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Direct Tax Code will net Vodafone-like overseas deals

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The proposed rollout of the Direct Taxes Code (DTC), a key tax reform that is in the offing, specifically provides for the imposition of capital gains tax on overseas acquisitions if the acquired company holds over 50 per cent assets in India. This provision will ensure that such transactions fall under the tax net once the DTC is enacted. So, Vodafone may have ended up paying tax on the $11.1 billion purchase of Hutchison's stake in the Indian telecom venture.

The Direct Taxes Code Bill 2010 proposes to implement the general anti-avoidance rule (GAAR) for the first time in the context of a domestic legislation. GAAR refer to provisions that can invalidate an arrangement entered into by a taxpayer for claiming tax benefits. It is expected to sufficiently empower the authorities to determine tax consequences for any arrangement that is deemed a tax avoidance transaction.

Under the proposed rules, transactions where a company owns an underlying asset in which the Indian assets are in excess of 50 per cent, the capital gain is to be correspondingly charged on a proportional basis.

The provision essentially implies that if 70 per cent of an acquired foreign company's assets are in India, the acquirer will have to pay 70 per cent of the capital gains tax accruing from the transaction.

Before the matter was conclusively settled by Friday's apex court ruling, Vodafone had disputed the Income Tax Department's notice by claiming that no tax was payable on its deal with Hutchison since the shares that changed hands rested in Cayman Islands.
On the other hand, the I-T Department consistently maintained that it had full jurisdiction to tax Vodafone as the deal involved Indian assets.

"The tax policy shift to usher in GAAR has followed the government's endeavour to give legislative teeth against questionable transactions that lead to tax leakages. The Indian tax administration has been battling with interpretation of its 50-year-old tax law for source-based rules of taxation. Foreign investors on the other hand believe that they have been subjected to the most rigorous form of treaty and source based rules — the Vodafone controversy being the most popular case on interpretation of source based rule," said **Mukesh Butani**, Partner, BMR Advisors.

The Direct Taxes Code is expected to be rolled-out in April 2013, effectively replacing the Income Tax Act, 1961. Efforts by the Government to tighten the tax norms need to be seen in the context of the increasing volume and value of mergers and acquisition deals involving overseas players in the country.

Mergers and acquisitions (M&A) and private equity (PE) involving Indian companies together clocked $54 billion in 2011 from 1,026 deals, according to a report by Grant Thornton.