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The Supreme Court of India has ruled in favor of the taxpayer in the high-profile *"Vodafone"* case, holding that Vodafone is not liable to pay billions of dollars in Indian tax it did not withhold in connection with its indirect acquisition of an Indian company. Under Indian law, a purchaser is required to withhold Indian capital gains tax from proceeds paid to a non-resident shareholder for stock of an Indian company. Previously, the Indian tax authorities had successfully argued to a lower court that although Vodafone acquired a non-Indian company that owned an Indian subsidiary the acquisition involved an indirect acquisition of an Indian company and was therefore subject to capital gains tax in India. Effectively, the Indian tax authorities convinced the lower court that the law allowed for a "look through" approach, under which India could impose its capital gains tax on a non-Indian selling shareholder. Under this approach, the lower court concluded that Vodafone should have withheld tax from the payment it made to the selling shareholder, and that Vodafone itself was liable for the tax that should have been withheld. The Indian Supreme Court disagreed.

The Indian Supreme Court held that the Indian tax authorities did not have jurisdiction to impose tax on the acquisition of a non-Indian company since the transaction was a purely offshore transaction between two non-Indian entities. The Vodafone transaction did not involve the sale of an Indian company's shares and the taxing authorities could not look through the structure to tax a deemed sale of the Indian subsidiary. The Supreme Court found that the structure involved in the Vodafone transaction was implemented to achieve tax efficiency and was not a vehicle employed for tax evasion. According to the Court, the use of non-Indian companies for legitimate tax planning purposes is permissible and will not be ignored in applying India's tax laws. Finally, and importantly for investors considering the Indian market, the Supreme Court recognized the importance of a stable tax policy that provides certainty for investors.

The Indian Supreme Court's ruling in Vodafone is a significant and welcome development. The uncertainty created by the lower court's ruling had posed difficult issues for parties negotiating acquisitions of non-Indian companies with an Indian subsidiary. Notwithstanding this positive development in India, buyers and sellers of multinational enterprises need to consider the possibility of indirect taxation in certain other jurisdictions, including China and Brazil, which may seek to tax offshore transactions that involve an indirect transfer of a company resident in those countries.

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Key Contacts

Aaron Pomeroy Colorado	apomeroy@cooley.com +1 720 566 4108
Mark Windfeld-Hansen Palo Alto	mwindfeldhansen@cooley.com +1 650 843 5111

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