as to Capital Gain Tax under the Income Tax Act, 1961 by analyzing its applicability and complexities also bringing into spotlight the various loopholes in the Vodafone case. Since Vodafone is an instance of a lot importance from the perspective of Corporate Law, Investment Law, Arbitration Law and Tax Law, the article also deals on these wide understandings and points of view on Vodafone.

Lastly, the article would also deal with remedies and recommendations for the better application and usage of CGT under Tax laws and changes or new consolidations to the provisions of CGT under the IT Act if required.

Keyword: *Indian Constitution, Capital Gain Tax, business, Corporate Law*

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[1] INDIA CONST. art. 265.

INTRODUCTION

The inception of CGT in India goes back to 1956 after the proposals given by Prof. Kaldor to levy tax on benefits emerging from any transfer or sale of the determined non-stock resource i.e. non-inventory assets. Because of steady development, CGT, as it stands today, is collected on the transfer of every Capital Asset (other than held as stock-in-exchange/trade) which is done with the appropriate mechanism mentioned under Sections 45 – 55A of the IT Act[2]. Section 2 (14)[3] of the Income Tax Act, characterizes the expression "Capital Assets". It is characterized as to incorporate property of any kind, regardless of whether fixed, flowing, versatile, steadfast, substantial or immaterial and whether utilized with the end goal of his business and calling. It likewise determines rejections under Section 2 (14) of the IT Act.

Generally, Capital Gains are assessable in the year in which the transfer of Capital Asset has been made. Section 2 (47) of the Income Tax Act defines the term 'transfer.' The term ‘transfer’ in connection to Capital Asset incorporates sale, relinquishment, exchange, or any obligatory acquisition of the asset or extinguishment of any rights in that asset.[4]
With the end goal of computation of Income Tax, the Capital Assets are divided under two categories:-

- Long Term Capital Assets
- Short Term Capital Assets

It is fundamental that the technique for calculation of Income chargeable to tax and paces of assessments are diverse for both the sorts of Capital Gains. Momentary or Short Term Capital Assets signifies any Capital Asset held by an assesse for not over three years, quickly preceding its date of transfer. Then again, Long Term Capital Assets signifies any Capital Asset held by an assesse for over three years, quickly before its date of transfer.
However, the above rule of three years has certain extraordinary circumstances wherein such period is taken as years i.e. 12 months are as follows:

- Securities like debentures, etc. which on a recognized stock exchange is listed
- Equity or preference shares which may be quoted or unquoted of a company
- Units of a Mutual funds, etc.

VODAFONE CASE: THE FACTUAL ANALYSIS

In February 2007, Vodafone International Holding (VIH), a Dutch Company had procured 100 percent shares in CGP Investments (Holding) Ltd (hereinafter CGP), a Cayman Islands Company for USD 11.1 billion from Hutchison Telecommunications International Limited. CGP, through different transitional organizations/authoritative courses of action controlled 67 percent of Hutchison Essar Limited (hereinafter HEL), an Indian Company. The acquisition came about in Vodafone getting command over CGP and its downstream the subsidiaries including eventually Hutchison Essar Limited. HEL was a joint endeavor between the Hutchison

[2]The Income Tax Act, 1961, No. 43, Acts of Parliament, 1961.
[3]*Id.*
[4] Sec. 2, cl 47, the Income Tax Act, 1961, No. 43, Acts of Parliament, 1961.

gathering and the Essar gathering. It had acquired telecom licenses to give cell communication in various circles in India starting from November 1994.[5]

In September 2007, the Indian Tax Department gave a show-cause notice to the Vodafone Company to clarify why tax was not retained on installments made to HTIL in connection to the above concerned transaction. The Tax department argued that the said transaction of transfer of shares in CGP had the impact of aberrant or indirect transfer of assets located in India.

Vodafone filed a petition in Bombay High Court, among other things, challenged the jurisdiction of the tax authorities in this issue where the Court held that the Indian Income Tax authorities had the jurisdiction over this issue. The order was then challenged in the Supreme Court of India. In 2009, the Court directed the tax authorities to initially decide the jurisdictional issue raised before the court through appeal in the present case.

