CHAPTER 13
THE CAG ON TREATY SHOPPING: AN ALARMING EXPOSE

SYNOPSIS

The *condition upon which God hath given liberty to man is eternal vigilance.*

—John Philpot Curran[1]

"But I would answer that neither comity nor rule of international law can be invoked to prevent a sovereign state from taking steps to protect its own revenue laws from gross abuse or save its own."

—Viscount Simonds in Collco Dealings LTD v. IRC[2]

I

1. The CAG's Report No. 13 of 2005

Dr Ambedkar had observed, while the Constitution was being framed, that the Comptroller and Auditor General of India "shall be the most important officer under the Constitution". He has a lot of constitutional protection analogous to that enjoyed by the Judges of the Supreme Court. The CAG subscribes to an oath or affirmation, which is the same for the Judges of the Supreme Court. He, like the Supreme Court Judges, is mandated by the Constitution "to uphold the Constitution of India". The Constitution adopted the British designation rather than what was under the Government of India Act, 1935 to emphasize his high status. The Constitution grants him a secure tenure; his expenditure charged on the Consolidated Fund. His reports relating to the accounts must be placed for legislative scrutiny. But its high role has been frustrated by the sinister outcome of the nexus between the superior bureaucrats and the wielders of political power.

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1. From his speech on July 10, 1790.
2. [1961] 1 All E R 762 at 765.

Justice J.C. Shah rightly called this nexus, in the famous Shah Commission Report, "the root of all evil". The abuse of the Indo-Mauritius Double Taxation Avoidance Convention would have been detected long before if the revenue audit could have played an effective role. It is time the institution of the CAG is made effective by making appropriate constitutional or statutory provisions. The prime duty of the CAG is to examine receipts and expenditure. Outcomes or outputs are considered from the observation post of a constitutional watchdog. They are revealed through transactions audit also. The teleology of the CAG is shaped by the white heat of his constitutional commitments. The idea that system should empower and trust the executive could excusably be found only in the edicts of the Stuarts, or in Bismarck's harangue to the German Diet. In a democracy, all public power and resources are under trust. The executive and the CAG have distinct constitutional roles. The CAG is neither an appraiser nor an adversary. He provides Parliament an opportunity to weigh the executive that is accountable and responsible to it. The CAG is also a sentinel on the qui vive. As a watchdog it watches and reports on the counts of illegality, procedural impropriety, irrationality, and lack of proportionality noticed within the sphere of its operation. This institution is a watchdog; it is neither a lap dog nor a hound. To say the obvious, holders of constitutional assignments can ill afford to be lily-livered or timorous souls, as they have to respond to the challenges of the day.[3]

Article 149 of the Constitution prescribes the powers and duties of the C&AG whose role was described by Sri A.K Roy, the then C&AG in his lecture delivered at the Defence Service Staff College on November 14, 1964:

> "He himself determines the extent and scope of audit in regard to various types of transactions… He has absolute discretion in regard to the accounts to be included in his reports to Parliament and the State Legislature and the executive can in no way fetter his discretion in his matter. Unlike the U.S.A. he has no power to settle claims by or against Govt. nor has he the power to impose a fine as done by the audit courts of Europe. His audit transcends the mere formal or legal aspects of audit and includes what may be called efficiency-*cum*-propriety audit."

This view is valid even under the Comptroller and Auditor-General's (Duties Powers and Conditions of Service) Act, 1971. Examination of accounts involves *ipso jure* the examination of the legality and propriety of the receipts and expenditure; and also the coeval pursuits to examine to what extent the legitimate and prudent expectations have materialized. He audits, besides many other things, the receipts and expenditure to keep an effective check on assessment, collection and proper allocation of revenue.

