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SC refuses relief to Vodafone

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The Supreme Court on Monday denied the extension of an eight-week stay granted by the Mumbai high court to Vodafone in tax liability case relating to the purchase of the Indian assets of Hutchison Whampoa for $11.1 billion in 2007.
The apex court directed the income-tax (I-T) department to determine the taxes payable by Vodafone by October 25 when the next hearing is scheduled. The court, however, admitted a petition filed by the UK-based telecom major that challenged the liability as well as jurisdiction of the Indian taxation authorities over the deal.
Some industry analysts see an adverse impact on Vodafone, given the huge tax burden it faces. But they rule out the possibility of the case outcome impacting its 3G rollout plans or network expansion.
“Some part of the deal is taxable and some part not. The apportionment of the quantum of tax to be paid by Vodafone will be done on October 25,” said counsel for the company, Harish Salve.
Nishith Desai, chairman of Nishith Desai Associates and special counsel to Vodafone, told Financial Chronicle: “We will see on what basis the tax department apportions the tax liability. In our view there is no tax to be paid at all.”
The company that bought the Indian operations of Hutchison Whampoa three years ago came under the tax scanner for its failure to pay capital gains tax of Rs 12,297 crore. Vodafone has contested the tax department’s claim and contended that it has no jurisdiction over the deal as it was between two overseas companies.
The tax department on the other hand maintained that since most of company assets were in India, it was liable to pay tax.
“Vodafone is an overseas company that bought shares in another overseas company from another overseas company. Hence, we believe this transaction is not subject to tax and we have not made any capital gains on it,” said the Vodafone group spokesperson in a telephonic interview from London.

Officials of the Central Board of Direct Taxes said the assessing officer would pass an order under Section 201 of the Income- Tax Act within four weeks, as stipulated by the Supreme Court, determining the tax deduction at source (TDS) that Vodafone should have withheld towards capital gains related to the transaction.
The order will also impose an interest of 1 per cent per month on tax dues. This amounts to 36 per cent interest since three years have elapsed since the deal.
Simultaneously, officials explained, the tax authorities would also slap a demand notice on Vodafone under Section 256 of the act giving it one month to pay the dues along with interest charges. The income- tax authorities have inherent powers under the act to allow dues to be paid in part or in instalments.
The tax department has already hinted that the Vodafone tax liability in the deal would be around Rs 12,297 crore. In a letter sent to Vodafone on May 31 this year, the department had asked the company to approach the tax authorities with their explanation. This was not a formal demand notice. Tax officials said a formal determination of taxes due would now be made. It is premature to say whether the liability would be higher or lower than the initial estimate that had been made.
Vodafone’s tax troubles came not too long after its write-down of $3.5 billion of its enterprise value in May

earlier this year. Analysts, however, feel that while Vodafone will definitely take a hit and its cash flows impacted, the company is large enough to weather the storm.

“It is likely to have a huge impact on their overall finances and future deployment. But I don’t think they will like to lose their first- mover advantage in the 3G rollout and vacate the space for the competition,” said country managing director of Protiviti Consulting, Mritunjay Kapur. He, however, felt that the ruling would have a major impact on future cross-border private equity deals. “It will definitely increase the cost of mergers and acquisitions,” he added.

The debt burden of Rs 11,620 crore, or £1.74 billion, due to the licence fee for 3G spectrum did not affect Vodafone’s financials much. According to the Vodafone group's financial report for June quarter, net debt on June 30 this year was £32.7 billion, lower than the burden of £ 33.31 billion at end of previous quarter. Vodafone’s quarterly report said free cash flows generated during the quarter and favourable foreign exchange movement together broadly offset spectrum payments. The only other spectrum payment by Vodafone was in Germany, of around £1.26 billion. A telecom analyst and director of Com First, a telecom consultancy, Mahesh Uppal, said the ruling might not imply a major course correction for the company’s India plans. “While they will have to just grin and bear it, I don’t see it as a setback from which the company can’t recover,” he said.

Shrishti Anand, a telecom analyst with Angel Broking, believed the tax obligation would not have any serious ramification on the company’s 3G rollout or its financial performance in India. “Vodafone has a very strong balance sheet with good parental support unlike many Indian telecos which have stretched them elves to bid for 3G licences.”

A Motilal Oswal report last month said Vodafone Essar subscription fell 4 per cent month on month (MoM) to 2.31 million, but grew five per cent year on year (YoY). The company’s overall subscriber base grew 41 per cent YoY and two per cent MoM to 113.8 million.

As of June 30, Vodafone’s India operations contributed around 80 per cent revenue from the Asia Pacific and West Asian regions. The total revenue for quarter ended June 30 grew 13.7 per cent to 954 million pounds, the company said. The total revenues from India, for the Vodafone group, in 2009-10 were £ 3.11 billion.

(With inputs from Rajesh Gajra in New Delhi and Vikas Srivastav in Mumbai)

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