

## Bombay High Court Validates Right of First Refusal

## Vodafone – Hutchison Deal Caught in Tax Net

### LexCounsel, Law Offices

C-10, Gulmohar Park  
New Delhi 110 049, INDIA.

Tel.: +91.11.4166.2861

Fax: +91.11.4166.2862

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The Bombay High Court, in its recent judgment in Messer Holdings Limited Vs. Shyam Madanmohan Ruia and Others, has upheld the validity of the agreements like 'right of first refusal' inter se the shareholders of a company. The court has ruled that such agreements do not violate section 111A of the Companies Act, 1956, which specifies that the shares and debentures of companies must be freely transferable.

The division bench judgment has come as reversal of an earlier judgment by a single bench of the same High Court in Western Maharashtra Development Corporation Ltd. Vs. Bajaj Auto Ltd., which had deemed any sort of restriction on the transferability of the shares of a company as illegal.

Under the 'right of first refusal', any shareholder planning to exit the company, is obliged to give the other shareholders of such company, an opportunity to buy the shares before the shares can be sold to a third party. In addition, contemporary shareholder agreements include various other rights such as 'tag along, 'drag along etc., which could in view of the earlier judgment be considered as a restriction on free transferability of shares.

The earlier judgment of the single bench had sent tremors running into the corporate and financial community as the provisions like 'right of first refusal'; 'tag along; 'drag along etc., are important exit provisions for any financial investor or strategic partner. The judgment of the division bench is, thus, much awaited relief for the corporate community.

## Vodafone – Hutchison Deal Caught in Tax Net

The Bombay High Court, in a landmark verdict, on September 8, 2010 held that the Indian tax authorities were correct in assessing Vodafone for its Indian tax liability in the \$11 billion acquisition of a controlling 67% stake in the mobile phone operator Hutchison Essar in 2007.

Vodafone, through the acquisition of Hutchison's 67% equity share in Cayman Islands, gained control of Hutchison Essar Limited ("HEL") in India, which has since been renamed as Vodafone Essar. The remaining 33% of HEL is held by the Ruias of Essar Group. The Income Tax Department had issued show cause notice to Vodafone in 2007, requiring Vodafone to explain as to why it should not be treated as an 'assessee in default' for failure to withhold tax when it cleared payments to Hutchison. Vodafone filed a petition in the Bombay High Court against the above order.

The Income Tax Department sought to impose capital gains tax on the ground that the transfer of shares resulted in consequential transfer of control over an Indian entity and therefore gave rise to capital gains, taxable in India. As opposed to this, Vodafone argued that Indian law did not require it to deduct tax since Vodafone bought the stake in Hutchison Essar in a deal that took place in the Cayman Islands and thus there was no sum chargeable to tax in India.

The High Court opined that because of the fact that the transaction took place overseas, it cannot be implied that the transaction was outside the purview

of the Indian tax laws. The Court held that the Income Tax Department was within its jurisdiction when it initiated the matter as the operating assets of HEL were in India. The Court held that “In the present case, the transaction in question had a significant nexus with India. The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The Petitioner (Vodafone) by the diverse agreements that it entered into has a nexus with Indian jurisdiction. In these circumstances, the proceedings which have been initiated by the Income Tax Department Authorities cannot be held to lack jurisdiction.”

The order of the High Court could result in approximately \$2.6 billion tax liability for Vodafone. The judgment is also expected to have a bearing on similar cross border transactions including GE-Genpact, Mitsui Vedanta Group, Idea-AT&T, SABMiller-Foster and Sanofi Aventis-Shanta Biotech, on which tax department has already made claims on similar grounds.