During the British days the Auditor-General was accountable to the Secretary of State for India who, like other ministers, was responsible to the British Parliament. The Indian senior officials were responsible only to the Secretary of the State. The writ of the Auditor-General ran effectively as every government

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3. Based on the author's article published in the *Tribune*, 17 August, 2003.

authority feared the displeasure of the Secretary of State. Now ground realities have changed making the great office of the C&AG a virtual constitutional orphan. In its latest Report No. 13 of 2005 laid on the table of Parliament on 6th May 2005, the CAG has made critical remarks about the misuse of the DTAC in general and Treaty Shopping in particular. The criticism of Treaty Shopping made by the CAG is markedly different from that of the Supreme Court in *Azadi Bachao.* There is nothing wrong if the CAG strikes a different note in its Report. This authority to the CAG emanates from the very nature of its constitutional oath. The logic of our written Constitution and the grammar of the constitutional oath that the CAG shares with our Judges in swearing remind one of what Chief Justice Marshall had said in *Marbury v. Madison*[4]:

> 'Why otherwise does it direct the judges to take an oath to support it? This oath certainly applies in an especial manner, to their conduct in their official character. How immoral to impose on them, if they were to be used as the instrument, and the knowing instruments, for violating what they swear to support!"…'

The criticism in the CAG Report should make our Parliament respond. Justice Frankfurter observed; "Criticism is the spur of reform". And Gilbert said; "I never read favourable criticism," he said; "I prefer reading unfavourable ones. I know how good I am, but I do *not* know how bad I am".

II

The author in his capacity as the Chief Commissioner of Income-tax, Bihar, Orissa and the North-east, and also as a PIL litigant had enough time to observe the plight of the CAG. The author was, in his pensive mood, driven to think that the CAG is now a constitutional orphan; and the executive its trouncer. He does not have power, which even the Class II income Tax Officer possesses Tulsidass had rightly said, "No obedience without fear". Before our Independence his counterpart wielded a lot of authority as he was reporting to the Secretary of State for India who was feared even by the Governor-General and Viceroy, not to say of the other minor minions. After Independence things started changing for worse. Now this great glamourous authority can report to the politicians and bureaucrats who after having established a nexus between themselves do not bother much about propriety. Our civic culture and public morale both are now abysmally low. It is high time to make the role of the CAG comprehensive and effective both.

But after having sung a litany of laments on our present destiny, the author hopes that we would learn before it is too late to give importance to the Reports of the CAG. In effect the CAG works for Parliament. Dr D. D Basu has aptly stated:

> "The foundation of parliamentary system of Government …is the responsibility of the Executive and the Legislature and the essence of such control lies in the system

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4. 2 L Ed 60 (1803).

> of financial control by the Legislature. In order to enable the Legislature to discharge this function properly, it is essential that this Legislature should be aided by an agency, fully independent of the Executive, who would scrutinize the financial transactions of the Government and bring the results of such scrutiny before the Legislature."[5]

In a sense, the CAG's Report is to the people of the whole country. "We, the people" are present in Parliament through our representatives. There is much wisdom in what Sir Thomas Smith said on Parliament as far back 1565!:

> "And, to be short, all that ever the people of Rome might do either in Centuratis comitiis or tributes, the same may be done by Parliament of England which representeth and hath the power of the whole realm, both the head and body. For every Englishman is intended to be there present, either in person or by procuration and attorneys, of what preeminence, state, dignity, or quality so ever he be, from the prince (be he king or queen) to the lowest person in England. And the consent of the Parliament is taken to be every man's consent"[6].

His reports should shape Public Opinion so that Parliament acts on it. It would be sad if we enact in our nation's public life Beckett's play *Godot* in which nothing happens:

> "Vladimir: Well? Shall we go?
> Estragon: Yes, let's go.
> They do not move."

III

The Report of the CAG (No 13 of 2005) relates to System Appraisals in the segment of Direct Taxes. It contains 3 chapters, each one of which is of great interest. They are:

(1) Status of improvement of efficiency through the 'Restructuring' of the Income Tax Department

(2) Review on efficiency and effectiveness of administration and implementation of selected deductions and allowances under the Income Tax Act

(3) Review on some aspects of non-resident taxation with reference to double taxation avoidance agreements.

In this Chapter this author intends to highlight some important aspects of the Report relating to the double taxation agreements.

