KING & SPALDING

Client Alert

Tax Practice Group

February 2012

Indian Supreme Court Holds for Vodafone

On January 20, the Indian Supreme Court handed down a major victory for foreign investors in the landmark case of Vodafone International Holdings B.V.

The *Vodafone* case arose from Vodafone's 2007 acquisition of an indirect stake in Hutchison Essar Limited, an Indian telecom company (HEL). The acquisition involved the purchase by a Vodafone subsidiary of shares in a Cayman Islands holding company that owned a 67% interest in HEL.

Under Indian law, the purchaser of an asset located in India is required to withhold tax on payments to a non-resident seller. In the *Vodafone* case, the Indian tax authorities attempted to look through the Cayman Islands holding structure and treat the transaction as if it were the direct sale of the Indian assets of HEL and thus subject to withholding tax. The Bombay High Court ruled in favor of the government, exposing Vodafone to a potential tax liability in excess of $2 billion.

The case was significant for a number of reasons. Most investors use a holding company jurisdiction such as Mauritius to hold their investments in India. The practice is not uncommon for other jurisdictions as well. If the Indian government had been successful in *Vodafone*, other jurisdictions with similar taxing regimes might look to the decision and seek to apply a similar rule.

The Indian Supreme Court refused to disregard the form of the taxpayer's transaction and reversed the lower court's decision. The court drew a distinction between legitimate tax planning and prohibited tax evasion, and found that the Vodafone transaction involved legitimate planning. Several factors contributed to this conclusion, including the duration of the holding company structure and the generation of taxable revenue in India. Given these favorable factors, the court respected the holding company structure and held that the transaction was not taxable in India.

Significantly, the Indian Supreme Court recognized the importance of predictability in the taxation of foreign investment. The court declared that "tax policy certainty is crucial" for foreign taxpayers to make investment decisions. The ruling, combined with this piece of dicta, should provide taxpayers investing in India with greater comfort in their ability to rely on reasonable tax-planning structures.

For more information, contact:

Abraham N.M. Shashy, Jr.
+1 202 626 5614
hshashy@kslaw.com

John K. Sweet
+1 212 827 4382
jsweet@kslaw.com

John C. Taylor
+44 20 7551 7553
jtaylor@kslaw.com

Robert A. Beard
+1 404 572 2749
rbeard@kslaw.com

King & Spalding
Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

New York
1185 Avenue of the Americas
New York, New York 10036-4003
Tel: +1 212 556 2100
Fax: +1 212 556 2222

London
125 Old Broad Street
London EC2N 1AR
Tel: +44 20 7551 7500
Fax: +44 20 7551 7575

www.kslaw.com

The decision has important implications for cross-border structuring in India. The Indian Supreme Court has validated legitimate tax structuring as long as the underlying transactions are justified by commercial and business rationales. This means that parties must pay careful attention to ensure that the overall commercial objectives, formalities and substance of a transaction with embedded tax planning are clear and unambiguous.

* * *