

5 Reasons why Revenue lost the Vodafone Tax Case

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The 5 year, \$2bn tax saga has witnessed many dramatic twists and turns, captivating the attention of the tax world and the financial community at large. As tax professionals analyse and dissect every word of the Indian Supreme Court's historic judgment, Taxsutra unravels the story behind the story.

1. The Larger Bench “Historic Blunder” :

3.30 pm on Day 22 of the SC hearing in Vodafone case... when Solicitor General Rohinton Nariman launched into the SC decision in Azadi Bachao Andolan. Nariman cited certain paras of Azadi Bachao ruling to show that the 2 judge bench in Azadi had completely misconstrued the 5 judges decision in McDowell on the aspects of tax planning and tax evasion and made a huge error in holding that Justice Ranganath Mishra's views were different from Justice Reddy's in McDowell ruling. Nariman vehemently contended... "You (SC in Azadi) say the majority (in McDowell) said something different.. Where did they (2 judge bench in Azadi) get this from?", asked Nariman and then thundered " Azadi is perverse...if you want a relook at Justice Reddy's views (in McDowell), please constitute a 7 judge bench. " The entire courtroom was looking on in stunned silence, the judges appeared rattled and Justice Radhakrishnan even seemed to concur with Nariman..Justice Radhakrishnan observed “ It is not correct (observations in Azadi).” At this juncture Chief Justice Kapadia said “ We will consider a middle path (between Azadi & McDowell).” Nariman appeared satisfied and did not press his argument for a 7 judges congregation! The middle path ultimately turned out to be a Big ‘ No Entry’ for the Income tax department, a ‘one way’ for Vodafone and an unequivocal re-affirmation of Azadi on form vs substance!

I, for one, was flummoxed and surprised at Nariman's decision. Late that night (Sept 28, 2011) I could not resist calling up one of the tax department counsels assisting Nariman in this case. I asked him why did they not press for a larger bench on tax planning & tax avoidance? The unconvincing answer: “ We are confident that the middle path will be balanced and acceptable to both sides...” It was a self goal scored by Revenue after dribbling the ball past all the opposition players. And why was this an “ Historic Blunder?” The immediate point below....

2. Walfort & Dividend Stripping:

I have always believed that it pays to be a good student of History and Statistics. The Revenue & Govt counsels came up short on both counts. History ought to have told them that in 2010, the same bench of CJI and Justice Swatanter Kumar had upheld one of the most celebrated tax avoidance schemes called “ Dividend Stripping”, whereby you bought mutual fund units on a Friday (just before the dividend declaration date), sold them on Monday post dividend declaration, took home tax free dividend income and booked a ‘ artificial’ capital loss (as NAV fell post dividend) to set it off against your ‘real’ capital gains. If the apex court did not consider this a classic pre-ordained, tax avoidance scheme (which am told was even advertised in newspapers by Mutual Funds) , one wonders how did the Revenue expect the very same judges to lift the corporate veil of a structure through which \$11bn was invested in India!!! In that dividend stripping case (Walfort Share & Stock Broking), Chief Justice Kapadia dismissed Revenue’s reliance on McDowell and upheld the observations of Azadi Bachao on tax planning & tax avoidance; an important fact that should not have been lost on the Revenue.

3. Statistics - They Don’t Lie (Atleast not Always)

Judges are human beings. They too have emotions and their ideologies are shaped by their respective backgrounds and life experiences. So, every judge will have some sort of a leaning/bias. Being a keen student of Statistics, I was excited to compare how Chief Justice Kapadia’s tax judgments statistics compared with his predecessors. The table below is self explanatory....

Income tax Judgments passed by Supreme Court Judges*	In Favour of *			
	Assessee	Revenue	Assessee in percentage	Revenue in percentage
Justice S.P. Bharucha	72	101	42%	58%
Justice Suhas Sen	13	27	33%	67%
Justice Ranganathan	18	12	60%	40%
Justice Sabyasachi Mukherjee	22	15	59%	41%
Justice Jeevan Reddy	12	14	46%	54%
Justice Y.V. Chandrachud	10	12	45%	55%
Justice K. Venkataswami	4	3	57%	43%
Justice Y.K. Sabharwal	1	5	17%	83%
Justice Arijit Pasayat	14	13	52%	48%
Justice G.B. Pattanaik	8	16	33%	67%
Justice R.C. Lahoti	15	14	52%	48%
Justice B.N. Kirpal	5	5	50%	50%

