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Vodafone case in India

Speakers:
Mukesh Butani, Hans van den Hurk

Panellists:
Fernando Nunez Ciallella, Nupur Jalan

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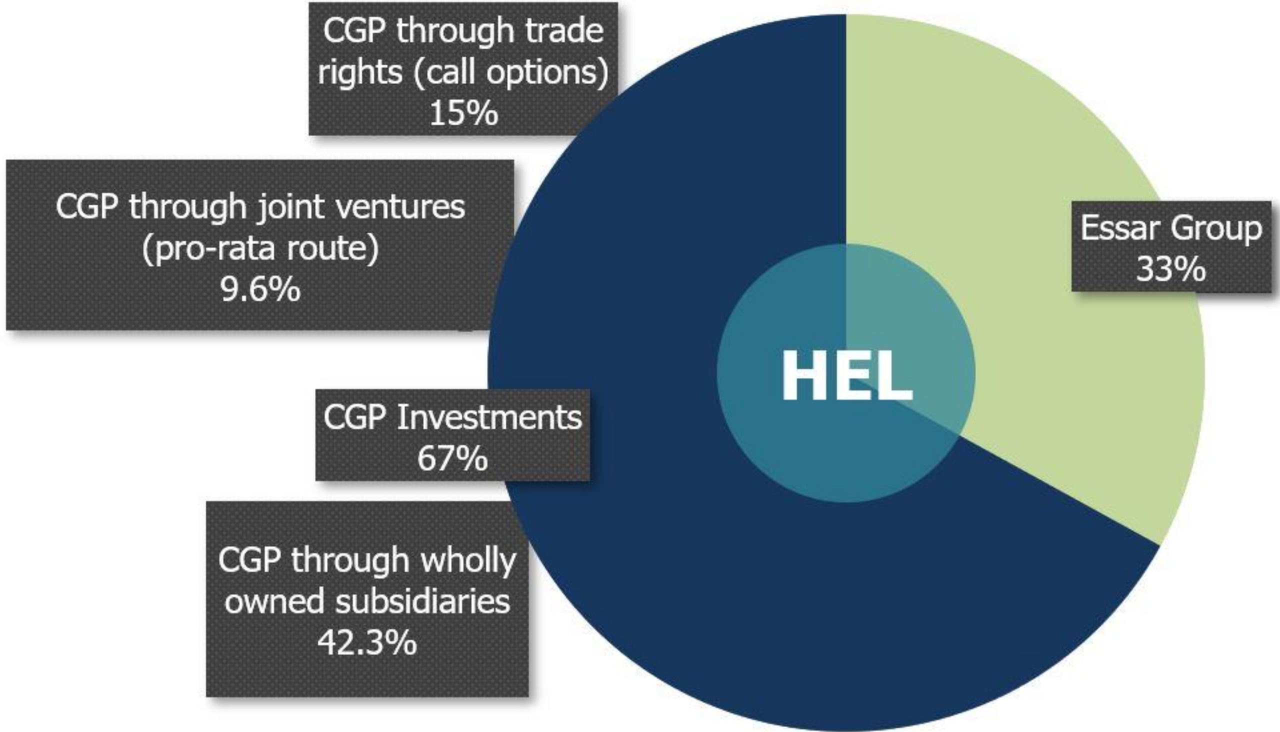

Overview of the controlling interest in Hutchison Essar Limited (HEL)

