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VODAFONE-HUTCH- AN UNENDING FINANCIAL DISTRESS SAGA

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ABSTRACT

The cases study covers the journey of Hutch and Vodafone deal which set a benchmark in Indian Taxation world and the Finance ministry made changes in the law to stop the companies from escaping the tax net. Simultaneously it also tracks the issues that linger long after the Merger and Acquisition deal is done and over with like in this case wherein the final decision regarding the taxation issues are still in legal proceedings even after almost 10 plus years of the deal.

INTRODUCTION:

Hutchison Whampoa -a Hong Kong based company entered joint venture with Max Group and formed Hutchison Max Telcom Ltd. (HMTL) on 21st February 1992.The company robustly acquired 13 of 23 telecom circle licenses till 2004. Hutchison Whampoa owned Hutch and Ruia owned Essar telecom decided in 2005 to consolidate their operations, under which 5 subsidiaries of HMTL Hutchison Essar Mobile Services, Hutchison Telecom East, Hutchison Essar South, Aircel Digilink India and Fasce will be consolidated. This led to renaming the company to Hutchison Essar Limited (HEL). Essar telecom continued to have 30% stake in the emerged entity with stakes of Hinduja Group, Kotak Mahindra/Hutchison Telecom International Joint Ventures, Max India and Hutchison Telcom International remaining unchanged. This name change came in backdrop of Essar Telcom acquiring 64% stake in BPL mobile with an aim to bring it under the combine of Hutchison Essar. Along with acquiring the BPL stake Hutchison also acquired Essar Spacetel a subsidiary of Essar group which had licenses of 7 telecom circles that hutch lacked. This led to the presence of HEL in all 23 telecom circles of India. Hutch had a focussed growth plan wherein the urban markets were targeted which was then followed by targeting the business users and high-end post-paid customers. This led to HEL consistently being able to generate a higher Average Revenue Per User (ARPU) than its competitors.

In February 2007, Vodafone Group Plc. Subsidiary acquired 67% direct and indirect equity and loan interests in Hutchison Essar Limited for total cash consideration (before costs, expenses and interests) of approximately $11.1 billion. The deal was completed by May 2007. This led to renaming company to Vodafone Essar and rebranding of 'Hutch' as 'Vodafone'. Further in July 2011, Vodafone further brought stake of Essar in Vodafone Essar for $5 billion approximately increasing the stake of Vodafone to 74%.In April 2014,India based Piramal Group sold its 11% Stake in Vodafone India to Prime Metals,an indirect subsidiary of Vodafone Group.

PROBLEM AND ISSUES FACED:

The February 2007 sale between Hutch and Vodafone led to legal taxation battle by the Indian Income tax Department. The tax dispute was worth $2.5 billion wherein the Indian tax authorities alleged that as the acquisition deal involved purchase of assets of an Indian company Hutch was supposed to pay capital gains tax and this as responsibility was to be collected as TDS by Vodafone. Vodafone defended that the transaction was offshore so the liability to collected any kind of tax on this transaction did not lie on Vodafone. Vodafone Group Plc–a British company through one of its subsidiary company-Vodafone International Holdings B.V.-a Netherland based company got into an agreement with Hutchison Telecommunications International Limited (HTIL) to purchase 100% share of one of its companies-CGP Holdings which was based in Cayman Islands. Now this CGP was the company that held 67% share of the Hutchison Essar which was in India. So technically CGP was nothing but a Special Purpose Vehicle (SPV) utilized by Vodafone and Hutch to transfer the holding of HEL without carrying out the actual transaction in India or by conducting any transfer of the asset in India. Vodafone and Hutch literally did nothing except transfer the shares of one of the companies to other, that too outside India. Using this as their defence mechanism Vodafone denied any tax to be paid.