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5. Basu, *Introduction to the Constitution of India* 19th ed. p. 195.
6. quoted from *De Republica Anglorum* 48-9 in G. R. Elton, *The Tudor Constitution* p. 235.

The Report has exposed how pressure groups and persuaders bend the government to their will to pick up favours not due to them. This craft is well tested since days of yore: to quote from the Report:

> "3.6.3 An impression was sought to be created that denial of DTAA relief to some Mauritius based entities by rejecting residency certificate had led to flight of capital and investment from India. However, an appraisal of the transactions in the capital markets during November 1999 to October 2000 as highlighted in the Annual Reports of SEBI indicated that there were 'inflows' with respect to FIIs in this period. During January 2000 to March 2000, when returns in some cases were being processed by the departmental officers in Mumbai for denial of relief under Indo-Mauritius DTAA, there was a net increase in investment. Subsequent to the issue of circular there was, in fact, a net outflow of investment (Column 4, ibid). Thus, there was neither substantial decrease in investment consequent to denial of benefits to a few third country based companies investing through Mauritius nor marked increase after issue of Circular 789 in April 2000 as shown in Table 3."

> "3.1.14 At around the same time, there were fluctuations in the stock markets and general perception that the action of the department denying the benefit of Mauritius residency to some Mauritius based FIls was the root cause for such fluctuations. It was projected that this would have or had resulted in huge outflows of foreign investment from India. To clear the doubts, as also to clarify the intent of the Indo-Mauritius DTAA, the Board issued Circular 789 dated 13 April 200, inter alia, requiring the assessing officer to accept the certificate of residence granted under the local legislation of Mauritius to OBCs operating from third countries including India."

It is interesting to note that the fraudsters in all the phases of history have crafted their scripts in the same design, in the same protocol. It is interesting to read Charles Mackay's *Memories of Extraordinary Popular Delusion and the Madness of Crowds*[7]. It is interesting to know the difference between the art of Shakespeare and the craft of Milton's Comus, the great fraudester to whom a reference is made by a jurist whose view has been quoted by our Supreme Court in *Shrisht Dhawan v. Shah Bros*[8] Shakespeare took stories by others for using them as plots in his plays, tragedies or comedies. It matters not wherefrom he borrowed and what he borrowed; what matters most is what he made of these in his great pieces of art. But these scamsters are the morbid maggots who only make a healthy system sick. They may script again and again the same story. The authors of the infamous Bihar Fodder Scam, the swindlers and the scamsters of the share-market, or the third country residents sailing under false colours (the Treaty Shoppers) script their plots again and again in the same style. What makes their strategy invincible most often is the guile and logic with which it is promoted. But one thing is clear, fraudesters cannot succeed unless we fail in maintaining vigilance. It is well said that God has granted us liberty on the condition of maintaining vigilance. Vigilance alone ensure accountability of the institutions we have set

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7. London Richard Bentley 1941.
8. AIR 1992 SC 1555.

up under our system of governments. In the early 1700s, itself people had the foretaste of what can be the worst in the stock market. There was an exuberant and mindless stock market booms in Paris and London. In Paris, under the auspices (and from some points of view because of the genius) of John Law, there was a wonderful inflation in the stock of the Mississippi Company (compagnie d'Occident), which had been created to work for the allegedly rich but, alas, wholly imaginary gold mines of Louisiana. In London there was the South Sea company & a variety of other companies, including one to exploit a Hitherto underutilized energy sources, namely, the wheel of perpetual motion, and another, much celebrated in the history of speculation for its reticence. It was "for carrying on an undertaking of great advantage", but nobody to know what it is. The Stock-Market crash of the thirties of the 20th Century was itself stage-managed. After a rapid expansion, the speculators rode the stock market roughshod. Holding companies and trusts proliferated; and large bank loans facilitated rabid and rapid speculation to bring about the accursed "Black Thursday", or "Black Monday" or "Black Tuesday" (October 29, 1929). Of late the crash of the stock market is made to supply a reason for the ascent of market. A Milton Friedman or a Ronald Coase and many other leading lights of the mainstream neoclassical economists tend to think that the faulty economic management by the governments caused the crash. In their world-view the government must receive bashing till it falls prostrate to the service of *Pax Mercatus*. They say that the government should rollback allowing the market-forces to flourish and dominate. Never before had the art of Deception ever been crafted to the point of perfection better than what has been done in our own time.

