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# Vodafone wins in US\$2.7bn tax arbitration against India

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# LEGAL UPDATE

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## INTRODUCTION

An international arbitral tribunal sitting in the Permanent Court of Arbitration (“**PCA**”) has unanimously ruled in favour of Vodafone International Holdings BV (“**VIHBV**”) against the Indian government, in relation to a long-standing tax dispute between both parties.

The tribunal held that the Indian government’s retrospective levying of a US\$2.7 billion tax on VIHBV is in breach of India’s obligations under the Netherlands-India bilateral investment treaty of 6 November 1995 (“**Netherlands-India BIT**”), particularly the obligation to accord fair and equitable treatment to VIHBV’s investments.

The three-member tribunal, which included India’s appointed arbitrator Mr. Rodrigo Oreamuno, further held that any attempt by India to enforce the retrospective tax demand would be a violation of India’s international law obligations.

The tribunal further ordered that India reimburse VIHBV for 60% of its legal costs, amounting to approximately £4.3 million.

## BACKGROUND

VIHBV is an Amsterdam-based subsidiary of the UK-based Vodafone Group Plc. In 2007, VIHBV entered into an US\$11 billion transaction with the Hong Kong-based Hutchison Telecommunications International Limited (“**HTIL**”), under which VIHBV acquired HTIL’s Cayman Islands-based subsidiary CGP Investments (Holdings) Ltd (“**CGP**”). CGP itself owned approximately 52% of the share capital in one of India’s largest mobile operators, Hutchison Essar Limited (“**HEL**”), as well as options to acquire a further 15% shareholding interest in HEL. The transaction thus ultimately resulted in VIHBV acquiring a controlling stake in HEL.

The Indian tax authorities thus sought to impose a US\$2.7 billion tax on capital gains arising from the sale of share capital in CGP, on the basis that CGP held the underlying Indian assets, and that the aim of the transaction was to acquire a controlling interest in HEL.

While the Bombay High Court had ruled in favour of the Indian tax authorities in 2010, this was overturned by an Indian Supreme Court decision in 2012, which held that the transaction concerned a share sale rather than a sale of assets.

Shortly after the 2012 Supreme Court decision was issued, the Indian government retrospectively amended its Income Tax Act in March 2012. The retrospective amendment effectively nullified the Supreme Court’s verdict that VIHBV did not have any liability to pay tax on its acquisition of HEL, and was challenged by VIHBV in the PCA arbitration.

In the PCA Arbitration, VIH BV brought a claim against India under the Netherlands-India BIT, arguing among other things that India had breached its treaty obligation to accord fair and equitable treatment to VIH BV's investments.

## THE ARBITRAL TRIBUNAL'S DECISION

The Tribunal's Award dated 25 September 2020 remains confidential, and has not been published in full. Based on the limited information presently available in the public domain, the dispositive part of Award has held that:

1. The tribunal has jurisdiction under the Netherlands-India BIT to hear VIH BV's claim for India's breach of the Netherlands-India BIT;
2. VIH BV is entitled, in respect of its investments in mobile telecommunications in India, to the protection of the guarantee of fair and equitable treatment ("FET") laid down in Article 4(1) of the Netherlands-India BIT;
3. India's conduct in respect of the imposition of the tax liability notwithstanding the Supreme Court's decision is in breach of the guarantee of FET laid down in Article 4(1) of the Netherlands-India BIT, as is its imposition of interest and non-payment penalties on the unpaid tax liability;
4. The tribunal's finding that India has breached Article 4(1) of the Netherlands-India BIT entails an obligation on India to cease the conduct in question, and any failure to comply with this obligation will engage India's international responsibility; and
5. The costs of the arbitration are to be borne equally between both parties, but India is to reimburse VIH BV for 60% of its legal costs, in the sum of £4,327,294.50.

## COMMENTARY

### KEYPOINT

*The PCA tribunal's watershed decision could set an important precedent for future investor-state arbitrations, particularly for foreign investors seeking to challenge unfairly aggressive tax decisions made by the host state's government*

It is interesting to see whether a similar award will be rendered in the arbitration brought by Scottish oil giant Cairn Energy against the Indian government. The Cairn Energy arbitration involves the same retrospective tax amendment, but was brought under the terms of the India-UK bilateral investment treaty.

While potential claimants have every reason to be enthusiastic about the PCA tribunal's decision in favour of VIH BV, a few words of caution should be advised.

First, VIH BV may face considerable difficulties in enforcing the Award that has been rendered in favour of it. Even apart from the prohibitive wording of the Award which stated only that India was obliged to “*cease the conduct in question*”, it remains uncertain whether investment arbitral awards will be enforced by the domestic courts in India. When it signed the New York Convention, India made a commercial reservation pursuant to Article I(3), as reflected in Section 44 of the Indian Arbitration and Conciliation Act. Indian courts will only enforce foreign international arbitral awards arising out of legal relationships considered commercial under Indian domestic law, which casts significant doubt over the enforceability of investment arbitral awards involving sovereigns and private investors.

Second, the PCA tribunal's decision likely turned on the particular facts of the aggressive approach taken by the Indian tax authorities. The Award took care to expressly specify that India's conduct *notwithstanding the Supreme Court's decision* was in breach of the FET standards guaranteed under the Netherlands-India BIT. In light of the tribunal's deliberate emphasis on the India Supreme Court's decision, it is likely that the tribunal's reasoning was swayed by the Indian legislature's blatant and aggressive attempt to retrospectively nullify the decision rendered against it by its own judiciary.

Notwithstanding the above, the Award represents a timely warning to domestic tax regulatory and/or legislative bodies who are considering similarly aggressive taxation, or other retrospective administrative action. In line with the growing trend of investment arbitration, foreign investors are no longer limited to availing themselves of traditional contractual remedies, and may be emboldened to directly enforce a host state's international obligations before an independent international arbitral tribunal.

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