Taxmen, Stop Grrr, Now We Have Gaar

Focus on source of funds, not valuation of shares

Income-tax authorities have reportedly raised tax demands on unlisted companies, alleging excessive valuation in share transactions. Such demands are often arbitrary, will lead to festering disputes, and make it difficult to do business in the country. Nevertheless, the revenue department has invoked a rule that mandates an unlisted company to pay tax when the issue price is higher than the fair market value of shares computed by the tax department. The anti-abuse measure, introduced in 2012, is meant to curb errant promoters issuing shares at a premium to domestic investors, and using this route to launder some of their own unaccounted income. So, the share premium in excess of the fair market value is deemed as income of the company and charged to tax. The onus is also on the company to explain the source of funds. Such cumbersome requirements for companies should be dispensed with, now that the government has made mapping of the permanent account number, or PAN, with Aadhaar mandatory.

Aadhaar makes it easier to track the source of funds of the investor. A promoter of a shell company set up for a purpose that is not legitimate should be penalised. But genuine companies issuing shares at a premium to strengthen their capital base should not face needless harassment. Startups have been exempt from this anti-abuse rule. So, it is baffling that the department has raised tax demands on startups. Second-guessing the valuation of a startup is tough, and, hence, imputing a fair market value is arbitrary and subjective. Take, for example, Facebook's acquisition of Instagram for a hefty $1 billion. The rapid growth of Instagram was viewed as a threat by Facebook and the acquisition effectively killed competition. Typically, in India, shares are issued to investors in startups at a commercially negotiated price. Arbitrary tax demands, if any, must stop.

Having introduced the general anti-avoidance rules, or Gaar, to curb sharp practices, rules such as treating the share premium in excess of the fair market value as income, should be removed from the statute.

Killer Hospitals are a Curable Malaise

The high number of deaths of children in hospitals across Uttar Pradesh point to a flawed healthcare system. This is a system defined by missing accountability and transparency, erosion of medical ethics, rampant and criminal collusion of doctors, administrators and business. All of this is made worse by the absence of a redeeming health policy.

Public spending on health continues to be low, a little over 1% in 2016-17. Higher funding is essential but not enough to fix the system. There has to be greater accountability within the system. There must be stronger and more transparent regulation of medical education and practice. In Farrukhabad, there are some 50 private hospitals in an 800-metre radius of the government hospital. These operate in collusion with doctors, hospital administrators, and district and health officials. The practice of allowing doctors in government hospitals to work in private establishments has to end. Systems and protocols for clinical care, and drug procurement and management must be put in place. Digitisation would be useful. Improved primary healthcare institutions are central to prevent such tragic recurrences. Fixing the dysfunctional healthcare system is not enough. The tragedy that befell these 49 infants began long before they reached Farrukhabad's Ram Manohar Lohia Hospital.

The hospital was the last chapter in their short tragic lives. Like the children in Gorakhpur, they were victims of the multiple failures of the public health system. Many of these infants have low birth-weight; born of undernourished, underweight mothers, they are vulnerable to infections arising from unhygienic living environments. Fixing the system will require funds, dedication, better systems and accountability — hard work, but not impossible.

Why netas shouldn't look like they are living off the fat of the land

All About Weighty Political Matters

Shortly after the recent Cabinet reshuffle when she was shifted from the water resources and Ganga rejuvenation ministry and given the less weighty portfolio of sanitation and drinking water, Uma Bharati is reported to have confided that the prime minister had scolded her not for her performance but for her portliness. It would seem that an excess of girth can prove a drawback when seeking the berth of public office. Embonpoint does not go down well with an electorate that might prove to be sceptical of aspirants to high gaddi who look as though, once seated on it, they might cause it to collapse through force not of gravitas but gravity.

The Supreme Court has also looked askance at metaphoric fat cats with bulging asset portfolios far in excess of their known sources of income. Citing the case of over 280 MPs and MLAs whose wealth has increased by as much as 500% during their tenure in office, the Supreme Court has asked the central government to institute a probe in the matter. It would appear that in the political arena, while a 56-inch chest is to be vaunted, such amplitude is undesirable for the rest of one's anatomy or for one's bank balance. As the anti-incumbency factor has repeatedly shown, the body politic has had a bellyful of those perceived to assume public office only to lard it over the rest of us.

FOLK THEOREM There is probably only one thing that explains India's mysterious import rush

The Phantom of Our Opera

Abheek Barman

Buy when there is blood on the streets, even if the blood is your own," said Nathan Mayer Rothschild, the 18th-century banker who single-handedly founded a financial empire. What a pity overseas investors don't share his contrarian views on their India portfolios.

In the first quarter, profits shrank. Businesses are struggling to understand the goods and services tax (GST), supposed to simplify our earlier indirect taxes. The gap between imports and exports is widening and GDP growth is down.

Money Flees, Through FIIs...

