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# Case Comment on:

# Vodafone International Holdings Ltd.

# V.

# Government Of India (Case No. 2016-35)

Manisha Jayanti[1]

## Introduction:

The Vodafone case in the Permanent Court of Arbitration involved a tax dispute between Vodafone and the Indian government. In this case, Vodafone International Holdings B.V Limited, a multinational telecommunications company filed a case against Government of India in the Permanent Court of Arbitration in Hague, Netherlands. The case centered around whether Vodafone was liable for capital gains taxes related to a 2007 acquisition of a subsidiary, operating in India. Vodafone argued that it was not liable for the taxes, while the

[1]*Student of VIII Semester, B.A.,LL.B. (Hons), School of Legal Studies, CMR University.*

Indian government maintained that it was. The case eventually went to arbitration, with a tribunal ruling in favor of Vodafone and ordering the Indian government to pay damages. This case essentially highlighted tensions over tax policies and investment treaties.

## Facts of the case:

Hutchinson Telecommunications International Limited (HTIL) a company based in Cayman Islands fully owned CGP Investment Holdings Ltd.(CGP), another company based in Cayman Islands for 11.1 billion USD. Subsequently CGP acquired a 67% share in Hutch Essar Ltd.(HEL) an Indian company. In 2007, Vodafone International Holdings(Vodafone), A Netherlands based company acquired 100% shares in CGP thereby indirectly allowing it to own HEL through a chain of subsidiaries.[2] Indian tax authorities in 2007, issued a tax notice of a total 112 Crore Rupees [3] because Vodafone had to pay the withholding tax to the Indian government on gains realized by HTIL according to sections 195 and 201 of the Indian Income Tax Act 1961[4]. Vodafone failed to pay the same as it believed

[2] N.C. Hegde & Heta Mathruia, *The Vodafone Case - Looking Back, Looking Ahead*, 13 CORP. Bus. TAX'n MONTHLY 15 (2012).
[3] [2012] 1 S.C.R
[4] The Income Tax Act, 1961, § 195 & 201, No. 43, Acts of Parliament, 1961 (India).

that the Indian Income Tax Authorities did not have a jurisdiction over the transaction as it involved no Indian entity.

*Verdict of Bombay High court:*

The court found that CGP did not have an independent existence and did not even have a bank account. Therefore, any entity buying CGP was not interested in its shares, but in the assets that came with it. The court concluded that the sale of CGP Investments alone was not enough to complete the transaction, and all the rights and entitlements of Hutchison's Indian assets needed to be transferred to Vodafone. As a result, the tax authorities were justified in pursuing Vodafone for taxes related to the transaction.[5]

*Verdict of the Supreme Court of India:*

The Supreme Court of India made three key observations in the Vodafone tax case. Firstly, it was observed that Section 9(1)(i) of the Income Tax Act did not recognize indirect transfers of fixed assets to India, therefore the Indian tax authorities could not impose taxes on the transfer of shares to CGP. Secondly, the transfer of HTIL's property rights was due to the transfer of CGP shares and not the purchase contract, and it was established that CGP had commercial

[5] 2010 (13) STR 338 (Bom).

content. Thirdly, Section 195 of the Income Tax Act only applied to transactions between an Indian resident and a non-resident, and Section 163 did not apply to transactions between two non-resident companies executed outside India. The Supreme Court upheld the ruling that the Indian tax authorities could not impose taxes on foreign transactions between two non-resident companies in which the non-resident company acquired a controlling stake in a resident company.[6] Justice Radhakrishnan further stated that the Income Tax authorities' demand for capital gains tax would "amount to imposing capital punishment for capital investment since it lacks the authority of law."[7]

*The aftermath of the Supreme Court Judgment*

In order to nullify the judgment given by the Supreme Court of India, the Indian government introduced a retrospective amendment through Section 9 of the Income Tax Act, 1961 in 2012 Finance Bill which stated that "an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been

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[6] *Supra note* 2.
[7] Aayushi, Singh (2022) *A Chronological Analysis of Vodafone and Cairn - A BIT-ter Saga.* National Law School Business Law Review. ISSN 2456-1010.

situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India."[8]

