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Vodafone back to square one

INCOME TAX LAW: Experts call the move unconstitutional say will drive away foreign investors

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The finance minister has opened a can of worms — or tax cases. A clarification to the Income Tax Act said transactions between foreign entities which hold assets in India will now be taxed in India, and that too, retrospectively.

The most high profile case is the 2007 transaction of British major Vodafone Plc, as it bought out Hutchinson's stake in Indian entities. The company is still celebrating a favourable Supreme Court verdict which said since the law does not specify it, the transaction cannot be taxed. The case, which could result in Rs 11,297 crore to revenue authorities' coffers, may now be re-opened.

The immediate government reaction was that no new move will be made in the Vodafone case.Finance Secretary R S Gujral told reporters that the finance ministry will not make a fresh demand as a review petition is pending in the Supreme Court.

BATTLING IT OUT

M&A deals in courts across India:

- Idea Cellular-AT&T $ 150 mn deal pending in Bombay HC
- GE-Genpact $ 500 mn deal pending in Delhi HC
- Mitsui-Vedanta $981 mn deal in Sesa Goa pending in Goa HC
- Sabmiller-Fosters 2006 deal pending in Bombay HC
- Sanofi Aventis-Shantha Biotech $770 mn deal pending in Bombay HC

Vodafone's legal counsel reacted sharply. "This is oppressive, shortsighted and is liable to be declared unconstitutional," said Fereshte Sethna, Mumba- based partner at Dutt , Menon Dunmorrsett, and a member of the legal team that advised Vodafone Plc in the Supreme Court. "The Vodafone tax case having had the benefit of the final un-appealable verdict of the apex court is effectively entitled to be excluded from the ambit of any purported retrospective proposed legislation."

The Vodafone ruling seems to have prompted the government to insert the explanation into the Income Tax act. "For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India," it said.

Government lawyers said Vodafone celebrated its victory too soon. Mohan Parasaran, the additional solicitor general who represented the Income Tax or I-T Department in the Vodafone case, said, "They are back to square one now. There is an order in place and the case will automatically stands opened unless, of course, someone challenges the amendment."

N C Hegde, Partner, Deloitte Haskins and Sells said that there have been many cases where judicial proceedings have been overruled. "Even in the Vodafone case, they have been very clear that the government will frame the law, we will interpret it," he said.

Foreign investors will shy away

Nishith Desai, the head of international law firm Nishith Desai and Associates called it the 'budget with a vengeance'. "Today's move disregards and opposed Supreme Court and even the constitution in some ways as they are imposing liabilities retrospectively. It is a sure-shot way to drive away foreign investors," he said.

Many foreign investors are already fighting tax battles over claims by the I-T department. As many as six other cases are being contested in courts. A deal which has been affected is between Vedanta group and Cairn Energy. Cairn has agreed to pay tax in India as well as the UK on selling its stake in Cairn India to Vedanta Resources. The tax liability could be anywhere between $868 million to $1.1 billion.

"Foreign investors’ confidence in the rule of law being upheld in India will be shaken and they have to be prepared to invest in an aura of uncertainty," said Hitesh Gajaria, Partner, KPMG.

Deals that may feel the pinch include old ones and new. A case being heard in the Delhi High Court involves the 2004 deal where General Electric (GE) sold stake in Genpact to General Atlantic and Oak Hill Partners. "This will increase complexity. It is extremely worrisome. You are trying to bridge the revenue gap through a retrograde step. Mind you, the whole world is watching," warned Pramod Bhasin, vice-chairman, Genpact.

Other deals under the scanner of the I-T department can include sale of AT&T stake in Idea Cellular to the Tata group, which was done through a Mauritius-based subsidiary. Mitsui, which sold 51 per cent in Sesa Goa to Vedanta group in 2007, routed it through a UK-based company. Others include SABMiller's acquisition of Foster's India, and French company Sanofi Aventis' deal to buy majority stake in vaccine company Shantha Biotech in 2009.