Vodafone, FIIs get huge tax breather

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The Parthasarathi Shome Committee on Tuesday offered potentially massive relief to Vodafone, the world's biggest mobile phone company, when it recommended that asset transfer deals should not be taxed retrospectively.

If passed by the government, it will mean Vodafone won't need to pay Rs12,000 crore of retrospective tax for its acquisition of majority stake in Hutchison Essar in 2007.

The panel also clarified that foreign institutional investors and private equities investing indirectly in Indian companies will not be hit by such indirect transfer tax rule, providing massive relief to investors in Indian capital markets which were worried about the 'draconian' tax twists in the times of finance minister and now president Pranab Mukherjee.

Sudhir Kapadia, National Tax Leader, Ernst & Young, said perhaps for the first time in Independent India, an expert committee has clearly articulated the need for government to exercise its Constitutional power to amend tax laws retrospectively only in "rarest of rare" cases.

It's noteworthy that this term is used in awarding death sentences in criminal law jurisprudence and the committee rightly believes that this a drastic weapon in the hands of government that ought not be used indiscriminately just to "increase the tax base", he said. This also means an income earner should not be penalised with interest and penalties on back taxes leviable on him.

Pranay Bhatia, partner, economic laws practice, RSM Astute Consulting Group, said if the recommendations go through, not only Vodafone, but other transactions like Cadbury's acquisition of Kraft Foods globally could also get relief," he said.

Vodafone will also be exempt of complete tax liability if these recommendations are followed, including exemption from all purchases (including purchase of shares which were done in good faith according to the laws of the land at that time).

"If at all anyone has to pay in Vodafone's case, it has to be the seller (Hutchison Whampoa) which will be taxed retrospectively. However, in the case of other companies, the report has protected small investors by stating that small shareholders holding less than 26% stake in the company need not be taxed," Bhatia said.

The Shome panel said retrospective application of tax law should occur only in "rarest of rare cases" and that the government should best avoid introducing fundamental changes to tax provisions without consultations and thus not anticipated by the taxpayer.

These recommendations, coupled with several more, bring in a lot of clarity on the retrospective amendments introduced in the Finance Act, 2012, replacing some provisions in the Income Tax Act, 1961.

The most prominent of these amendments was Section 9(1)(i) of the Act which became effective retrospectively as of April 1, 1962, bringing asset transfers between two non-resident entities under taxation which has an underlying asset in India.

Anuradha Dutt, Vodafone counsel, said making Vodafone pay retrospectively was unfair and the company welcomes the decision.

Nishith Desai of Nishith Desai Associates said there is absolutely no question of the government losing any revenue because of this.

"It was never due to our country, so how can we say there was a loss? If you artificially try to test something, you can't say you are losing revenue. The GAAR provisions were extra-territorial. It would have led to breach of Comity of Nations and unleashed economic war if every country said the same thing," Desai said.

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