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VODAFONE ITA AWARD AGAINST INDIA: A CALL FOR A CHANGE IN THE INDIAN INVESTMENT LANDSCAPE

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1. INTRODUCTION

Finally, after an epitome of litigation against the Government of India, on 25th September 2020, the telecom giant Vodafone won the investment treaty arbitration against India. The dispute initiated under the India-Netherlands Bilateral Investment Treaty was against the retrospective amendment made to the Indian Income Tax Act and the related tax imposition on Vodafone's transaction with Hutch. The arbitral award is expected to have a greater impact on the Indian investment landscape and it's worth to have look at the background of the dispute and its probable outcomes.

2. FACTUAL MATRIX

2.1 Vodafone – India Tax Dispute

The saga commenced with Vodafone's acquisition of a majority stake from Hutchison Telecommunications International Limited (HTIL) in 2007. HTIL, a Hong Kong entity, and Vodafone International Holdings B.V., (VIHBV), a Dutch entity, are pioneers in the international telecommunication sector. In 2007, VIHBV acquired HTIL's stake (67%) in a Cayman-based entity, which indirectly held the shares of the Indian subsidiary of HTIL, Hutchinson Essar Limited (HEL) for a consideration of \$11.1 billion. Subsequently, the Indian Income Tax (IT) authorities served a notice to VIHBV demanding the payment of capital gains tax (\$ 2.2 billion). The IT authorities considered that the transaction between HEL and VIHBV

included the transfer of capital gains, which was taxable at source as per Section 195 of the Income Tax Act, 1961 (hereinafter, IT Act).

As VIHBV failed to make tax payments for this transfer, the IT authorities served the demand notice for non-deduction of tax according to the provisions of the IT Act. Vodafone contended that they were not liable to pay the amount since there was no transfer of capital assets situated in India in the transaction between VIHBV and HEL. Against the IT notice, VIHBV and HEL filed a writ petition before the High Court of Bombay and the Court held that Vodafone was liable to pay the taxes. Aggrieved by the decision, Vodafone applied for an SLP to the Supreme Court of India. Considering the petition¹ in 2012, the Supreme Court reversed the Bombay High Court's decision and held that the claims of the IT authorities were not sustainable and that Vodafone was not responsible for any tax deductions.²

2.2 India – Netherlands ITA

Vodafone's victory was however short-lived. Post the Supreme Court verdict, on the dispute, the IT Act was amended by introducing the Finance Bill, 2012. The amendment to the IT Act was given a retrospective effect and it provided for imposing a tax on the gain on transfer of shares in a foreign company that derives substantial value from the assets located in India.³ As a consequence of this amendment, Vodafone was again made liable to pay taxes. In 2013, the IT department issued notice to Vodafone demanding the payment of taxes.

Aggrieved by the imposition of taxes via the new amendment of the IT Act, Vodafone initiated Investment Treaty Arbitration (ITA) against the Republic of India in 2014 under the India-Netherlands Bilateral Investment Treaty (BIT). Vodafone contended that the imposition of taxes on them through the retrospective amendment of Sections 9(1) and 195 of the IT Act read with Section 119 of the Indian Finance Act, 2012 violated India's obligation to ensure '*fair and equitable treatment*' (FET) to investors from the Netherlands under Article 4.1 of the India-

¹Vodafone International Holdings B.V. v. Union of India, Civil Appeal No.733/2012.

²Aditi Mukundan and Bijal Ajinkya, *The Vodafone Decision: All Is Not Lost*, Nishith Desai Associates (Sept.27, 2010), available at http://www.nishithdesai.com/fileadmin/user_upload/pdfs/The_Vodafone_Decision_-_All_Is_Not_Lost.pdf.

³Income Tax Act, 1961, Explanation 2 to § 9(1), No.43, Acts of Parliament, 1961.

Netherlands BIT. On 17th April 2014, a notice of Arbitration was served to India by the VIH BV as provided under the India-Netherlands BIT.⁴

2.3 India-United Kingdom ITA

Meanwhile, on 24th January 2017, the UK based Vodafone Group Plc., the parent company of VIH BV invoked arbitration against India under the India-UK BIT. The Vodafone Group challenged the retrospective Amendment of the Indian IT Act, specifically Sections 9(1) and 195 read with Section 119 of the Indian Finance Act, 2012. Against this move, the Indian Government filed a suit seeking an anti-arbitration injunction against Vodafone Group proceeding with the ITA under the India-United Kingdom BIT before the High Court of Delhi.⁵ On 22nd August 2017, an interim ex parte order restraining the India-United Kingdom ITA was passed. Subsequently, on 7th May 2018, the Court dismissed the suit on the ground of abuse of process.⁶

2.4 VODAFONE-INDIA ITA AWARD

The arbitral award was rendered by the Permanent Court of Arbitration (PCA) on 25th September 2020. The operative part of the award published by certain sources is only available. The award was rendered in favour of the Vodafone Group, reportedly for the violation of FET provisions under Art 4.1 of the India-Netherlands BIT. The PCA directed the Indian Government to pay the legal costs (approximately INR 850 million) incurred as partial compensation and to reimburse the tax levied from Vodafone.⁷

3. REPERCUSSIONS AND THE WAY FORWARD

Though the upshot of the Vodafone-India ITA award is not predictable at this stage, it is obvious that the award will underscore the Indian government's unfavourable approach towards foreign investors. It is evident from the Indian arbitral history that generally, the ITA's were not

⁴Kshama Loya and Vyapak Desai, *Vodafone Investment Treaty Arbitration Award – Part I*, Nishith Desai Associates (Oct. 5, 2020), available at https://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/newsid/6279/html/1.html?no_cache=1.

