NTT DOCOMO FINDS ITSELF IN A TAX BIND

Brief facts of the dispute

On March 25, 2009, NTT DoCoMo Inc., a company incorporated in Japan (" **NTT**"), entered into a shareholders' agreement with Tata Teleservices Ltd. ("**TTL**"). Under the terms of the agreement, it was agreed that if TTL failed to satisfy certain "key performance indicators" within a period of five (5) years, then TTL would be required to find a buyer to purchase NTT's shares (26%) of TTL at the sale price that was higher of: (a) the fair value of those shares as of March 31, 2014; or (b) 50% of the price at which NTT purchased those shares. In July 2014, when TTL could not fulfill the performance indicators and, thereafter, could not find a buyer to purchase NTT's shares, NTT requested TTL to buy the shares at the price of INR58.04 per share. For this, TTL sought permission of the Reserve Bank of India (the " **RBI**") but the RBI, pursuant to the instructions received by it from the India's Ministry of Finance, objected to the assured return contract and stated that the acquisition could only be made at the fair market value (the "**FMV**") of the shares. Accordingly, TTL offered to acquire the 26% stake of NTT at the FMV of INR23 per share. A dispute arose, and NTT commenced arbitration proceedings in the London Court of International Arbitration.

Issues before the arbitral tribunal

The following issues were raised before the arbitral tribunal: (a) whether the RBI's special permission was required to sell the shares in excess of the FMV; (b) whether TTL had an obligation to perform the sale; (c) whether TTL and NTT were obliged to make reasonable endeavours to obtain the RBI's special permission and the consequences if the RBI refused to grant special permission; (d) whether TTL's non-acquisition of the shares at the sale price constituted a breach of the SHA; and (e) whether a payment of an amount in excess of the FMV was prohibited, and if so, could such excess amount be indirectly made good by way of an award of damages?

The award

On June 22, 2016, after consideration of the legal submissions, the arbitral tribunal ruled in favour of NTT, and directed TTL to pay NTT an amount of US$1,172,137,717 as damages and an amount of US$65,276,963 towards interest on the amount of USS1,172,137,717 from December 3, 2014 until the date of the award (calculated at the rate of 3.5% per annum compounded with quarterly rests), along with arbitration costs and legal fees. The tribunal held that the sum awarded to NTT was in the nature of damages and was not the sale price of shares, and therefore, the question of having to seek the RBI's special permission did not arise.

RBI's intervention and mutual resolution

When TTL sought the RBI's approval for payment under the award, the RBI declined. Aggrieved, NTT filed a petition in the Delhi High Court (the " **DHC**") seeking enforcement of the award. TTL and the RBI filed their respective objections opposing this enforcement. In early 2017, TTL and NTT arrived at a mutual resolution and jointly filed a consent application in the DHC. TTL withdrew its objections and agreed to remit the award amount, which the DHC permitted, subject to the income tax authorities issuing a no objection certificate. The DHC held that as long as the award remained valid, there was no need for any special permission of the RBI for remission by TTL of the amount awarded to NTT as damages. The refusal by the RBI of such a permission, which was not required in the first place, would not affect the enforceability of the award.

Indian tax authorities issue a notice for payment of taxes

NTT applied to the Indian tax authorities for a no withholding tax certificate for the funds to be repatriated by TTL to NTT. Press reports suggest that the Indian tax authorities have issued a notice and have demanded taxes of INR2500 crores (approx. US$390,000,000) prior to allowing the funds to be repatriated by TTL to NTT.

Comments

At the outset, from a foreign award enforcement perspective, the DHC decision will surely improve investor confidence and reaffirm that the Indian legal system is efficient. However, the amount payable to NTT being characterized as "damages" and not as the sale price of shares has set the stage for a long-drawn-out tax litigation between NTT and the Indian tax authorities. The tax payment will depend on whether the damages can be categorized as business or other income (a revenue receipt), or income from capital assets (a capital receipt), and the implications under the double taxation avoidance agreement between India and Japan. Generally speaking, the characterization of damages awarded on commercial business contracts and the resulting tax treatment is difficult and depends on what the damages compensate for. If the damages compensate for loss of income, then the general principle is that the damages will be considered as business income and will, therefore, be taxable. If the damages awarded relate to the loss of an income-producing asset, then they will be considered as a capital receipt and will, therefore, not be taxable. A very thin line differentiates a loss of income and a loss of an income-producing asset, and there is no bright-line test to distinguish the two either. Essentially, if the damages received are for the failure to receive a sum of money that would have been income had it been received, the damages are likely deemed as income and taxed accordingly. At this point, we do not know what arguments NTT will adopt, and one will have to wait and watch how things progress. Interestingly, after failing to resolve the tax matters of Vodafone and Cairn, and with bilateral treaty arbitration awards going against the Indian government (e.g., the Antrix-Devas case), instead of laying low, the Indian tax department seems all set to go after yet another multinational company.