Vodafone broke FDI cap in Hutch deal, breach continues, says CBDT

A new controversy is set to cloud the telecom sector and queer the pitch for Vodafone in the R11,000 crore tax appeal before the Supreme Court. According to a note prepared by the Central Board of Direct Tax for the Foreign InvestmentPromotion Board, which has the approval of the finance secretary, Vodafone, which bought Hutch's controlling 67%stake in February 2007 forming Vodafone-Essar, has always been in violation of the 74% FDI limit allowed in the telecom sector. It has said that Max Group chairman Analjit Singh, Asim Ghosh, a former managing director of Hutch-Essar and Vodafone-Essar, and IDFC group companies were instrumental in violation of the FDI norms.

The note says though FIPB cleared the Vodafone deal when it bought the stake from Hutch in 2007, it was on the basis of the opinion given by the law ministry, which did not have all the relevant documents before it. The entire documents, including the shareholders' purchase agreements, were available to the officials only when the withholding tax dispute arose between Vodafone and the tax officials. Therefore, it has suggested that the FIPB may obtain a fresh view from the law ministry with the new facts emerging.

When contacted, Vodafone plc global spokesperson said: " The structure has received the FIPB's approval."

The development could prove to be setback for the company which this year has subsequently bought the 33% stake held by Essar group for $5.46 billion and roped in Piramal Healthcare to acquire 5.5% stake to stay within the stipulated 74% FDI limits. The deal is yet to be approved by the FIPB.

The CBDT note has based its case on the fact that the beneficial ownership of Telecom Investments India, which holds 19.54% stake in the company, and Omega Holdings, which has 5.11% (Singh, Ghosh and IDFC own stakes in Vodafone through these firms), always vested with Hutchison Telecom International India Ltd (a foreign company) which was transferred to Vodafone.

This, along with 11% stake held by Essar group through a Mauritius holding company, takes the company's foreign holding beyond the permitted 74%. Vodafone directly owns 42.34% in the company.

The 12-page note dated November 22 has also pointed out that Vodafone was in violation of the FDI norms even after the government amended it in April, 2007 bringing in the concept of Indian owned and controlled company, which basically meant that if the holding company was owned and controlled by resident Indians downstream investments by them would be considered domestic.

However, the CBDT through the share purchase agreements signed between Singh and Ghosh and Vodafone has concluded that Singh and Ghosh didn't have the powers to appoint directors and Vodafone could have acquired their stakes at any time at a pre-determined price (below the market price) so the companies controlled and owned by them were in reality owned and controlled by Vodafone.

“Vodafone is the beneficial owner of the entire share capital of TII and Omega as it enjoys the fruits of ownership. As per the shareholders agreement between Vodafone and Essar group of companies, Vodafone is entitled to appoint 8directors out of 12 (Essar group may appoint 4) and thus enjoys the entire 19.54% stake of TII and 5.11% of Omega in Vodafone-Essar. No directors in Vodafone-Essar are appointed by Asim Ghosh, Analjist Singh and IDFC group of companies. Further, Vodafone can acquire the stake of these people by paying a pre-determined price. Thus, Singh and Ghosh and IDFC group of companies have assumed no risks or rewards through their investments in Vodafone-Essar as they are receiving a pre-determined price. The risks and rewards of the investments lies with Vodafone. Thus Vodafone is the beneficial owner of equities of TII and Omega for the purpose of FDI policy also as contained in Press Note No. 2 of 2009,” the note has concluded.

It has said that the directors appointed by Singh and Ghosh in TII and Omega were actually appointed by Vodafone since it had the call options on the equity held by the two. Further, the CBDT has pointed out that the share purchase agreement of HTIL had given a vendor warranty that it will procure resignation of the directors of TII and Omega so that the purchaser (Vodafone) can appoint its own directors.

“This warranty given by HTIL and accepted by Vodafone, is possible only when Vodafone has the effective power to appoint all the directors. However, on this issue, more facts needs to be ascertained as to how the directors of TII changed since 2007 and on whose instance,” the CBDT has observed.

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