Structure of the Hutchison-Vodafone Deal

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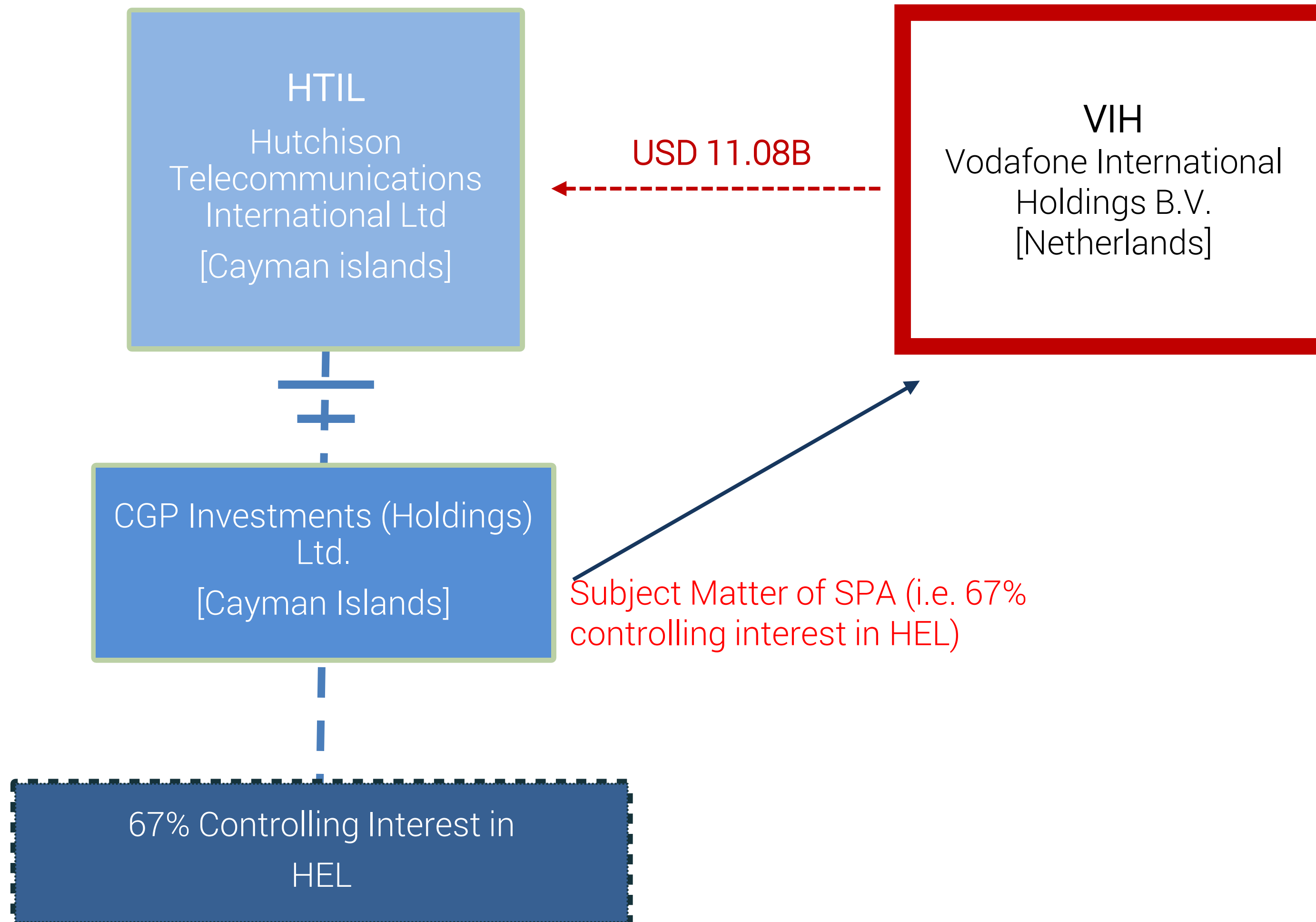

Object of the deal: Vodafone proposed to acquire all Hutchison's Telecom assets in India.

- The shareholding of Indian business was through subsidiaries of a Cayman Islands entity, CGP Investments (Holdings) Ltd – a 100% held subsidiary of HTIL.
- VIH acquired CGP Investments (Holdings) Ltd. and trade rights held by CGP and HTIL for USD 11.08 bn. [11 February 2007]
- This led to VIH having **52%** through wos and indirect shareholding (pro-rata) in Hutchison Essar Ltd. In addition, VIH gained the right to another **15%** of the shareholding through call options (67% controlling interest = 52% +15%)

Arbitration award in Vodafone tax case

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Vodafone wins international arbitration against India in $2 billion tax case

Imposition of a tax liability under retrospective amendments to tax laws is in breach of 'fair and equitable treatment' under BIT between India and Netherlands.

The award pertained to (BIT) between India and Netherlands. The question was whether BIT cover issues related to tax policy. India maintains that taxation is a sovereign right that cannot be challenged under BIT.