Initially the Bombay High court and when challenged its decision even in High Court the jurisdiction of Indian Tax authorities over this transfer was to be decided. When the jurisdiction was decided in favour of the tax authorities the case was put before Bombay High court which ruled in favour of tax authorities for recovering the tax amount from Vodafone. This was further challenged in Supreme court which before moving forward asked Vodafone to deposit INR 25000 million and provide a bank guarantee of INR 85000 million. After this the case heard by the Supreme court a judgement was passed in 20 January 2012 in favour of Vodafone with the key highlights interpreting Section 9(1)(I) of the Act. It stated that as per the referred section, inter alia, income accruing or arising directly or indirectly from the transfer of a capital asset situated in India is deemed to accrue/arise in India in the hands of a non-resident. The legislature has not used the words 'indirect transfer' in Section 9(1)(i) of the Act. If the word 'indirect' is read into Section 9(1)(i) of the Act, then the phrase 'capital asset situated in India' would be insignificant. Section 9(1)(i) of the Act does not have 'look through' provisions, and it cannot be extended to cover indirect transfers of capital assets/ property situated in India. The law has a limited scope and it cannot be expanded by giving purposive interpretation, particularly if the result of such interpretation is to transform the concept of chargeability which is also there in Section 9(1)(i) of the Act.

Briefly, the Supreme Court stated that the Indian Income tax authorities have no jurisdiction to levy tax on overseas transactions between companies incorporated outside India and that being applied to this case as the transfer of shares in CGP was not of asset situated in India as well as by companies situated outside India, Vodafone was to be refunded its Rs.25000 million deposited earlier along with 4% interest as well as the bank guarantee. The GOI was not accepting of this decision and thereby in May 2012, amended various provisions of Income Tax Act with retrospective effect to tax any gain on transfer of shares in a non-Indian company, which derives substantial value from underlying Indian assets. GAAR-General Anti avoidance Rules were also introduced. The Income tax authorities then served a notice in 2013 demanding Rs.14200 crores of tax with interest from Vodafone which was challenged by Vodafone under Dutch BIT in 2014.The tax authorities again in 2016 served a noticed for Rs.22100 crores of tax with interest from the date of the original demand.

A BIT-Bilateral Investment Treaty is a treaty between two sovereign states for protection and benefit of investors from one state which has invested in other state. Vodafone initially had asked for arbitration under India-Netherlands BIT, going one step further it also invoked India-UK BIT in 2017.This was challenged by the Union of Government again raising the objection that with one BIT pending a second BIT cannot be filed as it is abuse of process. The High court and then the Supreme Court passed the judgment to participate in the appointment of the arbitration panel and disposing off the case of the Union granting it the liberty to raise the issue of abuse of process in front of the arbitral tribunal constituted under the India-UK BIT.As per the latest development the Vodafone Hutch case hearing with the tribunal headed by Sir Franklin Berman, constituted in June 2016 will start from February 2019 wherein Vodafone was to file its response by July 2018 and India by December 2018.Indian officials are riding high on the confidence that the tax demands don't fall within the preview of investment treaties but only time will prove what the ruling would be.

The income tax department in another move had sent Income tax notices demanding 32000 crore Rs. which includes capital gains tax, penalty and interest from Hong Kong based company Hutchison Holdings as a result of the deal to sell its mobile business to Vodafone in 2007.This was the first time the Indian Income tax had approached Hutchison for this tax for they were targeting Vodafone till now. Hutchison, in its filing to the exchange, stated the taxes were invalid as the Supreme Court in 2012 had itself ruled out that the deal was not taxable in India and the tax demands raised violates the principles of international law. This step of Income tax authorities could well raise a point in the tribunal of Vodafone for asking to 2 entities to pay the same tax. The status of all of it would be clear only after the tribunal starts hearing.

On an Indian front Vodafone and Idea Cellular merged to form the largest telecom provider in India with almost 400 million customers and accounting for 35% of the Indian cellular market. Vodafone owning 45.1% of the new company was valued at $12.6 billion and Idea's parent company, the Aditya Birla Group owning own 26 percent was valued at $11.02 billion.

CONCLUSION:

Vodafone-Hutch was a case not just of an acquisition that led to changing of management and workings but also a reflection of the force of the external factors like international treaties, taxation laws, government policies, judiciary systems, economic policies and not to say it has ended it still goes on. But as an entity Vodafone was rebranded over the period of years and every time has emerged stronger, healthier and with higher growth- just one of those perfect examples how acquisitions and mergers when used in a systematic way can lead to the growth of the company on a whole.

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