Coming back to the Indo-Mauritius tax treaty, with the Assessing Officers in Mumbai there were 24 cases of the Treaty Shoppers. They discovered them in the normal exercise of their statutory jurisdiction. Under the income-tax law in this country whosoever earns income is chargeable to tax unless the earner establishes to the satisfaction of the Assessing Officers that any provision of law exempted him, or mitigated the rigour of law for his benefit. Their investigation brought out that these cases had earned income: hence *ex facie* bore the burden of Indian tax. They could not grant the assesses the benefit under the Indo-Mauritius Double Taxation Avoidance Convention as they could not come within the scope of the Convention. Ordinary assessees would have tested the correctness of this view under the statutory appellate channel, or could have moved the High Court for Judicial Review. But this procedure could be only for the ordinary persons. The predatory international financiers and their protégées were extraordinary. They were the darlings of the Market in which everything was *res commercium* on the corporate terms. They enacted an old melodrama. Sensex was made to fall. An environment of surrealism was created. India would go to dogs as such administrative actions would annoy the corporate *imperium* whose hirelings acting overtime made the government believe that heaven would surely fall if instant action is not taken. It was made out that if remedial measure were not immediately taken, India would face her worst days. It is in this panic-stricken environment that the pressure group and the persuaders made the

Central Board of Direct Taxes issue its Circular No. 789 dated April 13, 2000. Such criminal credulousness is itself a morbid complicity.

The facts brought out in the paragraph quoted above should be educative. We wish the government learns lesson, and never becomes a victim to delusion. Most important thing in the art of learning is to have a will to learn.

Old dramatics were again see-afoot when the UPA government came to power. The Common Minimum Programme contained a commitment:" "Misuse of double taxation agreements will be stopped." Besides, it was felt that the Left might create roadblocks to the marauding march of *Pax Mercatus.* Sensex again fell. Cries went out. Wires were pulled. Oh! It all reminded one of Pope's couplet in the *Rape of Lock*:

Sooner let earth, air, sea, to chaos fall,
Men, monkeys, lap-dogs, parrots, perish all.

Worry turned into frenzy when the Financial Express (Mumbai edition dt. 29/05/2004) said:

> "We have gone into it in great details. In fact, if you ask me candidly the misuse that we have discovered in one or two cases is not the misuse by foreign investors but the misuse by some Indians."

Panic was engineered to grip our government. And the Finance Minister air-dashed to Mumbai to placate the annoyed and the angry. How apt was Robert Burns in addressing to a Mouse:

Wee, sleekit, cow'rin, tim'rous beastie
O what a panic's in thy breastie!
Thou need na start awa sae hasty,
Wi'bickering brattle!

The Finance Minister assuaged them, as his predecessors had done. We do not know what sort of assurance made sensex zoom again. The era of secret diplomacy and secret treaties is yet to go! We ordinary citizens can at best see and suffer. The CAG had done a good job by highlighting the strategy of the protagonists of the stock market and their mighty beneficiaries. Will Parliament learn a lesson from its own CAG?

IV

It is strange that the government of our country did not feel alarmed by the fact that Mauritius, a country with an area of 2040 sq kms and population of 1195000 was topping foreign direct investment in India in the last four years that the CAG considered. But the CAG is not correct in thinking that the possible reasons for extra-ordinary indulgence to Mauritius was our affinity with Mauritius. The CAG says:

'A study of the articles dealing with residency and taxation of capital gains reveals that special consideration was bestowed to business entities of Mauritius in view, perhaps of the fact that Mauritius was a less developed country than India and has long standing special relationship with India."

