

Whether Moral or Ethical Values merit consideration in tax matters?

CA Rashmin Chandulal Sanghvi

(Note: This article was published in Taxmann's magazine: International Taxation, August, 2013 issue.)

In the last few years, we have seen some very interesting tax avoidance schemes and court decisions. I have submitted lengthy articles technically going into controversial details. Theme of the present issue demands that I keep technicalities aside and go to the root of the matter.

This paper is divided into two parts. **First Part** straight deals with the question asked: "Whether Moral or Ethical Values merit consideration in tax matters?" **Second part** deals with some specific tax issues. However, technical discussions are avoided in both parts. Those who are interested in technical details of tax planning executed by Global corporations, and possible anti avoidance measures, may see the technical article available on this link:

http://www.rashminsanghvi.com/downloads/taxation/electronic_commerce/133_Taxation_of_a_Global_Corporation.pdf

Part I. Direct answer to a direct question.

1. Let me narrate a real conversation that I had with an advocate specialising in tax prosecution matters.

Advocate: It is my duty to protect my client in a Court of Law.

Rashmin: That is true. However, if your client has done something wrong, will you still protect him?

Advocate: It is not my duty to judge right or wrong. My duty is to protect the client.

Rashmin: Assume that a person has committed rape. He is prosecuted. Will you knowingly protect him?

Advocate: Yes. That is my duty as an advocate.

Rashmin: Assume further that the lady raped was your sister. Would you still protect the client?

Advocate: Silence.

2. One can argue:

2.1 This is a criminal matter. We are talking of taxation. Same principles cannot be applied to taxation. Especially when the Government is corrupt, what right does it have to expect citizens to be honest?

2.2 A section of Government is corrupt. But “an Eye for an Eye will leave the whole world blind”.

When I want to be a dishonest tax payer; and I want to justify it because others are dishonest, whole country will be reduced to a country of dishonest people. Then the country can go insolvent. Many countries are insolvent today.

2.3.1 Most people are honest in their private dealings. They won't cheat an individual in their business or personal matters – even if they have a chance to cheat without being caught. They find it okay to cheat Government. After all, Government is an abstract, corrupt entity.

2.3.2 Another way of looking at it: Government is not the owner of the country. It is only an administrator – not withstanding its arrogance. When I cheat on taxation, I am cheating 125 crores of people. Not just the Government.

3. I asked a wise old man:

3.1 Does philosophy have a place in commercial life?

He replied: “Gandhiji believed in it. He was not ready to sacrifice truth & non-violence even for the sake of independence. He practised what he preached.”

3.2 Possible response: “Ultimately what happened? Nehru, Sardar, Maulana Azad and all the leaders of Congress were desperate for independence at any cost. With or without partition, with or without violence. Gandhiji was side lined.”

Yes. That is what usually happens. Society runs on greed and fear. Those who refuse to be pushed around by greed and fear will be side lined by majorities at many levels.

Ultimately it is an individual's choice.

4. Mahavir Bhagwan has said: “Dharma starts with Vivek”. Dharma means a life lived with morals and ethics, with love and truth.

Vivek means the process of distinguishing “Shubh” and “Labh” and then following “Shubh”. (“Shubh” means that which helps spiritual evolution. “Labh” means that which is beneficial materially.)

5. “Should I be moral/ ethical?” “Why?” “What is the benefit (Labh) by being ethical?” are not new questions. People from all walks of life have raised these questions since the beginning of society. Because we are in tax practice, we relate this issue with tax practice. Others relate this issue with their own field of activity.

This is actually a dilemma or even an internal confrontation between mind and intellect. The mind pulls towards temptations (Labh) and intellect pulls towards morals (Shubh).

In Indian mythology this perennial internal confrontation is beautifully illustrated by the story of Gajagraha - fight between elephant (Gaja) and crocodile (Graha). Fight between intellect and mind. Fight between wisdom and temptations.