Indian Government is yet to decide if to appeal against the International Arbitration Tribunal's order in Singapore Tribunal.

Implications and way forward post Arbitration award

Delhi High Court has held:

- Arbitration under Investment treaties are different than commercial disputes.
- These disputes are to be resolved based on Public International law and not under Arbitration and Conciliation Act, 1996 (A… of India.

Award by PCA under BIT cannot been considered as foreign decree (to be executed in India) as these awards are not delivered by 'courts' as defined in Code of the Civil Procedure, 1908. Hence High Courts in Indian may not have jurisdiction over PCA award.

India may repeat the question on jurisdiction of PCA over the issue of tax dispute under the India-Netherlands BIT to the High Court in Singapore.

Decision to honour the award is expected to be a political decision given that India has been trying to be seen as a preferred destination for foreign investment. Not honouring the Award will be seen as India is not abiding the international commitment under BITs

Indian Jurisprudence in Global reorganisations

Sanofi Case: Before Advance Ruling Authority
Transfer of offshore shares between two French Residents

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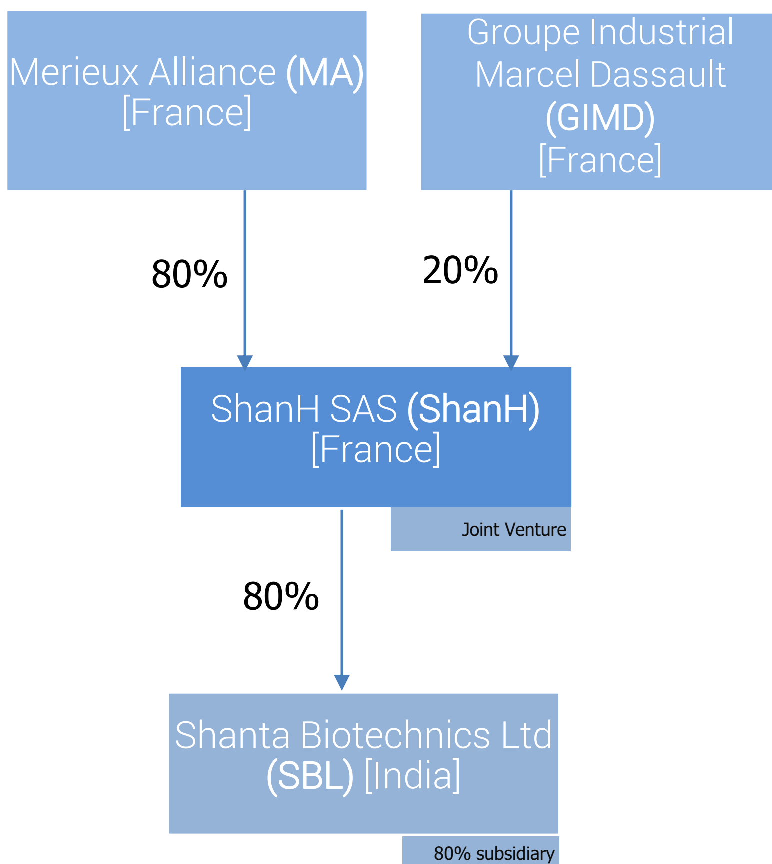

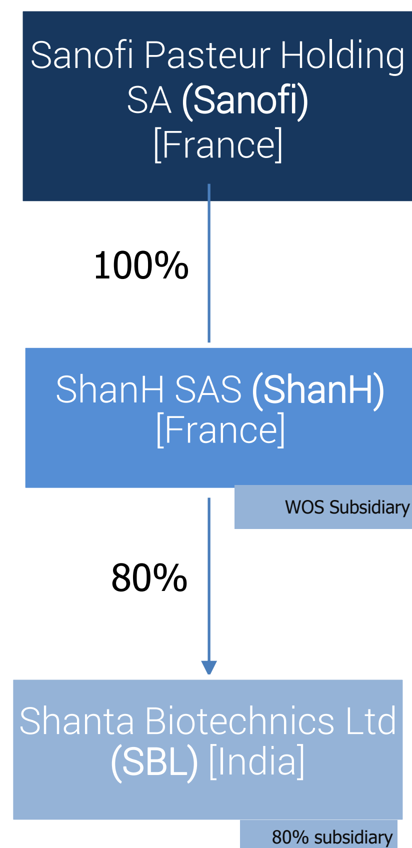

Facts:

- MA had nominated a director on the Board of ShanH.
- Sanofi purchased shares from MA and GIMD and continued with the director appointed by MA.

