

The need to tackle the substance of tax havens

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Vodafone won its tax appeal in India yesterday, saving it a substantial tax bill that India had been claiming was due on its takeover of the Hutchinson mobile phone network in that country. The [Economic Times of India](#) has as good a comment on the implications of the case as could be made:

The Supreme Court has ruled that Indian tax authorities have no jurisdiction over Vodafone's purchase of Hutchinson's interest in its mobile telephony joint venture in India with Essar, as the deal was executed through sale of a holding company registered in the Cayman Islands.

The ruling is a setback not only for India's fight against tax havens but also for taxation in general. For, the court's privileging of form over substance, maintaining the corporate veil, could lead to elaborate and extensive tax planning that results in enormous leakage of revenue.

The implication is clear. The judges are interpreting the law as it stands. India needs to rewrite its tax laws, to enable it to deal with commercial practice in a globalising world.

If every ABC Ltd operating in India is henceforth not to be owned through a holding company registered in some tax haven or the other, so as to permit acquisition by XYZ Ltd through its holding company registered in another tax haven without paying any capital gains tax, the language of tax law will have to make it clear that what counts is whether value accrues to the company changing ownership because of its economic activity in India.

Precisely so.

This was a transaction relating to Indian assets that India wanted to tax, and thought it could tax. But it was recorded 'elsewhere' in a tax haven structure. And the result is that the legal form of recording it 'elsewhere' has meant that India's laws have been subverted and tax is not due. That's the tax haven issue in a nutshell.

Now it is time for the OECD, UN and others to agree how such abuse can be tackled so

that transactions are not taxed where there form is but where their substance is. Because the cost to society otherwise will be enormous, as it is in this case where a developing country has lost out on resources it badly needs.