It is always a personal fight, personal struggle. Neither debates nor sermons can help anyone.

One who can win over all temptations is called Mahaveer.

Part II. Tax Legal Issues.

Let us summarise some recent developments and then view them from a different angle.

1. **Hutchison - Vodafone** indirect transfer of shares through Cayman Island Company and Avoidance of Tax is well known. Following facts are summarised:

(i) Almost the whole of Indian media and tax profession was and is in favour of Vodafone; and against retrospective amendment of law, against the Income-tax department. (Authors of this article are exceptions.)

(ii) While the matter was in appeal before Honourable Courts in other words, while it was sub judice, at Vodafone’s request British Ministers and even U.S. Officials appealed to Government of India that Vodafone should not be taxed. Prominent people came for television and newspaper interviews; criticised Government of India (GOI) and Income-tax Department (I.T. Dept.). They unequivocally supported Vodafone’s case with eloquent arguments.

I remember Late Mr. Nani Palkhiwala’s statements on “**subjudice**” matters. He had challenged some constitutional amendments by Late PM Mrs. Indira Gandhi. He realised that common man does not understand

fine principles of constitution. So he made a campaign and gave talks at various cities around the country. However, he said that once a case is admitted before the Court, it is subjudice. Thereafter any public comments in the matter cannot be made. When he filed a case in the Court, he stopped speaking in the public. All that he said was said only in the Court. Why? Does it amount to "Influencing the Court"; "Contempt of Court"? Does it attract provisions of prosecution?

Probably, the law & views on "Subjudice" matters have undergone substantial changes.

2. Different Standards:

Hutchison & Vodafone together avoided Indian taxes and the British and American Governments came out in favour of Vodafone. When Vodafone avoided British taxes, it was penalised for substantial amount.

In India, the experts distinguish between "Tax Avoidance / Planning" and "Tax Evasion". In U.S.A., the IRS does not distinguish the two. Many big tax experts in USA have been penalised when they sold tax avoidance products to their clients. Some have paid hundreds of millions dollars and some have been dissolved.

Are U.S. and U.K. Governments convinced that different principles apply to USA/ U.K. and different to India? Irrespective of their conviction, how is it that Indian media and experts accept such a behaviour?

3. E-commerce: Google Corpn.

3.1 In the year 1998, at **IFA congress** in London, I raised the issue that the concept of Permanent Establishment (PE) is outdated. While it will continue to be useful for business in physical goods, it cannot be applied to E-commerce.

In the year 2000, the **High Powered Committee** on E-Commerce gave a report and said that the traditional concepts of "Residential Status" and "PE" are outdated and cannot be applied to E-commerce. Committee knew that in the absence of global support such radical issues will not have any impact. And of course, most of the global Governments, institutions and professionals did not accept these views.

3.2 In the year 2005, after a study lasting over eight years, **OECD** published its report on E-Commerce & concluded that: E-commerce business is too small. Traditional principles of E-Commerce **do not need any modifications.**

3.3 It is now officially reported by **British Parliamentary Committee** that **Google Corporation** has avoided substantial U.K. Income-taxes.

Similarly, several other MNCs doing distance/ E-Commerce business are reported to have avoided substantial income-taxes in U.S. & U.K.

- 3.4** Several North-Western (U.S. & European) Governments have come under severe financial crisis. The **financial crisis** that started in the year 2007 in USA and immediately spread to Europe – has still not ended. Many of these Governments and even their media have realised that aggressive tax avoidance by MNCs is one of the causes for huge financial crisis; budgetary cuts and **retrenchment** of many employees. Retrenchment in Europe is a big public issue.

Campaigns have been started in U.K. by the media – asking the people to stop buying products and services offered by these large tax avoiders. Britishers are now using **Gandhiji's technic of Statyagraha**. They are picketing against these MNCs' stores in U.K. and turning away potential customers.

How is that these news are blacked out by Indian media? Why no one (except Tax Sutra) is starting a campaign against aggressive tax avoidance?