This rule was applied retrospectively from 1961 after which Vodafone was once again sent a notice to pay the tax with interest. By 2016, the Income Tax department demanded up to Rs. 22,100 crores along with interest. Aggrieved by this, Vodafone approached The Permanent Court of Arbitration( PCA) at Hague against the Indian government for violating article 4(1) of the Bilateral Investment Treaty (BIT) which states that ,

*"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."*[9]

## Arguments:

Vodafone argued that the Indian government had violated article 4(1) of India-Netherland BIT which talked about the fair and equitable treatment by each state in the agreement thereby strengthening the

[8] Finance Bill, 2012, Bill No. 11 of 2012, § 9,Ind.
[9] India- Netherlands BIT 1995, art 4.1.

ties between the countries and enjoying protection of not only investments but also full security in the territory of both the countries.

India contended that the bilateral investment treaty (BIT) excluded domestic tax legislation from the fair and equitable treatment (FET) protection according to article 4(4) of the treaty which states that,

"*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.*"[10]

## Issues

Whether the retrospective amendment made by the government of India is in breach of the provisions of Indian- Netherlands Bilateral Investment Treaty(BIT) which focuses on the protection of foreign investors in order to promote foreign investment between the concerned states.

[10] India- Netherlands BIT 1995, art 4.4.

# Award by PCA

On September 25, 2020, the Permanent Court of Arbitration, Hague, passed an award against India.[11]

The tribunal held that:

- The Claimant i.e. Vodafone is entitled to fair and equitable treatment, as stated in Article 4(1) of the Agreement, for its investments in mobile telecommunications in India.
- The Respondent's imposition of tax on the Claimant, despite the Supreme Court Judgement, along with the imposition of interest and penalties for non-payment of the sums in question, is in violation of the fair and equitable treatment clause of Article 4(1) of the Agreement.
- As the Tribunal has found breach of the fair and equitable treatment clause, it is unnecessary to proceed with the determination of the Claimant's other claims.
- The arbitration's costs will be divided equally between the Parties.

[11] Cyril Amarchand Mangaldas. *Case In Point, Volume IX, Issue IV, February 2021*. Accessed on (14 Mar 2023), https://www.cyrilshroff.com/wp-content/uploads/2021/02/Case-In-Point-Vol.IX-Issue-IV-Feb-2021.pdf.

- The Respondent must reimburse the Claimant with £ 4,327,294.50 or its equivalent in US Dollars, which is 60% of the legal representation and assistance costs incurred by the Claimant, and € 3,000 or its equivalent in US Dollars, which is 50% of the fees paid by the Claimant to the appointing authority.[12]

## Conclusion:

This award sets a reminder that foreign investors have access to remedies under international law. It ensures the availability of an effective mechanism to foreign investors.

After the award, India withdrew the retrospective amendment subjected to few conditions:

- If a certain amount of tax was assessed under these provisions, the government would repay it without any penalty or interest.
- If a case has been filed against the Government of India the companies have to withdraw the case.

[12] Final Award (Operative Part), Vodafone v. India (I),JUS MUNDI, https://jusmundi.com/en/document/decision/en-vodafone-international-holdings-bv-v-india-i-wednesday-1st-january-2014, (accessed on 25th Mar 2023).

- The concerned company has to give in writing that it would not claim any damages in future with respect to these provision.

The Vodafone arbitration case was a significant milestone in developing international arbitration law. It demonstrated the importance of arbitration as a mechanism for resolving complex commercial disputes and highlighted the benefits of arbitration over traditional litigation.

The case also underscored the need to carefully draft arbitration agreements to ensure they are enforceable and effective. In this case, the parties had included an arbitration clause in their agreement, which ultimately proved to be a critical factor in resolving the dispute.

The Vodafone arbitration case serves as a reminder of the importance of international arbitration as a means of resolving cross-border disputes in a fair, efficient, and cost-effective manner. It also highlights the need for businesses and legal practitioners to remain up-to-date on the latest arbitration law developments to ensure that their agreements and practices are consistent with best practices and industry standards.

Overall, the Vodafone arbitration case represents a significant step forward in the evolution of international arbitration and provides valuable lessons for businesses and legal practitioners alike.