Questions before AAR:

(i) If sale of shares of ShanH is taxable in India as per Article 14(5) of India-France DTAA ?

(ii) Is transfer of controlling interest (a separate asset) liable to be taxed in France under Article 14 (5) or 14(6) of DTAA?

AAR Decision pre-Vodafone judgement & amendments:
The transaction of sale of shares is taxable in India as it is a preordained scheme for tax avoidance, and hence, benefit under the DTAA in terms of Article 14(5) was denied.

Sanofi Case: Before the High Court – Post Vodafone & amendments

Questions before the Court

- Whether sale of shares of ShanH was sale of underlying assets of SBL (in India) is liable to tax under Article 14(5) of India-France DTAA?
- Whether the controlling Interest in SBL by ShanH transferred to Sanofi is liable to tax in India under Article 14(6) of India-France DTAA?
- Whether for interpretation the term 'alienation', is reference to the domestic laws permissible under Article 3(2) of DTAA?

Decision of High Court:

- Article 14(5) of India-France DTAA does not permit a 'see through' approach. Instead, on a true and fair interpretation, it deals with alienation of share in a company and does not recognise the terms of control or management.
- Since, Article14(5) doesn't apply, second question was not answered.
- Article 3(2) allows reference to the domestic laws, however, such should be defined in the domestic law, in the context of international law.
- Retrospective amendments, to the law are not fortified by a non-obstante clause expressed to over-ride tax treaties

Case Study

Case Study : Internal Reorg - listed Parent company (AE's 5%)

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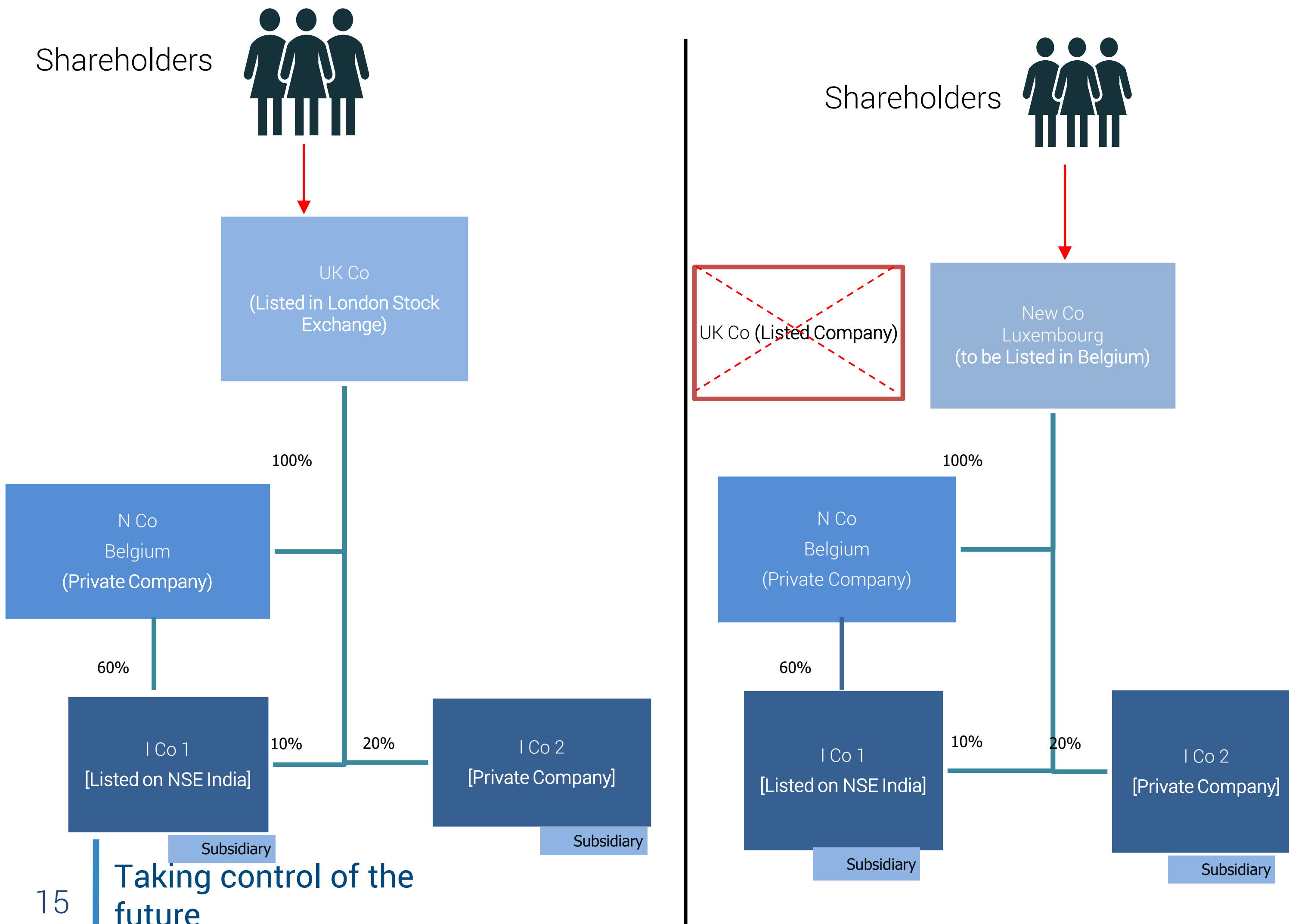