- 3.4.** In February, 2013 OECD has, in its report titled “Addressing Base Erosion & Profit Shifting” concluded that “existing rules of International Taxation are **outdated**. They need modifications”. U.K. Parliamentary Committee's conclusion is similar.

When developing countries lose tax revenue, it is fine. When developed countries lose tax revenue, the rules need to be changed!

- 4.** **Britishers** needed a committee to study the issue and come to a conclusion that something is wrong. They will have other committees to modify the law and Double Tax Avoidance Treaties.

In Indian CBDT, a small group of commissioners/ directors went ahead and suggested modifications in law. The then Finance Minister Mr. Pranab Mukherjee accepted their suggestions and Parliament amended the law with retrospective effect.

In India, certain lobbies are raising a huge voice against the retrospective amendment. In U.K., probably such commissioners would be recognised and respected – for protecting national revenue. One such Indian Commissioner told me: “Indian Military protects Indian geographical boundaries against foreign enemies. “Indian police protects common man against white collar frauds”. We are protecting Indian revenue from white collar, black suited tax avoidance. What is wrong that we are doing?”

One may add: “Every time an MNC succeeds in tax avoidance, every Indian suffers. How is it that Indian media which is so aggressive against corruption, is all in favour of tax avoidance?”

5. Let us consider a few illustrations:

5.1 Illustration 1. When fraudulent tax avoidance is attempted, should principles of justice be different under Indian Penal Code (IPC) and under Income-tax Act (ITA)?

It is alleged that a Central Government Minister accepted in his company, subscription of share capital of Rs. 200 crores by cheque. Income-tax commissioners are confused: how can one consider share capital subscription as income? They needed an amendment to Section 56 (2) and provided clause (vii) (b) to cover such cases prospectively.

However, for CBI it was no issue. They simply went ahead and arrested the minister on charges of corruption. Courts will take time before final decision is delivered. However, for a white collar man, imprisonment itself is a punishment.

When the minister was released on bail, his supporters celebrated the release, garlanded the accused and raised slogans in his favour. Is it true that one can always find a few hundred supporters for any cause?

5.2 Illustration 2.

(i) Mr. H, wholesale trader had stored 10,000 tonnes of wheat at a warehouse in Haryana. The warehouse owner gave him warehouse receipt (WR). Mr. H went out of India and sold the warehouse receipt (WR) to Mr. V. He claimed that since he has sold the WR outside India, he is not liable to income-tax on the trading profits that he made.

Income-tax department claims: WR is only a title document. Where the contract to sell the WR is executed, where the WR is actually transferred; and where the payment is made – all questions are irrelevant. H has sold wheat lying in India and he is liable to tax.

What is your judgement?

(ii) Now consider the case of Hutchison (Hong Kong Company) selling shares in Hutchison Essar (an Indian Company) to Vodafone through a Cayman Island Company. The share in Cayman Island Company was a mere title document for a controlling stake in the Indian company. Nothing turned on transfer of the Cayman Island Company.

Indian Income-tax department started proceedings against Vodafone for not deducting tax at source. Vodafone filed writ petition before Bombay High Court and lost the case. Vodafone went to SC and lost the case. Matter was remanded to the I.T. Department. Department levied tax. Matter went to Bombay H.C. Decision was against Vodafone. Total three Court decisions were against Vodafone.

Then the matter went in final appeal before Honourable SC. Massive media campaign within India and internationally went on in favour of Vodafone. In the final appeal before SC, it was decided that the transaction was not liable to tax in India. No explanation was given as to why this decision was contrary to earlier three decisions in the same matter. Revenue's arguments were either ignored or not cited adequately in the SC decision. References were made that "Hutchison had paid substantial taxes in the past", "FDI is important for the country" etc.

Justice Verma, retired from Supreme Court stated publicly - "This is one of the worst decisions rendered by the SC of India".

