



INDIAN LEGAL AND BUSINESS UPDATE
SEPTEMBER 1-SEPTEMBER 30, 2010

1. Bombay High Court holds Vodafone liable to pay capital gains tax

The Bombay High Court, in the landmark Vodafone tax case has ruled that Vodafone must pay capital gains tax on its USD 11 billion acquisition of a controlling stake in mobile phone operator Hutchison Essar that was completed in 2007. Estimates published prior to the judgment assign a USD 2 billion tax liability on Vodafone. The court has given the company eight weeks.

The IT department had issued a show cause notice to Vodafone in 2007, saying it should have withheld tax when it cleared payment to Hutchison. The UK based global telecom giant subsequently filed a petition against this in Mumbai. The case was heard in 2008 and in December that year, the high court dismissed Vodafone's petition. The company then appealed this in the Supreme Court, which sent the matter back to the high court to establish whether the tax department had jurisdiction on the transaction.

The current Bombay High Court judgment identifies two parts to the transaction one of the controlling interest that was through a share transfer in Cayman Islands comprising a maximum of 52 percent stake; the second related to contractual agreements, in the form of options that increased Vodafone's rights to 67 percent. Vodafone acquired 52 percent from Hutchison in an overseas transaction while 15percent was held by Analjit Singh and Asim Ghosh, who were in India.

The order then goes on to say parts of the transaction for which an Indian link is established can be taxed by the I-T department. The court has left that decision in the hands of the assessing officer, and at this point has not assigned a value to the tax liability.

The final outcome of the case may influence valuations and structuring of M & A transactions between offshore entities with underlying assets in India.

2. Vodafone refused stay of income tax refund by Supreme Court

The Supreme Court rejected the plea of Vodafone International Holdings BV to stay a Bombay High Court Judgment in a dispute over capital gains tax demands. Supreme Court has asked the income tax authorities to determine its precise liability according to the high court order.

The Supreme Court order, passed by a bench headed by Chief Justice SH Kapadia in the Vodafone appeal came after Attorney General GE Vahanvati submitted that the company should be heard only if half of the demand for Rs. 12,000 crore (USD 2.7 billion) was deposited beforehand.

The court issued notice to the income tax department and asked its officer in charge of tax deduction at source to come up with the exact figures of the foreign company's liability.

3. Supreme Court ruling on powers of Competition Commission of India (CCI)

The Supreme Court has recently ruled that the Commission has the power to order investigation without preliminary hearing into complaints that it receives alleging anti competitive agreements and abuse of dominant position in the market. Its decision to investigate cannot be challenged at the threshold before the Competition Appellate Tribunal (COMPAT). However, the bench, headed by Chief Justice SH Kapadia, said this power has to be exercised sparingly. It stipulated that the investigation must be completed within 60 days. Moreover, while directing investigations, the Commission has to record reasons.

The Commission had challenged the order of COMPAT stopping its director general for investigating into allegations leveled by Jindal Steel and power Ltd. against an exclusive agreement between Steel Authority of India and Indian Railways on the purchase of rails. JSPL contended that the agreement was anti competitive.

The solicitor general, who represented CCI, had argued that if the tribunal passes a stay order even before the commission started investigation and forms an opinion, it would be difficult for the commission to function. There was no need to hear the parties even before the commission forms a prima facie opinion on whether there was an injury to party in market.

4. Government clears draft bill to give FMC more teeth

The Union Cabinet has approved long pending amendments to the Forward Contracts (Regulation) Act. This is a prelude to seeking parliamentary approval to make the Forward Markets Commission (FMC) an independent regulator and allow the launch of the options in the commodity market, among a host of other changes. The amendments will also pay the way for the entry of institutional investors such as banks into the commodity derivatives market. However, the details will be finalized by sectoral regulators once Parliament clears the Bill.

In a statement, the government said that the proposed amendments would benefit various stakeholders. Farmers will also benefit from price discovery and price risk management. One of the most crucial aspects of the legislation is to strengthen FMC. The Mumbai based regulatory body that is part of the department of consumer affairs. The statement said changes were proposed in provisions relating to the composition and functioning of the agency. It will be able to recruit staff on the basis of domain knowledge, instead of the government appointing employees. FMC Officials complain that it does not have enough officers to undertake

surveillance.

In addition, the government proposes to enhance the powers of FMC. The powers would be akin to those of the Securities and Exchange Board of India. At present, FMC does not have sufficient penal powers, if has to ask exchanges to use their by-laws to penalize errant members. Also FMC will be able to levy a transaction charge in addition to monetary penalty

5. Supreme Court Ruling on obligation of the payer to deduct and deposit TDS in relation to remittances made to foreign parties.

Granting partial relief to foreign companies operating in the country, the Supreme Court today reversed the judgment of the Karnataka High Court that there was an obligation in each and every case of remittance made to foreign payees to deduct tax at source and only the issue of proportionality of the tax could be decided by the revenue department under Section 195 (2) of the Income tax Act.

A Bench headed by Chief Justice SH Kapadia held that it was not correct to say the moment a remittance was made to a foreign party, tax became deductible under the provisions of Section 195 of the Income Tax Act dealing with TDS (tax deducted at source) for non resident companies.

The issue relates to the obligation of the payer to deduct and deposit TDS in relation to remittance made to foreign parties who do not have any permanent establishment in India and are, therefore, not taxable under the Income Tax Act. It touches upon the current hot topic, highlighted involving the issue of extra territorial operation of the Income Tax Act.

Today's judgment assumes importance in view of the fact that a large number of remittances are made to foreign parties from India, on which the department has imposed interest and penalty for the payer not having deducted TDS. The companies concerned argued that no part of the payee's incomes arose in India nor did they have a permanent establishment in the country. More over, the income was exempt under double taxation avoidance agreements.

6. Airtel inks deal with IBM for Africa operations

Telecom service provider Bharti Airtel strengthened its six-year relationship with IBM by assigning the global IT major to manage its computing and mobile network across 16 African countries. The 10-year deal, according to industry sources, is estimated to be worth US Dollar 1.5 billion — one of the largest outsourcing deals signed by Bharti.

In March, Bharti had acquired Zain Telecom's African operations at an enterprise value of over US Dollar 10.7 billion. The Group is already planning to change the name of the brand in a few months to Airtel across various markets on the continent.

The strategic partnership with IBM will also enable Bharti to scale up its network and systems to cater to more than 100 million subscribers by 2012, from its current customer base of 42 million in these countries.

7. Transfer pricing clearance norms may be eased: CBDT chairman

THE Government will soon allow Indian units of foreign companies to file tax returns without the scrutiny of tax authorities, a move that will help such companies avoid procedural hassles. Currently, such companies have to get their transfer pricing returns cleared by the income tax department before filing them.

The CBDT, the apex government body on direct taxes, has set up a committee to formulate safe harbour provisions, under norms of which income tax authorities will be able to accept without scrutiny the tax returns of Indian units of foreign companies.

8. India-Japan trade pact to leave IP laws untouched

The India-Japan Comprehensive Economic Partnership Agreement (Cepa), expected to be signed towards the end of this year, will not call for any amendments to the existing intellectual property (IP) laws in either of the partner countries.

The decision should come as a major relief to the domestic pharmaceutical industry and the patient groups that were lobbying hard against the attempts of global multinational firms to introduce IP provisions beyond what has been mandated under the TRIPS (Trade Related Aspects of Intellectual Property Rights) provisions of the World Trade Organization through bilateral trade agreements.

With the Indo-Japan trade pact almost sealed, the focus of the lobbyists will now be on Indo-EU negotiations, where similar demands are still in the negotiation drafts.