The observation is incorrect for the following reasons:

(a) Mauritius is not less developed than India. This fact can be established by the figures in the following tables:

Sr. No.	Some select indicators*[9]	Mauritius	India
1.	Life expectancy at birth	Male 67.0 years Female 75.0 years	Male 61.9 years Female 63.1 years
2.	Per capita income	US $ 3,540	US $ 440
3.	Literacy	Males literate 87.1 % Females literate 78.8 %	Males Literates 75.8 % Females literates 54.2%
4.	Health	Physicians 1 per 1,123 persons, Hospital Bed 1 for 303 persons	Physicians 1 per 2,173 persons, Hospital Bed 1 per 1364 persons.

Sr. No.	Some select indicators *[10]	Mauritius	India
1.	Life expectancy at birth	Male 63.3 years Female 68.4 years	Male 53.9 years Female 52.9 years
2.	Per capita income	US $ 1,075	US $ 249
3.	Literacy	Males literate 90.5 % Females literate 78.8 %	Males Literates 46.7 % Females literates 24.9%
4.	Health	Physicians 1 per 1547 persons, Hospital Bed 1 for 335 persons	Physicians 1 per 2,554 persons, Hospital beds 1 per 1269 persons.

[9]. All figures in paragraph 1 & 2 are taken from 2002 *Britannica Book of the Year*.
[10]. All figures in paragraph 1 & 2 are taken from 2002 *Britannica Book of the Year*.

Our Government is, perhaps, yet to know the old adage about which Sir Thomas Brown said: " Charity begins at home, is the voice of the world". These select indicators of vital statistics of our vast country and of a tiny island nation would explain and illustrate what this adage counsels.

(b) Was it not possible even for the morons to know that the nationals of other advanced capitalist countries were masquerading as Mauritian residents to invest on the Indian stock-market to reap fast super profits and to repatriate them to the places of their choice neither paying tax in India nor in Mauritius on such capital gains. In many tax treaties the unjust advantage is by way of lesser rate of taxation on other items of income.

(c) The Central Government evaded realities; and was utterly indifferent to the conditions of common people. Under such circumstances any indulgence towards a foreign land amounts to a criminal indifference for own people of the country. The facts in the following table speak loudly about the fraud at work*:*

Country	Population	Area	**GNP**	Per Capita Income
Bahamas	274000	5378 sq mi	(1992) $3.2bn	$12020
Cyprus	600000	3571 sq mi	(1992) $7.1bn	$9820
Mauritius	1141000	720 sq mi	(1992) $3bn	$2700
Monaco	30600	0.75 sq mi	(1999) 475 mn	$16000
Nauru	9900	8.2 sq mi	(1989) $90mn	$10000
The Netherlands	15449000	13097 sq mi	(1992)$312 bn	$20590
France	58333000	212686 sq mi	(1992) $1279bn	$22300
Japan	124641000	145803 sq mi	(1992) $3508 bn	$28220
USA	262693000	3535935sq mi	(1994) $6727bn	$25744
India	944157000	1222396 sq mi	(1992) $272bn	$310

The Central Government should have realized that the price of being the trustee for "We, the people" is to show eternal vigilance, if draw should have inferences from facts by applying the principles of probability. J. Bronowski observes in the *Ascent of Man*: "There are many gifts that are unique in man; but at the centre of them all, the root from which all knowledge grows, lies the ability to draw conclusions from what we see to what we do not see."

(d) May be India was more kind to Mauritius than what was proper because of expectation of support in some international fora. India might have thought of the Mauritian support to her claim for the membership of the Security Council. But this could not warrant this sort of indulgence for the following two reasons:

(a) Agreements under section 90 of the Income-tax Act can not be made for an object other than that for which the power is conferred (howsoever noble it may be);[11] and

(b) Agreements under section 90 of the Income-tax Act should not be made for ulterior reasons with the tiny-tots on the earth treated under International Law as Sovereign States having the effect of:

(i) creating pockets on foreign lands wherefrom to plunder the legitimate revenues of our country; and

(ii) creating areas of darkness where dirty money is amassed and laundered for the benefit of fraudsters, scamsters, anti-national gangsters, crooks and knaves of all hues from the different lands.

