Investment Treaty Arbitration and USD 3 Billion in Taxes

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In 2007, Vodafone International Holding, a Dutch company, bought 100% of the shares of CGP Investments, a Cayman Island-based company, for USD 11.1 billion for the indirect control of 67% of Hutchison Essar Limited, an Indian company. The Indian tax department determined that the deal was designed to avoid capital gains tax in India, and thus, imposed a tax demand.

However, in 2012, the government's contention was rejected by the Indian Supreme Court. The Supreme Court noted that the Indian tax authorities' demand for capital gains tax "*would amount to imposing capital punishment for capital investment since it lacks the authority of law.*" To prevent the indirect transfers of Indian assets, the government subsequently amended the law to make transfers of this nature taxable in India; this resulted in a new tax demand being placed on Vodafone.

In 2014, Vodafone initiated international arbitration proceedings after an out-of-court settlement with the Indian government failed. The Permanent Court of Arbitration in The Hague ruled in favor of Vodafone. Interestingly, the decision was unanimous with India's own appointed arbitrator – Rodrigo Oreamuno – ruling in favor of Vodafone as well. The tribunal held that any attempt by India to enforce such tax demand would be a violation of India's obligations towards international law.

In August of this year, the International Court of Arbitration ruled that the Indian government – which was seeking USD 3 billion in taxes from Vodafone – was in "*breach of the guarantee of fair and equitable treatment*" which is guaranteed under the bilateral investment protection pact between India and the Netherlands, by using retrospective legislation.

Now, the Indian government is considering its legal options after losing the case regarding the retrospective taxation against Vodafone. The award will potentially be challenged before a court in Singapore in an attempt to limit the damages not only in Vodafone's case but also in a separate lawsuit with Cairn Energy PLC, a United Kingdom company, which could involve much more significant damages.

The British oil and gas explorer, Cairn Energy PLC, began its investments in India during the 1990s; in 2004, the company made its biggest hydrocarbon discovery of the Mangala oil field in the Rajasthan state. This was subsequently followed by discoveries of the Bhagyam and Aishwarya oil fields. So far, Cairn Energy PLC has invested approximately USD 6.15 billion in various projects in India.

In January 2014, Cairn Energy PLC received notice from the Indian tax authorities requesting information related to the reorganization of the company in 2006. The tax department accompanied this notice with details of the near 10% shareholding of Cairn Energy PLC in its former subsidiary, Cairn India, and implemented retrospective tax demands on the company. In 2015, Cairn Energy initiated international arbitration proceedings against the Indian government to challenge the retrospective taxation.

When it comes to the case against Cairn Energy PLC, the Indian government could potentially end up paying USD 1.5 billion – the losses Cairn Energy PLC claims to have incurred from the expropriation of its investments to enforce the retrospective tax demand – should a separate arbitration panel determine that India's tax demands are illegal.

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