Facts:

- UK Co is undergoing internal corporate restructuring - a New Co will be incorporated in Luxembourg. All assets and liabilities of UK Co will be transferred to New Co. Transaction is tax neutral in UK.
- Shareholders of UK Co will be **issued** new shares (in lieu) in New Co and UK Co will cease to exist.
- UK Co has direct and indirect subsidiaries in many jurisdictions, including India.
- Individual shareholders along with AE's (trusts with common trustees) cumulatively hold more than 5% shares in UK Co for which they will receive New Co shares.

Key Questions:

- Whether shares issued to individuals in New Co will trigger capital gains under ITL?
- Determine the value of the underlying assets in India held by UK Co, in the listed & unlisted company via N Co & directly.
- Definition of transfer includes exchange, extinguishment – will issuance of shares in New Co extinguish rights in UK co and trigger transfer
- Practical challenges for shareholders to comply
- Valuation & reporting requirements for such restructuring?

UN Proposed Provision on Offshore Indirect Transfers (OIT)

Proposed addition in Article 13 of UN Model

Though Indirect transfer of Immovable properties (IP) by transferring shares of a company (which derived substantial value from IP) is a separate sub article under Capital gain article under OECD and UN Model

Indirect transfer of shares in a Company is not covered in OECD or UN model which brings offshore transfer of entities to tax net of a third country as per the third country's domestic tax laws.

New sub-article has been proposed to be added under UN Model to cover offshore Indirect transfer of shares in a third country to cover offshore transfer of entities such as Vodafone's acquisition of Hutchison's Indian business

Recommendations for UN Model

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Exclusions :

Listed Companies

Intra-Group Transfers

20% shareholding threshold for Offshore Indirect Transfer is low

Evaluate impact on Foreign Investment, hence should be limited to anti abuse situations

For double taxation apart from credit mechanism, it should be also resolved by MAP

Determination of method for indirect ownership (Rules to be supplemented for computation mechanism)

Valuation for determination 50% threshold:

(Can domestic law be relied for determining 50% threshold?)

Grandfathering existing structures/investments

Satisfaction of ownership test at any time during 365 days of transfer

India-Netherlands BIT

Article 2

Scope of the agreement

This Agreement shall apply to **any investment made by investors of either Contracting Party in the territory of the other Contracting Party including an indirect investment made through another company, wherever located, which is fully owned by such investors, whether made before or after the coming into force of this Agreement.**

Article 4

National treatment and most favoured nation treatment

1) Investments of investors of each Contracting Party **shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party.**

2) Each Contracting Party shall accord to such investments, including their operation, management, maintenance, use, enjoyment or disposal by such investors, treatment which shall not be less favourable than that accorded either to investments of its own investors or to investments of investors of any third State, whichever is more favourable to the investor concerned.

