

The Exchequer, Vodafone and the Government

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Sometime back, news flashed that the efforts for a compromise between world's third largest telecom company Vodafone and the government of India have come to a dead end and the income tax department is going to slap a notice on Vodafone asking it to clear its dues immediately.

With the new turn of events, the whole issue has once again come to the fore. Earlier, with the court providing relief to the company and later because of renewed efforts of former Finance Minister Pranab Mukherjee, and again due to the attempts of the present incumbent in the Finance Ministry, this case has been making headlines for long.

What is the case?

The issue is, that the world's third largest telecom company Vodafone, acquired Hutchison Essar of India in 2007 at an agreed sum of \$11.2 billion for Hutchison's 67 per cent stake in the company. According to the Income Tax department this deal attracted a tax liability of 20 per cent on the capital gain (\$10 billion) made by the company; that was rupees 11,218 crores. Since the deal involved realization of capital gain, made by the dealing parties, capital gains tax was supposed to be paid to the income tax department. Unfortunately, neither Hutchison, nor Vodafone paid the tax to the Income tax department. That made the IT Department to raise demand of rupees 11,218 crores from Vodafone, the present owner of the company. It is to be noted that, by now this tax liability has reached rupees 20,000 crores, after taking into account interest and penalties.

Vodafone refused to accede to this demand and while refusing to pay this tax, it argued that this deal was made in Mauritius, with which the Government of India has Double Tax Avoidance Agreement (DTAA), according to which the company was liable to pay tax as per Mauritius laws and not in India. On the other hand the IT Department argues that this whole process of making this deal in Mauritius was intentionally adopted, with the sole aim to avoid tax; and if it is so, the company is liable to pay full tax and other charges. Vodafone approached the court against the government and got relief from the same.

Perturbed by the whole chain of events, the then Finance Minister framed a rule that made it mandatory for the company to pay the tax. To deal with such cases of deliberate attempts to avoid legitimate taxes, he proposed and got legislated, General Anti Avoidance Rules (GAAR), which empowered the Income Tax Department to collect taxes in those cases, where deals are deliberately made outside India to avoid taxes.

Later when P Chidambaram took over the reins of the Finance Ministry, after Pranab Mukherjee shifted to Raisina Hills, he proposed to postpone GAAR till 2016, as per the recommendations of the Partho Shome committee; for the purpose of what he termed as winning 'investors' confidence'. The major argument behind postponement of GAAR was that the country needs foreign investment and that the foreign investors are feeling uneasy over the provisions of GAAR, as they are facing uncertainty regarding India's tax regime. Major argument of the critics of GAAR is that since foreign investors take their decisions based on present provisions of taxes and availability of tax havens, therefore making laws with retrospective effect may vitiate the investment atmosphere in the country. Therefore if need be, rules should be made from current effect. Regarding GAAR, critics argue that these rules may give immense powers to tax authorities, which may be misused against small investors.

The other point of view is that if we accept all arguments against GAAR, it may put the exchequer to huge loss. Policy makers are expected to make laws which do not cause any loss to the exchequer. However, if we accept this argument of the critics that GAAR may cause troubles for small tax payers; same could be corrected by making GAAR applicable only to cases involving more than rupees 100 crores or more. But we cannot deal with cases of huge tax evasion leniently.

Pranab Mukherjee's Arguments

Pranab Mukherjee's argument in this regard has been that the Vodafone Company misrepresented the transaction, with the sole aim to avoid tax and therefore, making law with retrospective effect is not wrong. As per Indian income tax laws, if a transaction is made with an aim to evade tax, that amounts to evasion of tax and tax could be collected on that transaction legitimately. Moreover, Vodafone is an English company, and in England there are number of instances of making laws with retrospective effect. Therefore, to protect nation's exchequer making laws with retrospective effect is not wrong.

Importance of the Issue

This is a very important issue for us. Firstly, amount of tax loss or say prospective gain is very huge. It started with a tax demand of rupees 11,218 crores and by now it has reached a staggering rupees 20,000 crores after attracting interest and penalties. If the tax under demand is realised, the nation may afford to spend more on education and health. Secondly, if this tax is collected from Vodafone, a message will flash to the rest of the world that tax evaders cannot go unchecked in India. Thirdly, there are a number of other cases, similar to that of Vodafone; and if tax is realised from Vodafone, pressure would mount in other cases too. It is estimated that total such tax demand is nearly rupees 50,000 crores. More important is the fact that India has entered into Double Tax Avoidance Agreements (DTAAs) with a number of countries, including Mauritius; which are causing huge revenue losses to India. It is notable that though Mauritius is a small nation, without many resources, nearly 40 percent of foreign investment coming into India comes from Mauritius; which means, companies have been routing their investments through Mauritius, to avoid tax, and tax authorities have to remain mute spectators.

With the Vodafone case taking a serious turn, DTAAs are also under scanner. Demand from various quarters is being raised to reconsider these agreements, which are against national interest, by deleting the provisions which cause damage to our exchequer in tune with the international practices. For instance India does have such an agreement with England also. However, the provisions in the agreement are such that, if rate of tax is lower in one country and higher in the other, the difference may be collected from the parties concerned. For example if capital gain is made by a person or an entity in India, and the same is taxable at 20 percent in India; however, the rate of tax in England is 28 percent, the balance 8 percent would be collected by England's Income Tax Department. In this context it is notable that, capital gain is not taxable in Mauritius, however, Indian Income Tax Authorities cannot tax the same as the provisions of DTAA with Mauritius do not permit the same. Such agreements create tax havens, to the disadvantage of India.®

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