

Tax Hotline

July 10, 2008

THE VODAFONE TAX CONTROVERSY NDA COMMENTARIES ON COURT PROCEEDINGS*

The Vodafone tax controversy concerns a cross-border M&A transaction between non-resident entities and its taxability in India. The facts before the Bombay High Court are unique and unprecedented, and the outcome could have a telling impact on global mergers and acquisitions, indirectly involving an Indian subsidiary. Nishith Desai Associates brings you updates on the final hearing which concluded on July 9, 2008. The judgment is reserved

On July 9, 2008, Mr. Mohan Parasaran, counsel for the Income-tax Department ("**Revenue**"), continued his submissions with respect to the retrospective amendments to section 191 and 201 of the Income Tax Act, 1961 ("**ITA**"). He submitted that there was no alteration in law as it stood prior to the amendment in 2008, vis a vis the duty of the tax payer to deduct tax at the time of payment. He urged that under section 195, burden was cast on the Petitioner, i.e. Vodafone International Holdings BV ("**Vodafone**") to deduct tax at source before making payment to Hutchison Telecommunication International Limited ("**HTIL**") This was the same situation prior to the amendment. The amendment was merely clarificatory in nature and did not intend to affect the obligation cast on Vodafone.

He further submitted that unless it is demonstrated by the Petitioners that any of their rights are affected, it cannot challenge the retrospective amendment to section 191 and 201 as the Parliament possessed plenary powers to pass both prospective and retrospective amendments. Moreover, he urged that the petitioner having failed to avail of the mechanism provided under section 195 cannot turn around and complain that its rights are being affected and thereby cannot be allowed to take advantage of his own wrong. He concluded by submitting that it is settled law that the court must make every effort to uphold constitutional validity of a statute and also that fiscal statutes must be interpreted with more play in the joints i.e. courts must afford greater latitude to them than other statutes.

Mr. Chagla, counsel for Vodafone, in his rejoinder (rebuttal) to Revenue's arguments recapitulated his submissions made by placing the following propositions, before the Court:

1. The show cause notice is without jurisdiction as both before and after the 2008 amendment the Petitioner is not deemed to be an 'assessee in default'.
2. The provisions of section 195 have no extra territorial application. In an offshore transaction involving two non-residents in respect of a capital asset (i.e. share capital) and payment outside the country, even assuming that such transaction is chargeable to tax, there is no obligation to withhold tax under section 195.
3. The 2008 amendment to the extent that they purport to be retrospective are unconstitutional.
4. In any view of the matter the transaction in question is not chargeable to tax in India under section 9 or otherwise. The Petitioner accordingly was under no obligation to withhold tax as required under Section 195.

With regard to chargeability of the transaction, Mr. Chagla emphasized that the transaction in the present case is the transfer of share capital of a non-resident company and accordingly does not satisfy the definition of a capital asset situate in India. He further contended that *while there is a transfer of the controlling interest in the shares of Vodafone Essar Limited¹ ("**Vodafone India**") by the transfer of shares of CGP outside India, on the basis of judicial precedents (there is no transfer of a capital asset within India.* The expression "directly or indirectly" in Section 9 relates to income accruing or arising and not to the transfer of a capital asset. In other words income may arise directly or indirectly through the transfer of a capital asset but such capital asset must be situated in India. Where therefore there is no transfer of a capital asset, situate in India, lest controlling interest which is not a capital asset, Section 9 can have no application whatsoever. In this context he referred to section 64² of the ITA, where the expressions directly or indirectly qualify an asset and not income, unlike section 9. In this context, he urged that it is well settled that a taxing statute must be construed strictly and there is no room for intendment.

Mr. Chagla reiterated that the obligation to withhold tax even where the payee is chargeable to tax does not apply to a non-resident who has no presence in India. As a corollary he submitted that if section 195 is to apply to a non-resident having no presence in India, the machinery of deduction and collection of tax would be unworkable. He heavily relied on the principle of contextual interpretation of statutes as against the statutory interpretation relied on by the Revenue. Contrary to the Revenue's stand he emphasized that section 195 was not merely a machinery provision to collect tax but a substantive provision.

Finally on the retrospective amendments relying on his submissions, Mr. Chagla submitted that assuming the Petitioner was under an obligation to withhold tax under section 195, under section 191 the primary liability to pay the tax remains that of the payee. Therefore, by reason of failure to deduct or withhold tax, the Petitioner is liable to

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be penalized under section 271C but his liability to pay the tax arises only when the payee fails to pay the tax. It is the admitted position in the present case that the payee has not been called upon to pay the tax. The payee therefore cannot be said to have failed to pay the tax, in which case the condition precedent to the applicability of the deeming provision is not fulfilled. As a consequence thereof, Vodafone cannot be deemed to be an 'assessee in default' for the tax liability of the payee. Distinguishing the judgments cited by the Revenue on this aspect, he submitted that none dealt with the post 2008 amendment situation and hence are out of context.

The hearing finally concluded with Mr. Chagla requesting one week's time to file further written submissions summing up the above arguments in rejoinder (rebuttal to Revenue's reply). The case is reserved for orders. The judgment is estimated to take about a month's time. However, considering the importance of the matter and huge stakes involved, both parties have already indicated that depending on the judgment, either would prefer an appeal to the Supreme Court.

- **International Tax Team & M&A Team**

¹Earlier known as Hutch Essar Limited

²Section 64 deals with income of individual to include income of spouse, minor child etc. where the expression directly or indirectly are used in the context of transfer of asset to the spouse for adequate consideration.

* Previous commentaries: [June 27, 2008](#), [June 30, 2008](#) [July 2, 2008](#), [July 8, 2008](#),[July 9, 2008](#)

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