3) The provisions of paragraphs 1 and 2 in respect of the grant of most favoured nation treatment shall not apply to privileges which either Contracting Party accords to investors of third States on account of its membership of, or association with, a customs or economic union, a common market or a free trade area.

4) The provisions of **paragraphs 1 and 2 in respect of the grant of national treatment and most favoured nation treatment shall also not apply in respect of any international agreement or arrangement relating wholly or mainly to taxation or any domestic legislation or arrangements consequent to such legislation relating wholly or mainly to taxation**

5) Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party. Provided that dispute resolution under Article 9 of this Agreement shall only be applicable in the absence of a normal, local, judicial remedy being available.

India-Netherlands BIT

Article 16

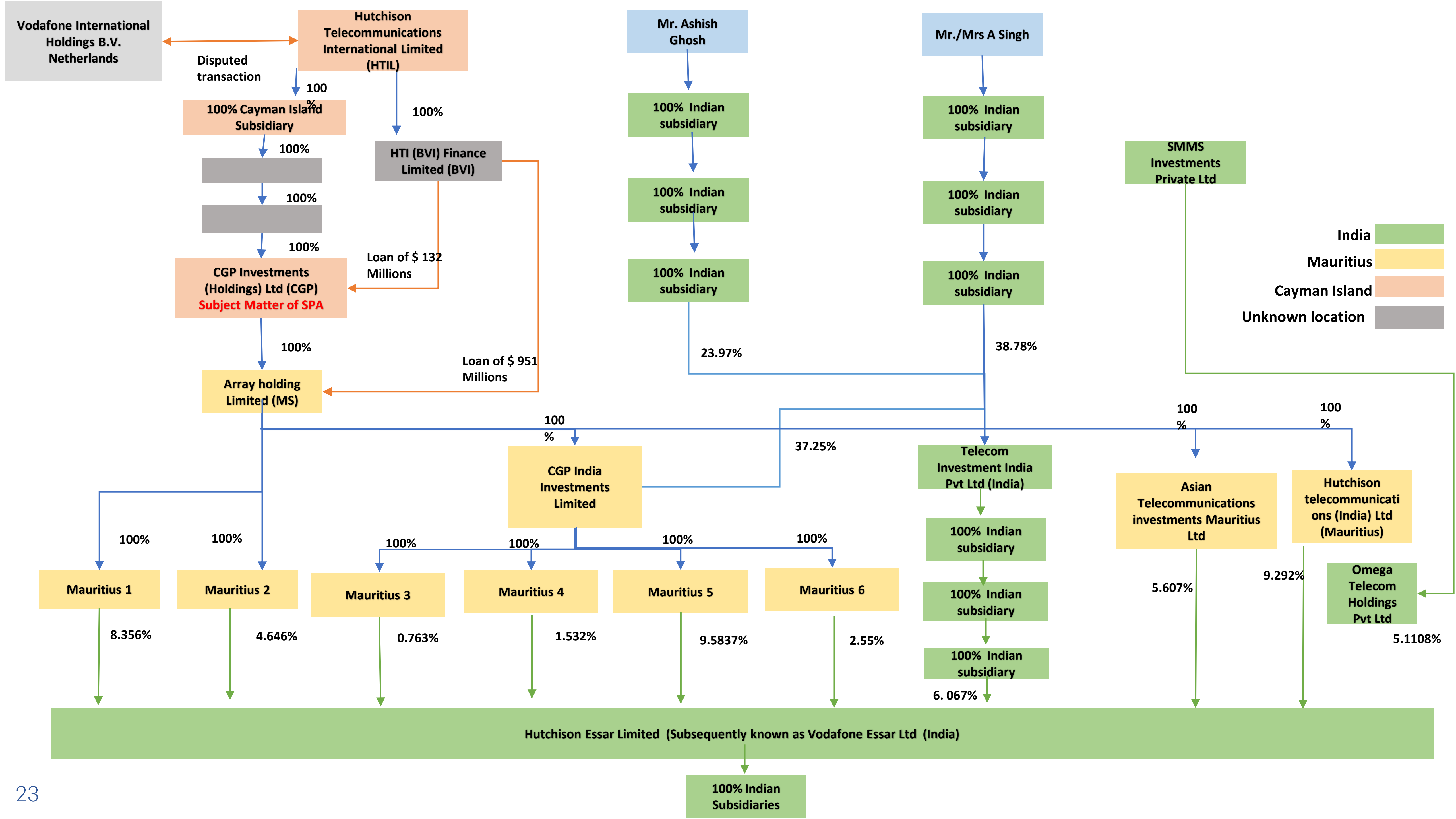
1. This agreement shall remain in force for a period of ten years. Unless notice of termination has been given by either Contracting Party at least six months before the date of the expiry of its validity, the present Agreement shall be deemed to have been extended for period of ten years at a time, each Contracting Party reserving the right to terminate the Agreement upon notice of at least six months before the date of expiry of the current period of validity. In respect of investments made before the date of the termination of the present Agreement the foregoing Articles shall continue to be effective for a further period of fifteen years from that date.

