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Updates on
• Tax

TAX

A. Vodafone controversy

The Bombay High Courts' judgment in Vodafone controversy has further raised uncertainty on the issue of taxation of cross border acquisitions between two foreign entities attributable to Indian operations, whether directly or indirectly.

Facts-

Hutchison Telecommunications International Limited sold shares of its wholly owned subsidiary CGP Investments, a Cayman Islands Company, which in turn held a controlling stake in Hutch Essar Limited ("Vodafone India") through various Mauritian

entities, to Vodafone International Holdings BV ("Vodafone"), a Dutch company, for a consideration of USD \$11.2 billion.

The Income Tax Authorities issued show cause notices to both, Vodafone and Vodafone India., Vodafone was alleged to be assessee in default," for its failure to withhold taxes at source and Vodafone India was issued the notice as a representative assessee.

Vodafone challenged the validity of the said show cause notices by filing a writ petition before the Bombay High Court.

Held-

The Bombay High Court dismissed the writ petition on the ground of non-maintainability and held that there was no patent illegality in issuance of the show cause notice by the revenue. The High

Court extended the stay granted earlier for a further period of eight weeks, so that Vodafone could approach the Supreme Court. The High Court was prima facie of the view that transfer of share in CGP by HTIL to Vodafone, which in turn effected the change in controlling interest in Vodafone India, amounted to transfer of capital assets in India. However, the question was left open to be decided by the IT Adjudicating Authorities. It also refrained from answering the question relating to the constitutional validity of the amendment in Sections 191 and 201 of the IT Act having retrospective effect. The question whether Section 195 of the IT Act applies to non-residents having no presence in India was also not answered.

Comment-

Vodafone's decision to challenge the show cause notice before the High Court may not have been the best strategy as it is a settled proposition of law that High Courts should not entertain writ petitions in those cases (especially tax related), where there is an alternate remedy available to the petitioner (filing of reply before adjudicating authority in this case), except in case of a show cause notice that is ipso facto illegal, unlawful or void.

Approaching the Authority of Advance Ruling (AAR) or simply filing a reply to the show cause notice might have been a better way forward, as the adverse observations could now be detrimental to Vodafone in the adjudication proceedings.

This decision should not impact the tax liability in other similar transactions involving a non resident transferor-transferee. However, it would be critical to examine the facts of each case to determine the withholding obligations of the payer.

The High Court's observations are not binding, as the main question before the Court was whether to interfere with the show cause notice. The Court was not testing a final decision of the IT Authorities on merits.

Note-

Vodafone had filed a special leave petition before the Supreme Court (SC) of India against the Bombay High Court's decision (supra), SC suggested that Vodafone should follow the normal course by replying to the challenged show cause notice of the assessing officer(AO) and henceforth AO to decide the issue of "jurisdiction" relating to taxability of the transaction. However, SC also took a liberal view towards Vodafone by granting liberty to

Vodafone to challenge decision/order of the AO, in the event of it being against the interest of Vodafone directly before the HC, instead of going through the mire of department's appellate procedure.

Please note that the SC's decision has yet not been reported.

B. Union of India vs Sicom Ltd

The Supreme Court of India, in its recent judgment, held that Government dues, including realization of arrears of the duty under the Central Excise Act, had no precedence over the secured debts under the State Financial Corporation Act.

Brief facts of the case are that Respondent No.2 ("Borrower") borrowed from SICOM Ltd. ("SICOM") and offered its property as security by an Indenture of Mortgage created under the provisions of the State Financial Corporation Act, 1951 ("Act"). The Borrower also owed to the Central Excise Department ("Government") by way of Central Excise duty under a confirmed assessment order. The Borrower committed a default in repayment to SICOM, forcing SICOM to seize and take possession of mortgaged property ("Properties") under the provisions of the Act. On the

other hand, the Government expressed its intention to proceed to recover the government dues from the said Properties, claiming first charge over the Properties. SICOM filed a writ petition before the High Court, claiming priority over the Government dues. The Bombay High Court allowed the said petition, which was further challenged by way of SLP before the Supreme Court.

Comment-

The Supreme Court of India has given an upper hand to the secured creditors, keeping aside the common law doctrine of priority of State's debts. The present ruling is a relief to all the financial institutions, who were fighting with the government authorities, to safeguard their interests as provided under Securitization Act or under various other statutes.

RBI, vide its circular dated December 11, 2008¹, in respect of off-shore outsourcing of financial services relating to Indian Operations, requires banks to ensure certain additional requirements including protection of data, accessibility of RBI to make inspections, issues in respect of jurisdiction of the courts and maintenance of records as detailed in the above mentioned circular.

¹ RBI/2008-09/322 DBOD.No.BP. 97 /21.04.158/2008 -09

DSK Legal Knowledge Center

Contact Details: dsklegal.knowledgecenter@dsklegal.com

Mumbai Office
4th Floor, Express Towers,
Nariman Point,
Mumbai 400 021
India
Tel: (91 - 22) 6658 8000
Fax: (91 - 22) 6658 8001

Delhi Office
46, Aradhana, Chanakyapuri,
New Delhi 110 066
India
Phone: (91 - 11) 2687 1122; 2687 1133;
2687 1144
Fax: (91 - 11) 2687 1155

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