(e) The Attorney General was incorrect in telling the Court that the Indo-Mauritius DTAC had been entered into with intent to provide a scope for Treaty Shopping. His statement is clearly false as:

(i) several times the author as the Petitioner before the Delhi High Court, and as a respondent before the Supreme Court asserted that there was no basis to say so, but no material, not even remote probability, was shown either by the Solicitor General or the Attorney General;

(ii) there is nothing in the preparatory materials of the DTAC to support the view that it was meant to provide scope for the Treaty Shoppers;

(iii) no material of any sort was shown which could show that the scope or terms of the DTAC were modified after its execution in 1983;

(iv) the plea is founded on a complete ignorance of public international law governing the scope of a bilateral tax treaty;

(v) such an intention cannot be conceived unless all other treaties were to be made redundant as the nationals of other countries could float their subsidiaries in thousands to remain ensconced in a hip-pocket of a handful of persons in Mauritius;

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11. A power is exercised fraudulently if its repository intends to achieve an object other than that for which he believes the power to have been conferred "de Smith's, Judicial Review of Administrative Action. P. 335.

(vi) the morbid effect of tax evasion, money-laundering and fraudulent actions could not have been contemplated unless the wielders of power are callous to national interest, and indifferent even to basic morality.

(i) On the JPC Report

The CAG in the very first paragraph of the segment dealing with the JPC has this to say:

> "Foreign institutional investors (FIls), realizing the opportunity, also channelised their investment into India through the Mauritius route. A few stockbrokers were considered to have exploited the same and contributed to huge inflow of monies to create undue fluctuations in the stock markets, which was identified as one of the causes of the securities scam, which was investigated by the "Joint Parliamentary Committee" (JPC). The Board in its action taken note on the report of JPC informed that, MOBAA, which restricted the exchange of information between India and Mauritius, had been repealed in November" 2001. Further, it was also stated that a Memorandum of Understanding with the Financial Services Commission of Mauritius was contemplated for exchange of information as a safeguard against the practices of money laundering."

The following comments are deserved:

(i) The JPC did not discover the reasons, which led the FIIs to channelise their investment into India through Mauritius. The CAG has also passed over it. Perhaps it is, from the practical point of view, prudent to do so. But it is not good to leave people to speculate about the reasons. It tarnishes the image of government and its agencies. All sorts of rumours are fathered. And nothing tarnishes of government more than the rumours ignored:

(ii) Scams take place; storms are raised but are quickly forgotten. The scamsters find a lot of friends to shield them, and discover a lot of ways to escape the dragnet. The JPC or the CAG would have suggested insertion of some new provisions in the Penal Code to meet the challenges posed by the derelictions by the politicians, and the organized economic crimes done by the wielders of political power. The author of the Indian Penal Code had never visualized a system of governance like ours in which abuse of power has become endemic. It is time to create some new offenses to respond to the contemporary challenges.

(iii) It is strange that neither the JPC nor the CAG suggested that the tax treaties be done with Parliamentary approval. Legislative control over

tax treaties is effected in almost all-important countries of the World[12]. Now through the Mutual Agreement Procedure it is possible to subvert the whole statute, even the Constitution! It reaches a most dangerous point after the insertion of provision in Section 90(1) by the Finance Act 2003 under which the Executive can wield enormous uncanalized power, a situation unheard of in any democracy. The author would come this topic in the Chapter dealing with "An Opaque System".

(iv) The repeal of MOBBA, and the execution of the Memorandum of Understanding illustrate Brownian motion. There was nothing to indicate that Mauritius is no longer a tax haven.[13]

(ii) Treaty Shopping

The CAG's Report is remarkable for the following two reasons:

(a)The Supreme Court in *Azadi Bachao*, despite going through JPC's findings criticized the Assessing Officers for having "spent their time, talent and energy on inconsequential matters". For the Supreme Court the exercise was "inconsequential" as it remained throughout indifferent to

