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Vodafone Is Liable for Tax on India Deal, Court Finds

By VIKAS BAJAJ

MUMBAI, India — A court on Wednesday ruled against Vodafone, the cellphone company, in a tax case that could deal a significant blow to foreign investors who own or want to buy shares and companies in India.

Ruling in favor of India's Income Tax Department, the Bombay High Court said Vodafone was liable for taxes on its $11 billion acquisition in 2007 of a controlling stake in one of India's largest cellphone companies. The court gave Vodafone eight weeks to appeal the judgment to the Supreme Court, India's highest court.

Legal specialists said the decision could have far-reaching ramifications if it established the precedent that any transaction involving Indian assets was subject to local taxation even when such deals were made overseas. It would raise the cost of new acquisitions and could result in tax bills on past deals that had escaped the notice of Indian authorities.

In a statement, Vodafone said it was considering appealing to the Supreme Court. "Vodafone remains confident that there is no tax to pay on the transaction," the statement read.

Indian tax authorities argued that Vodafone should have withheld capital gains taxes from the $11 billion it paid to Hutchison Whampoa for its 67 percent stake in Hutchison Essar, which is now known as Vodafone Essar, India's third-biggest cellphone company by subscribers.

Indian officials contend tax is owed on the deal because the assets sold are based in India — a position that the court affirmed on Wednesday — and that Vodafone, as the buyer, was responsible for remitting the money to the government.

But Vodafone has maintained that no tax was owed on the transaction because it took place between offshore corporations — Vodafone and Hutchison — and the entity that was acquired was legally registered in the Cayman Islands.

It is unclear how much Vodafone might have to pay. Indian authorities have not said how much they would be seeking, but analysts have said it could be as much as $2.6 billion. On Wednesday, the court suggested that tax might not be owed on the entire sale price.

Whatever the final amount, it is likely to sting Vodafone, which is already struggling with the high cost of its many acquisitions and intense competition in markets like India. In May, Vodafone wrote down the value of its Indian operations by £2.3 billion ($3.5 billion).

Though the ruling is unlikely to dissuade all foreigners from investing in India, one of the fastest-growing economies in the world, it will require them to evaluate any deal with a new risk and cost in mind: taxes.

For the Indian government, which has a large budget deficit, the case against Vodafone is part of a struggle to stem the use of offshore tax havens to shield from taxation income derived in India.

Most foreign investors who buy or invest in Indian companies do so through offshore entities to protect their gains from taxes. Even many Indian individuals and businesses use foreign shell companies to hide wealth and income from the government, critics say.

India is not alone in going after such deals.

Late last year, China issued a rule that made the sale of stakes in Chinese companies by offshore entities taxable in that country. The rule does not apply to the sale of shares that are traded on a public stock exchange.