

Retrospective taxation: the Vodafone case, and the Hague court ruling

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IN A unanimous decision, the Permanent Court of Arbitration at The Hague on Friday ruled that India's retrospective demand of Rs 22,100 crore as capital gains and withholding tax imposed on the British telecommunication company for a 2007 deal was "in breach of the guarantee of fair and equitable treatment". The court has also asked India not to pursue the tax demand any more against Vodafone Group.

What is the case?

In May 2007, Vodafone had bought a 67% stake in Hutchison Whampoa for \$11 billion. This included the mobile telephony business and other assets of Hutchison in India. In September that year, the India government for the first time raised a demand of Rs 7,990 crore in capital gains and withholding tax from Vodafone, saying the company should have deducted the tax at source before making a payment to Hutchison.

Vodafone challenged the demand notice in the Bombay High Court, which ruled in

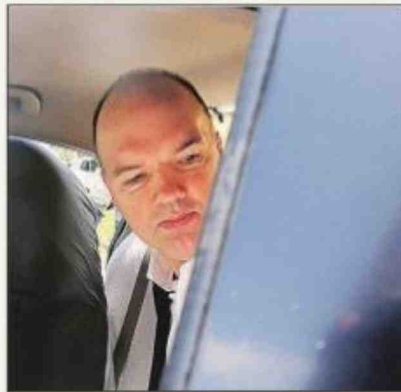
favour of the Income Tax Department. Subsequently, Vodafone challenged the High Court judgment in the Supreme Court, which in 2012 ruled that Vodafone Group's interpretation of the Income Tax Act of 1961 was correct and that it did not have to pay any taxes for the stake purchase.

The same year, the then Finance Minister, the late Pranab Mukherjee, circumvented the Supreme Court's ruling by proposing an amendment to the Finance Act, thereby giving the Income Tax Department the power to retrospectively tax such deals. The Act was passed by Parliament that year and the onus to pay the taxes fell back on Vodafone. The case had by then become infamous as the 'retrospective taxation case'.

What is retrospective taxation?

As the name suggests, retrospective taxation allows a country to pass a rule on taxing certain products, items or services and deals and charge companies from a time behind the date on which the law is passed.

Countries use this route to correct any anomalies in their taxation policies that have, in the past, allowed companies to take advantage of such loopholes. While governments



Vodafone Group CEO Nick Read outside the Indian Parliament earlier this year. *Express Archive*

often use a retrospective amendment to taxation laws to "clarify" existing laws, it ends up hurting companies that had knowingly or unknowingly interpreted the tax rules differently.

Apart from India, many countries including the US, the UK, the Netherlands, Canada, Belgium, Australia and Italy have retrospec-

tively taxed companies, which had taken the benefit of loopholes in the previous law.

What happened after India passed the retrospective taxation law?

Once Parliament passed the amendment to the Finance Act in 2012, the onus to pay the taxes fell back on Vodafone. The amendment was criticised by investors globally, who said the change in law was "perverse" in nature.

"The retrospective amendment that overturned the decision of the highest court of the land was badly drafted in its wide generalities and carried a perverse sense of vindictiveness," said Nigam Nuggahalli, Dean of the School of Law at BML Munjal University.

Following international criticism, India tried to settle the matter amicably with Vodafone, but was unable to do so. After the new NDA government came to power, it said it would not create any fresh tax liabilities for companies using the retrospective taxation route.

By 2014, all attempts by the telco and the Finance Ministry to settle the issue had failed. Vodafone Group then invoked Clause 9 of the Bilateral Investment Treaty (BIT) signed between India and the Netherlands in 1995.

What is the Bilateral Investment Treaty?

On November 6, 1995, India and the Netherlands had signed a BIT for promotion and protection of investment by companies of each country in the other's jurisdiction.

Among the various agreements, the treaty had then stated that both countries would strive to "encourage and promote favourable conditions for investors" of the other country. The two countries would, under the BIT, ensure that companies present in each other's jurisdictions would be "at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other".

While the treaty was between India and the Netherlands, Vodafone invoked it as its Dutch unit, Vodafone International Holdings BV, had bought the Indian business operations of Hutchinson Telecommunication International Ltd. This made it a transaction between a Dutch firm and an Indian firm.

The BIT between India and the Netherlands expired on September 22, 2016.

What did the Permanent Court of Arbitration at The Hague say?

One of the major factors for the Court of

Arbitration to rule in favour of Vodafone was the violation of the BIT and the United Nations Commission on International Trade Law (UNCITRAL).

In 2014, when the Vodafone Group had initiated arbitration against India at the Court of Arbitration, it had done so under Article 9 of the BIT between India and the Netherlands.

Article 9 of the BIT says that any dispute between "an investor of one contracting party and the other contracting party in connection with an investment in the territory of the other contracting party" shall as far as possible be settled amicably through negotiations.

The other was Article 3 of the arbitration rules of UNCITRAL, which, among other things, says that "constitution of the arbitral tribunal shall not be hindered by any controversy with respect to the sufficiency of the notice of arbitration, which shall be finally resolved by the arbitral tribunal".

In its ruling, the arbitration tribunal also said that now since it had been established that India had breached the terms of the agreement, it must now stop efforts to recover the said taxes from Vodafone.