Indian Court Dismisses Vodafone's Tax Claim Challenge

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(Adds comment by Vodafone adviser in fourth paragraph.)

Sept. 8 (Bloomberg) -- The Bombay High Court dismissed Vodafone Group Plc's challenge of a tax claim exceeding $2 billion after the court ruled Indian authorities have the right to pursue the case.

Indian tax authorities have the jurisdiction to seek taxes from Vodafone International Holdings BV on its 2007 purchase of Hutchison Whampoa Ltd.'s wireless operations in the country, Judges D.Y. Chandrachud and J.P. Devadhar said. India's tax department had argued the world's biggest mobile-phone company failed to withhold taxes on its acquisition of Hutchison's stake in Hutchison Essar Ltd., or HEL.

The ruling is a setback for Vodafone in a case seen by investors as a test of India's tolerance toward the use of tax havens for acquisitions, according to Akil Hirani, a managing partner at Mumbai-based law firm Majmudar & Co. Britain's Prime Minister at the time Gordon Brown wrote in December to his Indian counterpart Manmohan Singh that taxing cross-border deals such as Vodafone's could create uncertainty for foreign investors and affect the country's investment climate.

"This will create a lot of difficulties in cross-border mergers and acquisitions," said Nishith Desai, managing partner at Mumbai-based law firm Nishith Desai Associates, which is advising Vodafone on the tax dispute.

Vodafone announced its $10.7 billion acquisition of a 67 percent stake in Hutchison Essar in 2007. The transaction was between Netherlands-based Vodafone International and Hong Kong- based Hutchison and the stake Vodafone acquired was owned by a Cayman Islands-based holding company.

Shares of Newbury, England-based Vodafone fell 0.2 percent to 159.55 pence as of 1:20 p.m. in London trading.

'Significant Nexus'

"The transaction in question had a significant nexus with India," Judges Devadhar and Chandrachud said in their 196-page judgment. "The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The transaction between the parties covered within its sweep, diverse rights and entitlements. The petitioner by the diverse agreements that it entered into has a nexus with Indian jurisdiction."

The court directed tax authorities to not issue a final order on its claim for a period of eight weeks and allowed Vodafone 12 weeks to appeal the ruling.

Vodafone is reviewing the judgment and is likely to appeal the ruling, spokesman Ben Padovan said by telephone.

'Adverse Impact'

"If they lose in the high court, we're going to see an adverse impact on M&A transactions, especially offshore transactions," Majmudar & Co.'s Hirani said, before the court announced its verdict. "In fact, the impact is already being felt, because over the last two years as the Vodafone controversy has ballooned, people have been wary, and deal structures are being looked at differently."

The outcome of the case will set an important precedent for how the Indian government taxes deals structured like the Vodafone-Hutchison deal, where the transaction takes place overseas but the underlying assets are in India.

"Large deals involving multinational companies and tax haven holding companies" are under scrutiny by Indian authorities, said Hitesh Jain, a partner at ALMT Legal in Mumbai. "Practically every such deal that's happened in the last two or three years is being studied."

SABMiller Plc was served a notice from the tax authority on June 21, for taxes on its in 2006 acquisition of Foster's Group Ltd.'s Indian beer business. SABMiller responded to the Indian tax authority's show-cause notice last month, Nigel Fairbrass, a London-based spokesman for the brewer, said in an e-mail. The company is "confident in the strength of its case," he wrote.

'Indian Nexus'

The Indian tax authority approached Vodafone in September 2007, saying the company owed the government taxes from the purchase. At the time, Vodafone Essar Chief Executive Officer Arun Sarin said the carrier would contest the $2 billion claim.

The Bombay High Court ruled in December 2008 against Vodafone's initial challenge of the tax claim. The carrier's appeal of that ruling was dismissed by India's Supreme Court in January 2009, and the case was heard again in the high court last month.

Vodafone argued that since the transaction took place between two overseas companies and the target asset was registered in the Cayman Islands, it doesn't owe taxes in India.

The Indian tax authority argued that the deal should be taxed because, although the share transfer was of a Cayman Islands entity, the deal had an "Indian nexus," according to Mohan Parasaran, the department's senior counsel.

Vodafone Essar Ltd. is India's third-largest wireless operator, with more 111 million subscribers and a 17 percent share of India's 652 million mobile-phone accounts at the end of July, according to the nation's telecommunications regulator.

--With assistance from Matthew Campbell in London. Editors: Suresh Seshadri, Young-Sam Cho, Robert Valpuesta.

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