

Tracing the colonial roots of the anti-avoidance provision in India

Show to an English tax lawyer the text of section 93 of the Indian Income Tax Act, and you will produce an interesting reaction. The younger of them will say that is exactly like s714 of the Income Tax Act 2007 (and the following 40 or so sections). Those who are a little older will instantly cry out, "That's section 739 ICTA 1988". A few of the older ones may say, "That reminds me of section 478 ICTA 1970". It's unlikely that anyone these days would say, "That's section 412 ITCA 1952". One suspects that there are few people alive now who would immediately react by saying, "That's clearly based on section 18 of the Finance Act 1936".

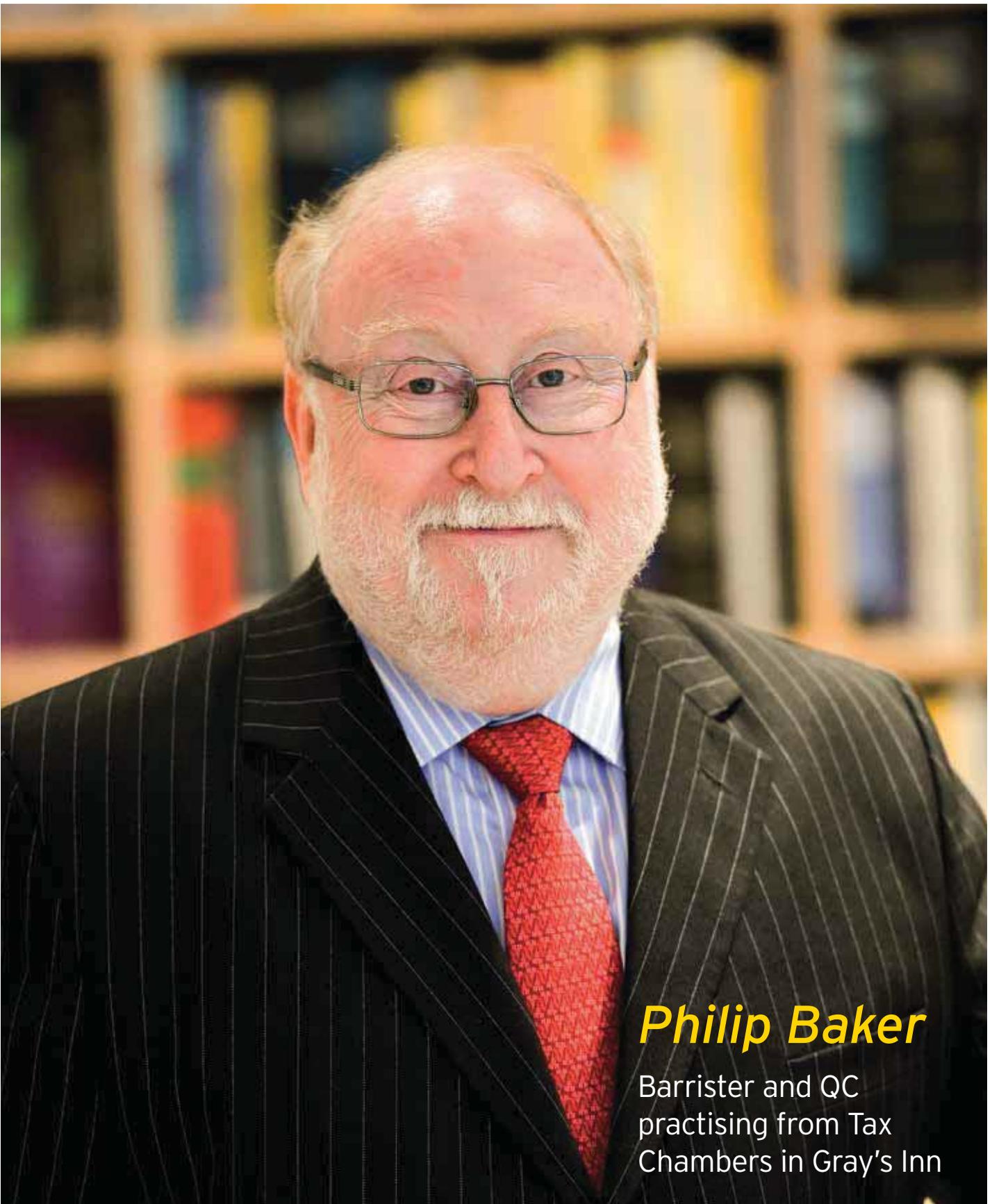
They are, of course, all referring to the fact that section 93 of the Indian Act has a very similar wording, because it has the same origin historically, to a provision that was first introduced in the UK in 1936 and which has been re-enacted, with a series of amendments, consistently since then. The current version is the chapter in the Income Tax Act 2007, most commonly referred to as the "transfer of assets abroad" provisions.