Income tax Judgments passed by Chief Justice S.H. Kapadia during his Supreme Court tenure*		Income tax Judgments passed by Chief Justice S.H. Kapadia from January 1, 2008 to January 24, 2012*	
In favour of Assessee	In favour of Revenue	Cases in Favour of Assessee (76%)	56
65	29	Upheld HC	24
		HC Set Aside	23
In terms of percentage	In terms of percentage	Against SLP of revenue	4
69%	31%	Remitted	4
		AAR Set Aside	1
		Cases in Favour of Revenue (24%)	18
		Upheld HC	7
		HC Set Aside	10
		Revenue Granted Relief to Move HC	1

* All figures based on search conducted on www.taxmann.com

When 3 out of 4 rulings delivered by the CJI in the last 3 years have gone against them, the Revenue should have been alarmed...instead they harboured a feeling (and am not sure what was the basis for the same) that they were arguing in front of a “tax collector” bench. Had they seen these statistics beforehand, the Revenue’s strategy may have been quite different. Senior tax department officials now privately admit that it was probably a mistake for them to have “overpitched” their case, especially the argument that the whole Hutchison structure be declared “bogus” and that the corporate veil therefore be lifted. This bench, led by the Chief Justice, was never going to do that. The Government would have been on a better wicket if they had repeated the Bombay High Court strategy of driving home the facts (razor sharp focus on Share Purchase Agreement), rather than trying to be seen as stretching the limits of the law (arguing that Sec 9 itself is a look through). For all the painstaking research and hard work they did on the case, the Income tax department would have been better served had they spent couple of days doing some basic research on Chief Justice Kapadia and his judgments.....

4. Salve Factor:

Some love him, his opponents surely don't ...but you cannot ignore him because post Vodafone ruling Salve is undoubtedly the numero uno lawyer in India and probably among the costliest in the world. Nariman returned every salvo thrown at him by Salve, but in the end the latter outlasted everyone everyone else in what proved to be a Game of Attrition. For 17 days (spread across 5 weeks), he argued relentlessly..many a times repeating the same points again and again and again.....his patience legendary, knowing fully well that the judges were intent on laying down the law of the land. In his inimitable style Salve finally brought the judges around to his viewpoint. Salve made some strategic concessions (especially on Azadi Bachao) early on in the hearings and kept harping on 2 points throughout the 17 days – importance of FDI & absence of a look through provision in Sec 9, both of which won him the Battle Royale.

5. FDI & Economy:

Both these factors were beyond the tax department's control but played a crucial role in the final judgment. Throughout the 28 days hearing, Chief Justice Kapadia sought to make a distinction between FDI & FII. Infact 6 days before he actually pronounced the judgment, Chief Justice Kapadia gave a hint of what was coming..In a speech delivered at a Nani Palkhiwala Foundation event in Mumbai on January 14th, Chief Justice Kapadia exhorted fellow judges to keep the 'economy' in mind while delivering judgments! Making matters worse for the Revenue – the economic downturn, perceived "policy paralysis" and the sustained campaign launched by the Western Media throughout the hearings and pre-judgment as to how the foreign investors would literally flee India if the SC ruled against Vodafone. The tax department was outraged and felt that the Western media campaign was trying to scare the judges but no one from the Government came forward to defend the Revenue's case. Which makes one wonder: Why did no minister from the Government utter even a word, backing the Revenue in this case?

Well, it would be unfair to conclude this article without making a few special mentions. They may have lost but the tax department special counsels and officers have every reason to hold their heads high up. Never before in the 50 years since this Income Tax Act was introduced, has the Revenue worked with such passion, determination and grit on a case. I know of a few officers connected with this case who wept after the SC pronounced its ruling. Such was their involvement. What this case has shown is that for all the flak they receive, the Indian Revenue Service boasts of some of the finest brains in the country and we

should be proud of them. They may go overboard once in a while, which is an instinct they should try and reign in. The one man from the tax world who stuck his neck out in this case from Day Zero and who was the mastermind behind Vodafone's strategy – Dinesh Kanabar. He stands vindicated today and can be safely counted as among the top tax professionals in Asia.

But what next? Has the Final Word been spoken? Keep watching this space.....