

## Tax Hotline

July 02, 2008

### THE VODAFONE TAX CONTROVERSY NDA COMMENTARIES ON COURT PROCEEDINGS\*

The Vodafone tax controversy concerns a cross-border M&A transaction between non-resident entities and its taxability in India. The facts before the Bombay High Court are unique and unprecedented, and the outcome could have a telling impact on global mergers and acquisitions, indirectly involving an Indian subsidiary. Nishith Desai Associates brings you updates on the final hearings as and when they develop in the courtroom.

On July 1, 2008, Senior Advocate Mr. Iqbal M. Chagla, counsel for Vodafone International Holdings BV (“Vodafone”) started the day in court by continuing his proposition from the [previous hearing on June 30, 2008](#). He completed this proposition examining the constitutional validity of the retrospective amendments made to Sections 191 and 201 of the Income Tax Act, 1961 (“ITA”). The counsel ended the day by introducing his next proposition, which deals with the very chargeability of a transaction between non-resident entities wherein an Indian subsidiary could be present.

With respect to the constitutional validity, the counsel reiterated that while the Parliament has plenary power to make retrospective amendments, these must satisfy the fundamental constitutional tenets of reasonableness and equality, lest they should be struck down as violative of Article 14 of the Indian Constitution. Article 14 of the Constitution of India provides that *the State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India*.

It was submitted that the impugned amendments to Sections 191 and 201, which are purported to be clarificatory, were violative of Article 14 insofar as they operated with retrospective effect from June 1, 2003 and June 1, 2002 respectively. The counsel emphasized that a clarification by its very nature must operate since the commencement of the statute and not for a specific period as the legislature cannot have different intentions for different periods of time. It was contended that such an amendment, if recognized, would amount to an unequal treatment of equals insofar as the liability of a person entering into a similar transaction prior to the respective dates of retrospective amendments would be different from that of a person thereafter.

It was further submitted that while it is for the legislature to legislate, it is only for the judiciary to interpret these laws. The counsel cited the judgment of the Constitution Bench of the Supreme Court in *Union of India v. Elphinstone Spinning & Weaving Co. Ltd.*,<sup>1</sup> which states that *once a statute leaves Parliament House, the Court's is the only authentic voice which may interpret the Parliament*. Therefore, he submitted that explanatory notes to the Finance Bill, 2008 could not dictate the legislative intent upon the court.

It was further reiterated that the impugned retrospective amendments were not clarificatory, but substantive in character and sought to levy additional liabilities, which did not hitherto exist. The counsel concluded this proposition by beseeching the Court to strike down the impugned amendments as unreasonable, inequitable and burdensome.

Towards the end of the day, Mr. Chagla introduced his next proposition dealing with the chargeability of capital gains tax in the hands of a non-resident under section 9 of the ITA. It is the contention of the Income Tax Department (“Revenue”) that Vodafone is liable to deduct tax at source from the payment made to a Cayman Islands company (“Vendor”) for the acquisition of another Cayman Islands company, which indirectly holds shares in an Indian company. Under the ITA, a non-resident is liable to tax only with respect to income which accrues or arises in India or income which can be so deemed to accrue or arise in India. Under Section 9 and in the facts and circumstances of the instant controversy, only income *accruing or arising, whether directly or indirectly, through or from a business connection in India or through the transfer of a capital asset situated in India can be brought to tax in India* at the hands of a non-resident. It was the counsel’s contention that the capital gains accruing to the Vendor satisfied neither of these conditions and hence were not taxable in India. He submitted, as a corollary, that Vodafone could have no responsibility to withhold tax from the consideration paid to the Vendor.

The counsel proposed to make detailed submissions regarding to the above proposition on Friday, July 4, 2008. We will once again attempt to bring to you accurate updates and analysis on the Vodafone Controversy as it unfolds in the courtroom.

- International Tax Team & M&A Team

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\* Previous commentaries: [June 27, 2008](#) & [June 30, 2008](#)

1 (2001) 4 SCC 139

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