In May 2010, the Tax authorities said that they had purview to continue against Vodafone for their supposed inability to retain tax from installments made under Section 201 of the Income Tax Act. This order was challenged by Vodafone in Bombay High Court. The Bombay High Court rejected Vodafone's challenge against the order. Vodafone then filed a Special Leave Petition (SLP) against the High Court decisionin the Supreme Court under Article 136 of Indian Constitution. In November 2010, the SLP was accepted and admitted, the Supreme Court also directed Vodafone to deposit a whole of INR 25000 million within three weeks and give a bank assurance of INR 85000 million in about two months from the date of order.

- Indirect transfer of Capital asset situated in India can be subjected to taxation?

The Court observed in respect of Section 9 which states that the Income is deemed to accrue or arise in India if it accruing or arising from a transfer of capital asset in India even for a non-resident[6] that there is omission of words ‘ indirect transfer’ under section 9(1)(i). On the off chance, if the word ‘indirect’ used is read with the expression ‘Capital asset situated in India’ then it would be rendered worthless. And, Section 9(1)(i) doesn’t have a ‘look through’ provision and so cannot be extended to cover indirect transfers of Capital Assets situated in India.[7]Hence, the transfer of shares to CGP did not resulted in the transfer of Capital Assets situated in India and was not subject to taxation.

- Transfer of HTIL’s property rights by extinguishment through SPA?

The tax authorities contended that the rights of control and management HTIL over HEL constituted the property rights which extinguished under the Agreement of sale and purchase of shares and loans (SPA) which was signed dated 15. 03. 2007[8]. This resulted in the transfer of the Capital asset in question taxable. The Supreme Court held that the rights were extinguished because of the transfer of the Capital Asset and because of the various clauses of the SPA.

Furthermore, the Supreme Court held that the sole reason for CGP was not exclusively to hold shares in subsidiary companies but was in addition to empower a smooth change of business. In this way, it couldn't be said that CGP had no business or business substance. Be that as it may, the Tax authorities contended that the transfer of the CGP share was not sufficient in itself to accomplish the object of fulfilling such transfer among HTIL and Vodafone Company and that the nature of the transfer was a transfer of other rights and privileges. It was additionally argued

[5]Vodafone International Holdings B.V. vs. Union of India & Ors, (2012) 6 SCC 613.
[6] Sec. 9, cl 1, sub cl (i), the Income Tax Act, 1961, No. 43, Acts of Parliament, 1961.
[7] Para 71, Vodafone International Holdings B.V. vs. Union of India & Ors, MANU SC 0051 2012.
[8] Para 76, Vodafone International Holdings B.V. vs. Union of India &Ors, MANU SC 0051 2012.

that such rights and privileges established Capital Assets and gains from such transfer are liable to taxation.

The Court observed that if a Non-Resident makes an indirect transfer through maltreatment of the organization structure or legal form and without a sensible and reasonable business reason, which brings about tax shirking or evasion of retaining tax, at that point the tax authorities may dismiss the type of the plan or the reproved activity through utilization of holding companies and may re-describe the equity transfer as indicated by its monetary substance and can impose tax.

- Interpretation of Section 5 and 195 of IT Act

Under Section 5 (1) of the IT Act, the income earned globally (counting any income that is actual or deemed to accrue/ arise/ received) of an individual resident in India is included within the ambit of total income. Under section 5(2) of the IT Act, for a non-resident, the income that is assessable or taxable is which accrue or arise or deemed to accrue or arise or receive or deemed to have received in India.[9]

Vodafone contended and urged the Court to embrace an interpretation of Section 195 as per the built up standards of contention of laws and authoritative purpose as it accepted that Section 195 was inapplicable to seaward entities making seaward or offshore installments/payments. Henceforth, the Court stated that chargeability and enforceability are particular and separate lawful ideas and issued certain guidelines on which Section 195 is to be interpreted such as the said section proposes two requirements, firstly, there must be an installment/payment made to a non-resident, and such payment must be an aggregate chargeable under the Act, the liability to deduct charge emerges if the expense is assessable in India, etc.[10]

