

Tax Hotline

June 27, 2008

THE VODAFONE TAX CONTROVERSY

NDA Commentaries on Court Proceedings

The Vodafone tax controversy concerns with 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 had reported **nascent developments** in the controversy and have, thereafter, received numerous queries regarding the case. The final hearings have now begun and we bring you updates on the proceedings as and when they develop in the courtroom.

Senior Advocate Mr. Iqbal M. Chagla, counsel for Vodafone International Holdings BV ("Vodafone"), was on his feet for a marathon two hours before the Bombay High Court on Thursday, June 26, 2008. His submissions before the division bench, consisting of Justice S. Radhakrishnan and Justice A. V. Nigude, essentially dealt with the scope of the expression "*person*" as used in Section 195 of the Income Tax Act, 1961 ("ITA"). Any person, under this provision, making a payment to a non-resident would be liable to deduct tax at source. It is the contention of the Income Tax Department ("**Revenue**") that Vodafone, a Dutch company was liable to deduct tax at source from the payment made to a Cayman Islands company for the acquisition of another Cayman Islands company, which indirectly holds shares in an Indian company.

The crux of the submissions advocated by Mr. Chagla was that the expression "*person*" cannot be interpreted to include a person having no presence in India. According to him, a plain reading of the expression in Section 195 would imply that even a foreign company without any presence in India would be liable to deduct tax at source. However, he submitted, the Court must "read down" the expression and interpret "*person*" to mean only persons, resident or non-resident, having a presence in India.

Mr. Chagla's submissions can be divided into the following broad heads:

1. When can a person be made liable to deduct tax at source in India?
 - Only a person who has a factual or taxable presence in India can be made liable to deduct tax in India.
2. The competency of a sovereign parliament to pass legislations with extra-territorial operation & the doctrine of 'economic nexus':
 - The Indian Parliament being a sovereign and plenary parliament and in light of Article 245 of the Constitution of India, has the authority to pass laws with extra-territorial operation. However these must be explicit in their extra-territorial ambit – for example Section 9, ITA. These may, however, not always be enforceable.
3. Contextual interpretation as warranted by Section 2 of the ITA:
 - The definition of "person" must be interpreted in the context of what was intended by the legislature in light of the language used in Section 2 of the ITA. Section 2, which defines various terms used in the ITA begins with: "*In this Act, unless the context otherwise requires...*".
4. The workability test in the interpretation of a fiscal statute:
 - The workability test was laid down by the House of Lords in *Clark v. Oceanic Contractors* [1983] 1 All ER 133, which has been upheld by various Indian judicial precedents, should be followed and the interpretation accorded to a provision should be enforceable. According to the counsel, the broader interpretation, if accorded to the expression "*person*", would render the provision unenforceable.
5. The rule of "reading down":
 - The rule of "reading down" must be applied to the expression "*person*" so as to make it compatible with the workability test.

The hearing has now been adjourned to Monday, June 30, 2008, when the counsel for Vodafone will put forth his detailed submissions on the constitutional validity of the retrospective amendment to Section 201 of the ITA. He proposed to put forth his submissions on the issue of chargeability of capital gains tax on Tuesday, July 1, 2008.

We will 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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