What were the options available to Government of India? Amending the law with retrospective effect - was it setting right an incorrect decision; or was the Government of India doing something wrong?

6. Consider the principle: There can never be a controversy of "**Form Vs. Substance**". Form must always represent substance. If the form does not represent substance; that form must be disregarded as "wrong", or in appropriate circumstances, as "Fraudulent".

When a tax haven company is represented by nothing but a file in the consultant's office; is it really a company? Does claiming such non-existent company as the real owner - amount to fraud? Can such claimants be prosecuted under the Indian Penal Code for **defrauding Government of India**?

7. In June, 2013 a conference was organised in Mumbai. About 200 experts in International taxation attended the conference and about 20 experts addressed the conference. The speakers included Indian and foreign experts. Barring one speaker, almost every speaker supported aggressive tax avoidance. (This excludes judges who spoke at the event.) For one case study Chairman of the conference - a judge of the Bombay High Court asked for the opinion of entire conference. He said: "All those who believe that the company should be taxed, raise their hands". Only two individuals raised their hands. These were not seen. It was observed that "the Sabha had unanimously observed: The Company is not liable to tax".

Can a minority of two persons be right against a majority of 198? If yes, what about the principles of democracy – where the majority decides certain issues?

May I quote something from Mahabharat: The Prince of Hastinapur – Duryodhan ordered Vastraharan of the queen of Indraprastha (present name “Delhi”). None of the persons including seniors opposed Duryodhan – except two persons: Vidurji & Vikarna. Draupadi asked for help and on failing to get any help questioned the silence by entire Sabha (present name “conference”). She said: Sanskrit:

न सा सभा यत्र न सन्ति वृद्धाः
 वृद्धाः न ते ये न वदन्ति धर्मम् ।
 धर्मो न सो यत्र न चास्ति सत्यं
 सत्यं न तद् यच्छलनानु वद्धम् ॥

English translation: Where there are no wise old men, it is not a conference. Those who do not support Dharma, are not wise old men. That which is not based on Truth, is not Dharma. That which is obtained by misrepresentation and fraud, is not Truth.

Has India lost its wise old men?

8. Some people believe that all the MNCs and their tax consultants know what is The Truth. But they are helpless. They just cannot stop their tax avoidance games. Duryodhan makes an appropriate statement in Mahabharat. Sanskrit:

जाना म धर्मम् न च मे प्रवृत्ति ।
 जाना म अधर्मम् न च मे निवृत्ति ॥

English translation: I know the Dharma. But I cannot practice it. I know what is Adharma. But I cannot leave it.

9. A colossal drama is unfolding on the global stage. Observe:

- 9.1 Powerful Influential lobbies developed aggressive tax avoidance products. They could not succeed in the USA. However, in developing countries they could confuse a lot of people and authorities. Many Governments knowingly or unknowingly permitted tax avoidance. Government of India went ahead, signed double tax avoidance agreements with a host of tax havens and literally invited treaty shopping on a grand scale.

Right from 1993 till 2013, many times it has been proved that Indian Income-tax Commissioners are more loyal to India than the Finance Ministers of Indian Government.

Developed world supported several tax havens. USA – Delaware, U.K. – several colonies, Switzerland and a host of the tax havens. They kept on pulling the wool over Governments' eyes. Massive tax avoidance and even money laundering is allegedly permitted by some tax havens.

9.2 Simultaneously another huge drama was developing. In USA banks succeeded in getting the laws changed to suit their products. Large banks and financial institutions got greedy and brought about huge financial crisis in the U.S. & Europe.

9.3 Development of E-commerce opened up new avenues of tax avoidance. MNCs went ahead in a big way and avoided billions of dollars in taxation.

9.4 Financial crisis has forced G20 Governments to try and plug tax avoidance. In India, media is ignoring global developments. Indian economy itself is fast deteriorating.

Drama is at climax.

Hold your breath and see what happens next.

Pranam

Rashmin Chandulal Sanghvi.