



THE WALL STREET JOURNAL
WSJ.com

April 19, 2012, 4:40 PM IST

Is India Willing to Bend on Tax Avoidance?

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Pranab Mukherjee gestured during a press conference in New Delhi, Jan. 25, 2011.

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A senior official gave what, as far as we can tell, is the first proper indication that the Indian government might – repeat: might – be prepared to bend a little on its controversial proposal to introduce new anti-tax avoidance legislation.

To recap: Finance Minister Pranab Mukherjee, when he presented the proposed budget last month, introduced the new regimen as part of the Finance Bill that will be debated in May. The rules, known by the mildly sinister acronym of GAAR (for general anti-avoidance regulations) were just one of a series of measures that have appalled foreign companies, investors and some companies in India, too.

The chief beef about GAAR, which are common around the world, was that the onus of proof was put not on tax authorities but on the company or investor under scrutiny: Prove to us that you did not do this to tax advantage of tax benefits. If the entity can't, then it is presumed they are in violation of the new rules.

Foreign investors also worried that GAAR could override India's tax treaty with Mauritius which exempts capital gains from being doubly taxed. Most foreign funds invest in Indian stocks and bonds through Mauritius.

But Revenue Secretary R.S. Gujral said in an interview Thursday with CNBC-TV18 that foreign investors have asked the government to make tax authorities solely responsible for proving the motive of such transactions. "This is an issue we are considering. Let us see how best we can address this concern," he said.

We realize this is not exactly a capitulation, but it is a small sign that the torrent of protest that has washed over New Delhi since these proposal were made public may finally be having some impact.

"The earlier proposal seemed to be more like 'guilty until proven innocent' which may have raised constitutional issues. A fiscal fraud may invite criminal penalties and the Constitution states that a person accused of any offense cannot be compelled to be a witness against himself," said Dhruv Sanghavi, a partner

at Nishith Desai Associates. He added that we will need to wait for an amendment to the income tax laws to see whether the change will happen.

A change in stance might also come as some good news to the standing committee on finance in Parliament, which had recommended that the onus should be put on the tax authorities – a recommendation that was ignored in the draft Finance Bill.

If Mr. Gujral's suggestion is followed through, and the onus of proof shifts when these rules become final, then India will be applauded for listening and changing a misguided proposal. The billions that fled the Indian markets when the proposal was first mooted might be reassured. And it could signal a willingness to bend on other issues, such as the proposal to tax retroactively some international mergers – another move that has gone down like a rat sandwich with western companies.

There is one caveat that we will add to our already-guarded optimism. Is it a coincidence that this flexibility comes hours before Finance Minister [Pranab Mukherjee meets in Washington with Treasury Secretary Timothy Geithner](#), who is being pressured by U.S. trade groups to protest the tax proposals, including the application of GAAR?

It would be disappointing if, as soon as Mr. Mukherjee exits the building, the official stance of the Indian government reverts to its customary stonewall.

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