…………………………………….

Open questions

- Enforceability of the arbitration award in the Indian context – India is not signatory to ICSID convention, and there are conflicting views on the applicability of Arbitration and Conciliation Act, 1996
- On what grounds Indian Government could challenge the judgement before the Singapore High court?
  - The domestic remedies were not exhausted, and Vodafone should have challenged the validity of the retroactive amendment before the constitution of India before moving for international arbitration?
- Though the arbitration award is not available in full, what could have been the considerations:
  - It was not possible for the investor to know at the time of investing that there can be a retroactive amendment? Was Vodafone stuck here by the impossibility of performance? (Whether the principle of lex non cogit ad impossibilia – the law does not compel a man to perform what he cannot possibly perform holds good here?)
  - It was possible for the investor to predict that the judgement of the highest court will be reversed?
- Many countries have taken the retrospective amendment in the past. So, the question arises was it more about the timing when this amendment was brought in. Has the situation been different if the timing of this amendment would have been different?
- Dispute resolution under Bilateral tax treaty and Bilateral Investment treaty. Should Vodafone have taken recourse under Bilateral tax treaty first?

Annexures



Vodafone International Holdings B.V. Netherlands
Hutchison Telecommunications International Limited (HTIL)
Disputed transaction
100 %
100%
100% Cayman Island Subsidiary
100%
HTI (BVI) Finance Limited (BVI)
100%
100%
CGP Investments (Holdings) Ltd (CGP)
Subject Matter of SPA
Loan of $ 132 Millions
100%
Loan of $ 951 Millions
Array holding Limited (MS)
100 %
CGP India Investments Limited
37.25%
Mr. Ashish Ghosh
100% Indian subsidiary
100% Indian subsidiary
100% Indian subsidiary
23.97%
Mr./Mrs A Singh
100% Indian subsidiary
100% Indian subsidiary
100% Indian subsidiary
38.78%
Telecom Investment India Pvt Ltd (India)
100% Indian subsidiary
100% Indian subsidiary
100% Indian subsidiary
6. 067%
SMMS Investments Private Ltd
India
Mauritius
Cayman Island
Unknown location
100 %
100 %
Asian Telecommunications investments Mauritius Ltd
Hutchison telecommunications (India) Ltd (Mauritius)
5.607%
9.292%
Omega Telecom Holdings Pvt Ltd
5.1108%
100%
100%
Mauritius 1
Mauritius 2
8.356%
4.646%
100%
100%
100%
100%
Mauritius 3
Mauritius 4
Mauritius 5
Mauritius 6
0.763%
1.532%
9.5837%
2.55%
Hutchison Essar Limited (Subsequently known as Vodafone Essar Ltd (India)
100% Indian Subsidiaries

Contact Details

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Mukesh Butani : mukesh.butani@bmrlegal.in

Hans van den Hurk : hans.vandenhurk@maastrichtuniversity.nl

Fernando Nunez Ciallella : fnunez@ehernandez.com.pe

Nupur Jalan : nupurjalan1@gmail.com

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H.J.E. Wenckebachweg 210 . 1096 AS Amsterdam . The Netherlands . +31 (0)20 462 3530 . tpa-global.com

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