THE CHANGING DYNAMICS IN TAXATION LAWS

Parties to contract are allowed to choose whatever legally valid agreement which will suit their business and business reason, yet the genuineness of the transfer can be determined distinctly by taking a look at the lawful course of action and agreement really entered in to and followed. One of the tests to analyze the validity of the structure is the 'timing test' i.e., the time of the consolidation or incorporation of the companies or transfer of the shares and so on. Structures made for authentic business reasons are those which are by and large made or gained when speculation is first made, or further made at the hour of consolidation. It can't be said that HTIL or Vodafone was a 'fly by night' administrator or brief time speculator, as the HTIL worked from 1994 and just in 2007 was the divestment made.[11]

In the present case, the Court applied the ‘look at’ test and said that the High Court had rightly observed that the arguments on behalf of the Department dithered and the reason behind this was ‘dissenting’ approach by them in their arguments. The ‘look at’ approach was clearly stated in W.T. Ramsay Case[12]according to which the work of the Revenue is to find out the lawful nature of the transfer and, at the same time, it needs to take a look at the whole transfer comprehensively and not to embrace an analyzing or dissecting approach. Also, one more perspective should be emphasized. There is a reasonable distinction between predetermined or

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[9] Sec. 5, the Income Tax Act, 1961, No. 43, Acts of Parliament, 1961.
[10] Para 89, Vodafone International Holdings B.V. vs. Union of India &Ors, MANU SC 0051 2012.
[11] Para 73, Vodafone International Holdings B.V. vs. Union of India &Ors, MANU SC 0051 2012.
[12]W.T. Ramsay Ltd. vs. Inland Revenue Commissioners, (1981) 1 All E.R. 865.

the preordained transfer which is made for tax evasion purposes, from one viewpoint, and a transfer which confirms investment to participate in India. So as to see if a given transfer proves a destined or predetermined transfer in the sense showed above or investment to take part, one needs to consider the components listed hereinabove, to be specific, term of time during which the holding structure existed, the time of business activities in India, generation of assessable income in India, etc. Hence, the sale of the shares of CGP Investments cannot be considered as a predetermined or preordained transfer with no other commercial purposes except the tax avoidance and so it was a genuine business transaction and was not a fraudulent one.

A 'Controlling Interest' is an occurrence of responsibility for of the Company and isn't a recognizable or particular Capital Asset independent of the holding of shares because it is an incident of ownership of shares in a company.[13]Those shares holds congeries of rights and liabilities which are creature of the essential documents of the Company and Statute governing it.[14]Transfer of the CGP Investments share consequently brings about certain results including transfer of controlling interestand all things considered, such interest can't be separated from CGP Investments share without a particular administrative or legislative intervention. Likewise, this Controlling Interest can't be dismembered or dissected to permeate and be treated as transfer of Controlling Interest of the downstream entities, and at last to that of HEL. Controlling interest, which stood transferred to Vodafone from HTIL goes with the CGP Investments share and can't be dissected. It is actually an instance of selling of the shares and not a sale of any asset.

At the point when any transaction includes transfer of shares lock, stock and barrel, it can't be separated into singularparts, resources, assets or rights.[15] The tax related provisions would apply just in case if installments are made by an occupant/resident to another non-resident, and not between two non-residents placed outside India. In Vodafone case, the said transaction was the transaction of a Capital Asset between two non-residents, through an agreement executed outside India and it was gone into on a head to-head basis and the consideration was likewise paid outside India.

Also, Vodafone Group's prior interest through the investments in Airtel can't be viewed as a presence in India to bring Vodafone under the purview of the income tax laws. Additionally it can't be viewed as an agent paying taxes in the interest or on behalf of the non-residents which necessitates that the income ought to have deemed to accruein India as there is no transfer of Capital Asset arranged in India. The rights of call and put options are the contractual rights and cannot be considered as Capital Assets until and until the statute governing states so and in its absence it may only be regarded as potential shares till the time such rights are exercised.[16]

THE VODAFONE CASE AND AVOIDANCE OF TAXES- A WIDER CONCEPT

The Vodafone Company argued that the retrospective effect of the tax amendments bring about a forswearing or the denial of justice as under the India-Netherlands Bilateral Tax

[13] Para 88, Vodafone International Holdings B.V. vs. Union of India &Ors, MANU SC 0051 2012.
[14] IRC vs. Crossman, (1936) 1 ALL ER 762.
[15]*Supra* note 13.
[16]CharanjitLal vs. Union of India, AIR 1951 SC 41.