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12. (a) US legal practice.
The United States Constitution provides in Article VI, cl. 2
Discussed in *Aiken Industries, Inc. Commrs*
(b) German Legal practice
"In Germany, a tax treaty is enacted in accordance with Art. 59 Abs. and Art 105 of the *Grundgesetz* (the Federal Constitution). [Klaus Vogel *on Double Taxation Conventions*, 3rd ed. p. 24].
(c) Canada : A tax treaty is by enactment viz. Canada-U.S. Tax Convention Act, 1984. discussed in *Crown Forest Industries v. Canada.*
(d) Australia: Every tax treaty is enacted under International Tax Agreements Act 1953.
(e) U.K.: A tax treaty is enacted through an Order in Council in accordance with Section 788 of the Income and Corporation Act 1988 which prescribes : "Before any Order in Council proposed to be made under this section is submitted to Her Majesty in Council, a draft of the Order shall be laid before the House of Commons, and the Order shall not be so submitted unless an Address is presented to Her Majesty by the House praying that the Order be made".
(f) In other countries tax treaties are enacted. [*Philip Baker* F-1 to F-3]
(g) Treaty practice in different countries with different constitutional provisions materially differs. Oppenhheim's *International Law* pp 52-86.

13. In the letter of assurance dated May 24, 2000 sent by the Minister of Finance of Mauritius to the Secretary-General of the OECD submitted apropos the runs as under:

"OECD's Report, "Harmful Tax Competition: an Emerging Global Issue" (the "OECD Report") said that the Government of Mauritius would work towards elimination of harmful tax by administrative and legislative actions, and would ensure effective exchange of information in tax matters, transparency, and the elimination of any aspects of the regimes for financial and other services that attracted business with no substantial domestic activities in a phased manner by the end of the year 2005. Mauritius assures that it would refrain from introducing any new regime that would constitute a harmful tax practice under the OECD Report." (http://www.oecd.org/daf/fa/harm_tax/advcom_mauritius.htm).

facts. Even the Assessment Order placed before it was excluded from consideration. It could have asked the Government to produce those 24 Assessment Orders that were passed in one go in March 2000 by the Assessing Officers in Mumbai. The Delhi High Court had applied its mind to facts that led it to observe in the judgment itself that the Government lost crores of revenues. The JPC had considered the loss of revenue "substantial". The CAG has given concrete cases of revenue loss. The Reports adds to our awareness though what it presents is not even the one-fifth of the iceberg. The author would mention an irony of India's public life. Measure and gravity of loss to the nation is always of peripheral concern. In Bihar's Fodder Scam nobody knows how much was involved. Some ignoramus wrote when its silouhoutte of the scam was visible that it involved 950 crores. Nobody has examined to see whether it is Rs 90 or 9 thousand crore!

(b) It was strange to ask the RBI or SEBI to gather details as to ownership of the companies operating through the Mauritius route. It was the statutory duty of the Assessing Officers under the Income-tax Act to look into them. They have statutory powers also to do so. They charge tax on real income of the real owners. The CBDT Circular 789 asked them to be under blinkers. Insincerity is evident. Yet it is satisfying to read in the CAG's Report:

> "3.7.6 The Committee had, therefore, recommended that in order that the benefits of Indo-Mauritius treaty were available only to bonafide residents, 'companies' investing in India through Mauritius should file details of 'ownership' with RBI and furnish a declaration that effective place of management was in Mauritius Board's circular of February 2003 clarified taxability of Indian companies involved in 'round tripping' through Mauritius. However, similar action was not taken with reference to residents of third countries availing the benefits."

(c) The CAG pensively writes:

> "It is interesting to note that the Ministry in July 1995 had opined "for Indian investors to be globally competitive, facilities available to foreign investors to use the relative advantages of Mauritius should also be available to Indian investors.'

The CAG records his failure to understand how the Circular of July 1995 was issued. He is right in being amazed as no such concession to the Indian residents operating through Mauritius could have been given in view of the specific provision, both in the treaty and the statute. that such operators are taxable in India. The Board's Circular of Feb 2003 confirmed this view as it directed that such persons come within the tiebreaker clause of the tax-treaty. The instruction of 1995 to which the CAG refers was ex facie dishonest. This must have been issued with ignoble motives to please the international financiers, corporate *imperium* and their mighty cohorts.