⁵*Union of India v. Vodafone Plc. and Anr.*, C.S. (S) 383 / 2017 (High Court of Delhi).

⁶Pushkar Anand, *Vodafone v. India – End of a Saga?*, THE WIRE (Sept.20, 2020), available at <https://thewire.in/business/vodafone-india-end-of-a-saga-investment-treaty-arbitration>.

⁷Bar and Bench, *Permanent Court of Arbitration Rules against Indian Government in the Vodafone Tax Case (Read DECISION)*, available at <https://www.barandbench.com/news/permanent-court-of-arbitration-rules-against-indian-government-in-the-vodafone-tax-case> (last visited Oct. 21, 2020).

favourable to India and Vodafone's win is the latest in the list. Now it's high time to learn from the past and act judiciously.

Regarding the Vodafone-India ITA award, certain immediate observations can be made at this juncture. For instance, the PCA has held that the imposition of tax by the Indian IT authorities on Vodafone, '*notwithstanding the Indian Supreme Court's decision*' is violative of the FET provision of the India-Netherlands BIT. But it's still unclear as to whether the retrospective amendment of the Indian IT Act has held to be violative of the FET provision by the PCA or not. The PCA has directed to '*cease the conduct in question*' but what will be the next move of Vodafone, it is something to wait and watch. Probably, Vodafone may enforce the award to the extent of the breach against India or may approach the PCA for an award seeking compensation for the breach.

The next step that India may take against this award will be filing a petition for setting aside the arbitral award before the national court. Since the tribunal was seated in Singapore, the setting aside proceedings will be initiated in the Singapore Courts. Recently, in the case related to Vodafone's initiation of an ITA against India under the India-United Kingdom BIT, the Delhi High Court queried whether the Indian government wants to abide by the Vodafone-India ITA (under India-Netherlands BIT) or they prefer to file a petition to set aside the arbitral award.⁸ The Indian government, however, has not given any official statement regarding their stand on this issue.

The award may have an impact on the pending ITAs against India such as the Cairn Plc – Vedanta arbitrations and the India-United Kingdom ITA initiated by Vodafone. Also, the Indian government's stand on the termination of the India-Netherlands BIT and proposed enactment of the national legislation for investment protection and initiation of investor-state disputes⁹ after rendering the Vodafone-India ITA award is something that the investors' community are awaiting. The award has also brought in ambiguity regarding India's position in initiating tax

⁸ET Bureau, *Delhi HC Asks Government if it will Challenge Tribunal Award in Vodafone Tax Case*, The ECONOMIC TIMES (Oct. 8, 2020, 08:37 AM), available at https://economictimes.indiatimes.com/news/politics-and-nation/delhi-hc-asks-govt-if-it-will-challenge-tribunalaward/articleshow/78541943.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

⁹Aditi Shah & Aftab, *Government Plans New Law to Protect Foreign Investment*, LIVEMINT (Jan.15, 2020, 04:07 PM), available at <https://www.livemint.com/news/india/government-plans-new-law-to-protect-foreign-investment-11579084078405.html>.

disputes under investment treaties. Generally, tax disputes were excluded from the BITs, almost all recent BITs signed by India measures regarding tax obligations were excluded. However, the impact of the Vodafone-India ITA award may persuade India further to negotiate for the incorporation of such exclusions in BITs.

Looking through a different lens, though the award may cause damage to India's credibility in BIT obligations, the Indian government can consider this as an opportunity to learn new lessons. The fault lies in the approach, most times the action is initiated when a case is brought before the courts and not afore. The same is the case in national and international disputes. Now, in the present context, BITs are one of the important defensive mechanism available to foreign investors, the clauses incorporated in it will be more favourable to them.

Therefore, the signatories of these BITs should have thorough knowledge about its provisions. But, often India is being criticized for signing BITs and other international instruments without knowing the provisions incorporated in it. This attitude of the Indian government should change. When governmental measures are taken which might have an adverse impact on the investors, the government must consider the obligations which are agreed to be fulfilled by it under the BITs. For this, firstly, there should be efficient synchronization of all the concerned government departments and Ministries (Ministry of Finance). Then, they should foresee the implications of the governmental measures on the investors and should take necessary steps in advance. Officers with expertise in the field of international law may be appointed within the said departments or ministries for this purpose. As it is said, '*prevention is better than cure*'.