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Genpact deal distinct from Vodafone: Experts

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New Delhi India’s tax authorities will likely stake claim to levy capital gains tax on Bain Capital’s purchase of a 30% stake in Indian BPO firm Genpact under the new law dealing with the indirect transfer of shares that have underlying Indian assets. However, the case would be distinct from the Vodafone case in many respects, tax experts reckon.

Unlike Hutchison Whampoa, the Indian assets of which (Hutch Essar) was bought by telecom giant Vodafone in an $11-billion deal through CGP, a Cayman Island firm, in 2007, Genpact is a widely held and listed entity. So it would be even more difficult for the tax man to cite the substance-over-form doctrine and dub the the structure a mere tax avoidance scheme. Besides, Genpact's entire income doesn't come from India, unlike in the Hutch Essar case.

Genpact delivers services from 18 countries around the world, including the US, where it has more than 3,000 employees. It cannot be argued that the sole purpose of creating a worldwide business structure is to avoid taxes in India, they said. “Even if the authorities want to tax the transaction, the rules regarding indirect transfer of assets are silent about the method of apportioning the cost of acquisition of the assets situated in India and the consideration,” said an expert, who did not want to be identified.

Moreover, according to Bijal Ajinkya, partner and head of international tax at Nishith Desai Associates, there is a lack of clarity since terms like "substantial value" are not yet defined. "This particular tax liability, if arising, is due to the retrospective amendment to the tax laws by the Finance Act, 2012. The constitutional validity of this amendment, by way of a clarification, is itself in question," said Ajinkya.

The Genpact deal would be an ideal example of portfolio investments, the taxation of which has been referred to the Parthasarathi Shome committee.

Another tax partner with a consultancy firm, who also declined to be identified, noted that unlike in the case of the Vodafone-Hutch deal, none of the sellers in Genpact — Oak Hill Capital and General Atlantic — has a 100% stake in the Indian assets. So it would be left to the tax authorities to define how the sale consideration and the cost of acquisition assignable to the Indian assets are determined.

Under Indian tax laws, liability to withhold tax is that of the payer (so Vodafone was asked to pay) and default of such obligation makes the payer liable for the principal sum, interest and penalties.

After the Supreme Court ruled in favour of Vodafone in a lengthy legal battle against the Indian tax authorities in January, dismissing a $2.2-billion tax demand over the British firm’s purchase of the Indian mobile assets five years earlier, the finance ministry retrospectively clarified that it has the right to tax income arising from the country irrespective of where the business is incorporated.

The amendment to section 9 of the Income Tax Act had caused widespread criticism, prompting the government to decide on addressing its unintended consequences. The Prime Minister's Office on July 30 referred the issue of portfolio investments to the Shome committee looking into anti-avoidance rules or GAAR. A clarification on the applicability of the amendment is awaited.

Mukesh Butani of BMR Advisors, a member of the government's working committee on international taxation, declined to comment on the deal but said, “The exercise of clarifying on the unintended consequences of the amendment to the Income Tax Act (Section 9) is on.”

The PMO had said it was necessary to have clarity on the tax liability of portfolio investors and foreign institutional investors as a result of this amendment, particularly when the investment is made through a registered stock exchange. Genpact is listed on the New York Stock Exchange.