(d) By writing the following the CAG wants the government to come clean, and be transparent. The CAG says:

> "3.7.8 It is also relevant to note that the Ministry in its submission to JPC had stated that there were problems in DTAAs with 17 other countries as well pertaining to taxation of long-term capital gains. Whether, exempting capital gains from taxation in India was a conscious policy of the Ministry as reflected in the Indo-Mauritius DTAA or the Ministry have been caught totally unawares of the adverse implications of changes in domestic laws in Mauritius on the Indian tax situation was not verifiable in Audit. The admission of the Ministry before the JPC, mentioned at paragraph 3.1.11 indicates, that the situation had become one of 'fait accompli' and progress, if any, to remedy the situation has been slow."

Two Comments are deserved:

(i) Under the international law there are ways to set right the evil effects of unintended consequences. The tax treaties themselves provide for revision. Our government has done nothing in connection with any of the treaties. Shakespeare said in the *Merchant of Venice:*

> *Agoodly apple rotten at heart.*
> *O, what a goodly outside falsehood hath!*

(ii) While examining, whether, exempting capital gains from taxation in India was a conscious policy, the Constitution of India should not be forgotten. Discrimination in the matter of the incidence of tax offends Art 14 (the old doctrine). Things unreasonable and arbitrary offend Art 14 (the new doctrine). A tax treaty operates in the domestic jurisdictions where crores of Indians exist. It is not a treaty at international plane where the effects manifest in the realm of no concern for the common people.

(iii) The idea of "fait accompli" is atrociously wrong. Nothing is fait accompli when it has a continuing effect. Didn't Ella Wheeler Wilcox say in *Settle the Questions Right*:

> *No question is ever settled*
> *Until it is settled right.*

(e) The CAG wants the government to take steps against Treaty Shopping. The Report says:

> "Audit noticed that the department did not have any proactive strategy or action plan to identify investors belonging to third countries routing their transactions/investments through Mauritius for the sole purpose of enjoying treaty benefits, to the detriment of revenues.

Audit also found that relief claimed by assessees under Indo-Mauritius DTAA was being allowed by assessing officers without proper scrutiny."

Audit noticed an instance of Indo-Mauritius DTAA being availed by a non-resident of a third country, USA. In Mumbai DIT (IT) charge, Vodafone International Inc (VII), USA had divested its share holding in favour of two Indian companies through its 100% subsidiary, M/s. Air Touch International Mauritius Ltd. (AIML) in Mauritius. AIML earned long-term capital gain amounting to Rs.79.59 crore and short-term capital gain of Rs.42.69 crore for the assessment year 2001-02 from the above transaction. AIML claimed exemption from capital gain tax under Indo-Mauritius DTAA, which was allowed after scrutiny in January 2004. Thus, VII, by divesting through Mauritius saved capital gain tax of Rs.20.77 crore by taking shelter of Indo-Mauritius DTAA. Had the shares been directly sold by VII USA, the entire capital gain would have been subjected to tax in India under Indo-US DTAA.

Ministry may, therefore, have to put in place an effective mechanism to ensure that the benefit of residency and taxation of capital gains are availed of only by bonafide residents of the countries with which DTAAs have been concluded and not extended to residents of third countries as a matter of course in a routine manner. Ministry may undertake a transparent cost benefit analysis of extension of such benefits through 'treaty shopping' so that it would become a recognized and clearly thought out policy of the Government to permit the same. *Ministry may also take urgent action* to include specific clause for enforcing 'limitation of treaty benefits' in all identified 'problem DTAAs' so that the consequential benefits are not availed by default".

It is good that the Parliamentary watchdog has said so to Parliament. Our Parliament did not listen the Supreme Court's *cri de Coeur* to provide a remedy against the abuse of tax-treaties. The Report has mentioned several cases of treaty misuse. Will it act now? Lord Bryce aptly said: "So may it be said that Democracy will never perish till after Hope has expired."[14]

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14. Bryce, *Modern Democracies* Vol II p. 670.