Treaty[17]obligations as to under Article 9.Publicists contrast and differs on the understanding of the expression ‘Denial of Justice’. The denial of justice apart from apart from cases where the court refuse to entertain a suit, it is subjected to undue delay may be done by ‘the clear and malicious misapplication of law’.[18]An individual is allowed to mastermind his business in such a manner along these lines, that he can maintain a strategic distance from a law and its malevolent outcomes insofar as he doesn't violate that or some other law. The significant question that arises under the International Taxation is that the retrospective tax collection adds up to considerable obstruction with Vodafone's shareholding or not. It is comprehended that the Government of India by then gave confirmation that retrospective tax assessment wouldn't be appropriate to Vodafone and no Indian Court will take access to it as a result of the treaty.All organizations rely upon charging of tax strategies, consistencies and sureness so as to design speculations as long as possible. The retrospective taxation principles ought to be presented uniquely in the rarest of rare cases and that, whenever applied to CGT, the authorities should seek after the vender/seller, not the purchaser and herein the Vodafone Company is the latter & not the previous for the situation in hand.

Additionally, a statute of taxation i.e. Income Tax Act is to be carefully understood. The source of intensity which doesn't talk about tax assessment explicitly can't be translated or interpreted by extending its width as to incorporate in it the power to impose by suggestion or by essential deduction. A subject will be obligated to assess for taxation and will be entitled for exclusion any such taxes as per strict language of the statute which is by applying the ‘literal rule of interpretation’[19]. If there is a case of an uncertainty or a question, it is well settled principle that the interpretation must be made for the assesse and against the income tax department. The standard of Strict Construction has been fervently weakened by the Supreme Court for the straightforward and clear reasons that the Vodafone Company being a remote Company isn't being subjected to Indian Jurisdiction thereby hampering the sound understanding of the taxation laws.

Global or the multinational companies, for example, Vodafone in this way work in a worldwide tax assessment condition which is dictated by governments working separately and all in all molded by voters in majority rules systems. Bigger organizations are progressively unpredictable, which thus implies a more prominent degree of multifaceted nature in applying the guidelines. Governments for the most part likewise require worldwide organizations to apply the transfer pricing rules in between the organizations’ activities to guarantee that the benefits and any other profits are allotted to the nations where the significant monetary actions takes place.

CONCLUDING REMARKS

The trans-border acquisition of Indian Companies has had been a focal point of the Tax Authority in the course of recent few years. It is well settled that if the acquisition includes an

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[17] Convention between the Kingdom of the Netherlands and the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital http://www.itc-leiden.nl/UserFiles/Documents/India%20ENG.pdf.

[18] Robert Azinian vs. The United Mexican States, ICSID Case No. ARB (AF)/97/2, Nov. 1999, paras. 102,103.

[19] CIT vs. N.C. Budharaja& Co, (1993) 204 ITR 412 SC.

immediate transfer of shares of any Indian Company, then the equivalent would trigger assessable Capital Gains under the taxation laws. In any case, there have not been cases which may be used for reference in the past where the tax authorities have endeavored to impose Capital Gains emerging on the transfer of shares of a foreign holding Company of an Indian subsidiary company on the basis that such transfer includes a circuitous transfer of the underlying Indian resources and assets.

The Vodafone case is an achievement in the Indian tax history which brought into spotlight the actual intentions of the parliament and the down to earth trouble in the application of CGT under the taxation laws. The intention of the Parliament can be best communicated uniquely through the content of the Income Tax Statute itself. Clearly, the most ideal approach to offer impact to Parliamentary Intention in Tax will be to express the policies and the arrangements unmistakably in the particular enactment by having a basic structure for the taxation system. Then again, the provisions as to CGT should be returned to and given more extensive degree to its importance in the ambit of International Taxation. It would help in increasing the clarity, transparency and legitimacy by giving full impact to Parliamentary Intentions without abrogating it.