Business Standard

Vodafone verdict: What lies ahead for India's tax laws, investment pacts

Will this award put the remaining issues around imposition of a tax on a retrospective basis?

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The Vodafone award would not have any impact on new bilateral investment treaties based on the new model | Illustration: Ajay Mohanty

The decade-long tax dispute between UK's Vodafone group and India seems to be entering its final phase of resolution with the Permanent Court of Arbitration at the Hague ruling in favour of the telecom giant.

Tax and arbitration experts explain the implications of this investment treaty arbitration dispute — under the India-Netherlands Bilateral Investment Treaty — on international investor sentiment and India's existing and new investment treaties.

Will this award put the remaining issues around imposition of a tax on a retrospective basis?

Not really. Most international tax and arbitration experts are of the opinion that this award is only one tribunal's view as to whether such a retrospective tax is consistent with India's obligations under a specific bilateral investment treaty. However, in other cases, tribunals need not take the same view. It would depend on interpretation of the treaty by each tribunal, they add.

“The investment treaty arbitration world does not follow the doctrine of stare decisis, according to which an award by one court would bind the other,” says Kshama A. Loya, leader, investment treaty & arbitration practice, at law firm Nishith Desai Associates.

Also, the award has no implications on India’s legal ability to impose taxes on a retrospective basis. However, it does raise a question as to whether such levies are compatible with India’s obligations under its existing investment treaties (including those that were terminated, but which have a sunset clause protecting existing investments), points out Hitesh D Gajaria, senior partner at KPMG in India.

There is considerable speculation as to whether this award would have any bearing on another Vodafone-type case, namely, the ongoing tax-related arbitration proceedings with Cairn Energy. The hearings at the international tribunal in this case were completed in December 2018 and the award is expected this year.

“It is unlikely that the Vodafone award would have a bearing on the award in Cairn which is expected anytime now,” says Loya. There would also be no impact on similar domestic cases pending with the Supreme Court or any of the high courts, experts add.

So, will issues around the retrospective tax continue to remain contentious?

Experts say it may depend on the government’s next course of action in the arbitration case with Vodafone. If it decides to challenge the award before the High Court of Singapore — Singapore being the seat of the arbitration while The Hague was chosen as venue for the hearings — the issue may continue to remain contentious, they add.

Many experts feel Vodafone could also face hurdles in enforcement of the treaty award in India, given uncertainty in the Indian legal regime.

Further, the favourable award may also encourage more foreign investors to challenge retrospective tax measures under applicable bilateral investment treaties.

“The Vodafone case is likely to make the government more wary of the challenges brought by investors,” says Dheeraj Nair, partner at law firm, J Sagar Associates.

However, the government’s stated position has been that it will not introduce retrospective tax legislations, going forward. India introduced a new Model Bilateral Investment Treaty in 2015, which restricts the scope of such treaties, and specifically seeks to exclude tax matters within the ambit of the ‘fair and equitable treatment’ clause.

Thereafter, India unilaterally terminated many of its key investment treaties (including the ones with the Netherlands and the UK).

So, will the award impact existing and new bilateral investment and tax treaties?

The government has said the new model bilateral investment treaty will form the template for future treaty negotiations, striking a fresh balance between investment protection and the state’s right to regulate.

The Vodafone award would not have any impact on new bilateral investment treaties based on the new model.

However, experts point out that protections under investment treaties provide a recourse to foreign investors in addition to remedies in domestic courts.

These protections will continue to be key in bilateral or multilateral trade and investment negotiations, they add.

“Claims under bilateral investment treaties are not going to go away in the near future. The government should factor in and plan for such litigation risk, going forward,” says Nair.

Sandeep Jhunjhunwala, partner, Nangia Andersen, feels India now has pressure to internalise global investment laws and bilateral treaties to fully ringfence its liabilities in Vodafone’s category of cases.

A way forward, feel experts, could be to implement the key recommendations of a government-mandated high-level committee, chaired by Justice BN Srikrishna. It focused on arbitrations involving the government and bilateral investment treaties.