

B K Syngal writes that Vodafone tax evasion case and its historical FDI pattern is a classical example of crony capitalism

In a two-part series article, Syngal argues that it is highly naïve to assume that Vodafone would not have withheld the capital gains tax amount, sillier to have assumed that none was payable. At best the company is posturing so that it can save the amount or at least earn some interest....The mother of democracy the British Parliament has mandated that retroactive legislation can be enacted to cover such smart moves. Why does Vodafone not raise a hue and cry in its own backyard? This may be due to the ill-repute invited by rampant corruption. Thus, companies don't think twice before trying to punch holes into India's legal and administrative fabric

Much brouhaha has been created by the recent reports about the Vodafone Tax case with respect to whether or not a capital gains tax is due from them on the purchase of assets in India. New lexicon has been created for the uninitiated - "tax avoidance" versus "tax evasion"; "look at" versus "look through" etc - to devise ways and means to dodge taxes and perpetuate crony capitalism, as if there was not enough already.

Vodafone is right. Primarily, the tax is not due from them (the buyer), but from the seller (Hutchison). Vodafone's crime is that they should have withheld the capital gains tax and paid that amount to the Government of India when a demand was raised on them. Whether or not they withheld the amount can be found out by going through their books for provisions they must have made against such possible liabilities, being a listed company.

It is highly naïve to assume that they would not have withheld the capital gains tax amount, sillier to have assumed that none was payable. At best the company is posturing so that it can save the amount or at least earn some interest or improve its cash flow.

Smart as the company is, when demands were raised, it took the Government of India to the courts and got a favourable verdict from the Supreme Court. The Supreme Court Judgment (SCJ) says that the way the deal was structured resulted in a tax avoidance situation and not evasion. There is a statement in the judgment that suggests we simply "look at" but not dissect and "look through" the facts. The SCJ thus implies continuance with all the loose rules and regulations and let investors enjoy, because they bring in dollars.



The prescription is to treat the cancer in the system with a headache pill. Although it is hardly difficult to see in the judgment that the tax is not payable, but it indicts the Government which should have had the rules in place to address situations like this rather than crying over split milk now.

But unfortunately, the Government of India has now resorted to retro-taxation, becoming wiser only after the event. Retro-taxation has been challenged on the grounds that it is investor unfriendly, and a manifestation of an unstable, unpredictable tax environment etc. This issue has already been taken care of by appropriate legislation by the mother of democracy the British Parliament, which has mandated that retroactive legislation can be enacted to cover such smart moves. Quote "In some nations that follow the Westminster system of government, such as the United Kingdom, ex post facto laws are technically possible, because the doctrine of parliamentary supremacy allows Parliament to pass any law it wishes" Unquote.

As a result Barclays Bank Barclays Bank has been ordered by the Treasury to pay half-a-billion pounds in tax which it had tried to avoid. Barclays was accused by HM Revenue and Customs of designing and using two schemes that were intended to avoid substantial amounts of tax. The government has taken the unusual step of introducing retrospective legislation to end such "aggressive tax avoidance" by financial institutions. Tax rules forced the bank to tell the authorities about its plans, thus the government has closed the schemes to retrieve £500m of lost tax and safeguard payments of billions of pounds of taxes in the future.



That is precisely what the Government of India has also done following that Supreme Court Judgment overruling the Tax demand from Vodafone. Therefore, the question

which one begets is why does Vodafone not raise a hue and cry in its own backyard, but kick up a storm in India? The answer may lie in the much maligned culture of jugaad and the ill-repute invited by rampant corruption, which is so typical of a banana republic. Thus, companies don't think twice before trying to punch holes into our legal and administrative fabric.

The perseverance of the taxman to retroactively collect the dues from Vodafone is welcome, and possibly the first step towards recognising the flaws within the approach to FDI policy in India.

The allegations pitted by Vodafone that the government is attempting to tax the company twice over are completely unfounded. In a global economy of massive trans-national entities, it is only natural that financial instruments will be inspected way after they have been applied, to understand the full scope of their utility to enterprises and the motivation behind their use, and in the larger public interest.

This leads me to the entire conundrum of the history of so called Foreign Direct Investment (FDI). To me the phased manner in which FDI has been invited is completely flawed. Stepping stones like sectoral caps, and within sectors increasing the caps in stages has proved to be not only unfruitful but also, questionable.

Further, there is the dubious practice of creating layers of investing companies, which for purposes of investment are counted as Indian should they be in the 49% (foreign) to 51% (domestic) ratio. There also used to be these preferential shares with limited rights leading up to ownerships up to 80% or so. One could at each step of these road blocks cash out at premiums of multiple times. These steps or toll gates were precisely created with vicious mind to enrich few unscrupulous citizens of India and not the Aam Admi at large.

It is becoming increasingly clear to citizens that the way in which FDI bars are set in India encourages crony capitalism. More often than not, shell entities, either in India or abroad, are used to funnel funds into companies above and beyond the FDI caps and controlling interest remains with Indian companies only on paper. As a result, the Indian economy suffers from having to bear the cost of surrogacy and only a handful of crony capitalists with access to the corridors of power gain from the various projects in the era of liberalisation.

(In the second of the two-part series to be published tomorrow, Syngal points out that the Supreme court decision stands out like a sore thumb in the judicial landscape of India and explains what went wrong).

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