These provisions represent the main defence in the UK against the offshore avoidance of income tax by individuals. They work - like the equivalent provisions in India - by disregarding the offshore company or trust or foundation, and making the

taxpayer pay tax on the income of the offshore entity.

The similarity and the common historical origin of the provisions under Indian and UK Tax Law prompt a number of thoughts about how tax systems sometimes develop differently, but all of them are facing similar issues of dealing with tax avoidance, and particularly offshore tax avoidance.

The provisions that are now in the UK "transfer of assets abroad" code and in section 93 in India, owe their origins to the position in the UK in the mid-1930s. Historical research at the UK National Archive shows that all these provisions originated due to a concern in 1934 by the Chairman of the Board of Inland Revenue that "tax evasion" (and he really did use the term "evasion" which, at the time, was not particularly clearly distinguished from tax avoidance) had got out of hand. His particular concern was the impact of the decision of the House of Lords in the Duke of Westminster (1934) case, which in his view had given support to these tax evasion strategies. There were three particular evasion strategies that he was concerned about - settlements for the benefits of the settlor and his children; close companies; and the transfer of assets abroad. With a war with Germany becoming increasingly likely, concerns that assets would



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be transferred out of the UK to avoid tax were particularly high on the government's concerns.

The answer to these concerns was a series of anti-avoidance provisions enacted in the UK in the Finance Act 1936. Subsequently, some of the provisions were also enacted in India in 1940. Interestingly, with the exception of the Republic of Ireland, most other British Dominions and Commonwealth countries did not adopt these anti-avoidance measures. At this instance of time, it is quite difficult to see why the UK, India and Ireland were the only countries to adopt equivalent provisions – it was common for the Colonial Office to circulate drafts to all colonies and dominions and for equivalent legislation to be enacted in each territory. It may have been a reflection on the territorial scope of different tax systems, or on the circumstances of the war time, that these overseas avoidance provisions were not more widely enacted.

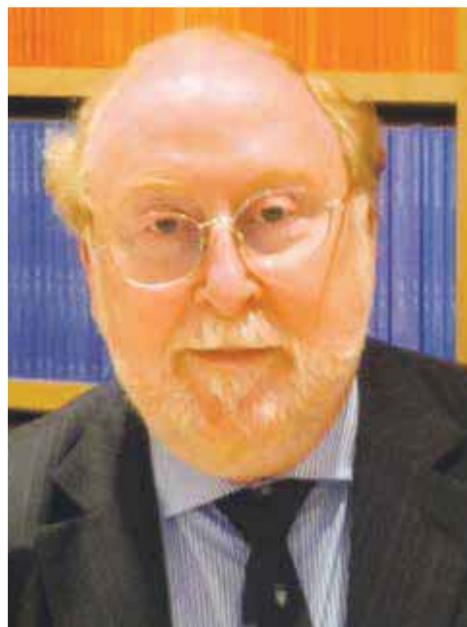
What is perhaps more interesting is to see how these provisions have developed differently in India and in the UK.

So far as India is concerned, the original legislation is still very much in the form in which it was enacted in 1940. There appears to have been only one leading, Supreme Court decision on the case - Chidambaram Chettiar (1966) - and very little further litigation on the meaning of the provision.

By contrast, the equivalent code in the UK has been the subject of a long series of cases, many of them going to the House of Lords (the former UK Supreme Court). Several of those decisions have prompted subsequent amendments to the legislation, with the result that the existing transfer of assets abroad code is almost

unrecognisable as the descendant from the common ancestor of the UK and Indian provisions. A series of House of Lords cases such as Congreve (1946), Herdman (1967) and Willoughby (1997) has identified a series of deficiencies or ambiguities in the original legislation. Legislation in the 1980s introduced separate charges on non-transferors, once it became clear that the original legislation could only apply to persons who made the transfer abroad. In addition, legislation in 2005 changed the nature and scope of the defence based upon the lack of a tax avoidance purpose. Finally, a redraft of the legislation, in accordance with the Tax Law Rewrite in 2007, has produced a code of some 40 or more sections.

What is perhaps most interesting is the way in which India and the UK have followed a route with a common starting point but with diverging paths to deal with overseas avoidance. The possibilities for avoiding tax by transfer of assets abroad are very significant. The income from assets that are located outside a jurisdiction has the potential to escape tax. Locating assets abroad also raises the possibility of tax evasion where the income is simply not declared. The problem of black money abroad is one that has become particularly high profile in India in recent years. Both countries are also reacting to the Duke of Westminster principle that "a tax payer may so arrange his affairs as to lawfully reduce the amount of tax due".



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