Figuratively, there's blood on the streets. Global investors ought to be gorging on Indian stocks. Well, no. In August, foreign institutional investors (FIIs) sold around ₹17,000 crore worth of paper assets. Through the first four trading days till September 6, FIIs sold every day. Remember, these are sales net of purchases. September's FII sell-off is already ₹3,500 crore.

In a month and four days, FIIs have sold around $3 billion worth of assets. Domestic institutions have tried, heroically, to stanch this outflow, with little success. A lot of folks in the markets are wondering what went wrong.

One, a huge bubble in Asia and Pacific markets is now leaking some air. In one month, Asia-Pacific has lost around 0.4% in equity values. Japan, Singapore, Pakistan, Hong Kong-listed companies, South Korea, Taiwan and Australia are in the red, with India. Investors in China, New Zealand, Malaysia, Indonesia and Bangladesh have pocketed gains.

Two, as Swaminathan Aiyar pointed out recently ('Why DeMo, GST Are Not to Blame for Slowdown', Sunday TOI, goo.gl/K2YQDB), no country has ever grown consistently if it imports more goods and services than it exports. We've seen that in export-led, post-World War 2 Japan, in the rise of Southeast Asian 'Tigers' like Malaysia, Taiwan and Indonesia, and in China, the global factory.

But in the last 68 years from 1949, for which reliable numbers are available, India had a trade surplus only twice. The first, worth $135 million, occurred in 1972-73. The next surplus, of $76 million, was in 1976-77.

For a while, during the mid-1990s to the early 2000s, it was said India could import its way to high growth. This is only possible if growth is so high that our appetite for consumption has to be fed from suppliers worldwide. And this deficit has to be made up by equally large inflows of foreign investment to balance the books.

Recent number-crunching by global investor JPMorgan supports the export-growth link. During 2003-08, exports grew at 17.8% every year, supported by average annual growth of 8.8%. Through 2013-17, GDP growth has been 6.9% per year; export growth is crawling at just over 3% annually.

FILE PHOTO

Stop them! Capital is fleeing!

Many economists have (correctly) argued that November 2016's demonetisation of nearly 90% of our currency dealt a big blow to small and medium industries. These dominate sectors like textiles, gems and jewellery, processed food, car components, segments of engineering and manufacturing, and so on. They pay their informal workforce in cash. Many companies have to deal with retailers and farmers in rural India in banknotes.

...Or Through Imports

As cash vanished, these sectors, which contribute heavily to exports, also slowed. During the first few months after demonetisation, exports crawled or shrank. From October's 9%, export growth fell to 2.6% in November, when demonetisation was implemented. Between January and March this year, exports contracted.

Economics 101 says the export fall could have been arrested by a falling rupee, making them more competitive. But through November 2016 and February 2017, the rupee was well under its October level, measured against a basket of six major currencies, including the dollar, euro and Chinese yuan.

A bigger mystery surrounds imports, which have been surging from October 2016 to June this year. Through this, India wasn't really growing fast enough to generate big demand hikes for phoren goods and services. Imports are supposed to grow when the rupee strengthens against other currencies. In this period, the rupee was actually weaker than in October 2016.

So, what gives on the import front? There was no big increase in domestic demand, no major hike in oil prices, nor a dramatic strengthening of the rupee to justify a nine-month import spike, peaking at nearly 47% in March.

So, there is probably only one thing that explains the import rush: capital flight through mis-invoicing. This is common in countries like China and India, which try to keep a tight leash on capital flows. But one way for companies with global exposure to get around this is to over-value imports and take money out to other markets.

Suppose the actual cost of something I import is $50. However, I ask the seller to send me a bill for $100. So, $50 pays for my import, the other $50 stays somewhere overseas. This extra $50 is a loss for India's reserves. But for savvy businesses, it is a powerful hedge against economic or other uncertainties.

> Probably only one thing explains the import rush: capital flight through mis-invoicing, which is common in countries that keep a tight leash on capital flows

PHARMACEUTICALS

Triple Helix of Innovation

Junaid Ahmad & Albert Sole

As the monsoon gathers pace, civic authorities are gearing up to deal with the spectre of malaria, chikungunya and an assortment of other maladies. Yet, while two-thirds of the world's people are at risk from these and other debilitating diseases, no vaccines have yet been developed to prevent them.

Even where vaccines exist — such as for dengue and the human papilloma virus, the precursor of cervical cancer — they don't target the strains prevalent in India. Or they are prohibitively expensive. Since it costs an average of $800 million to bring a single new drug to market, most R&D budgets focus on developing drugs that fetch high returns. This leaves the diseases that afflict the developing world with few takers.

India is well-placed to fill this gap. Two key strengths have enabled India to reach its pinnacle position as the world's largest manufacturer of high-quality generic medicines and vaccines. India's academia has established a strong base in scientific research that helps identify potential new drugs. The private too sector has mastered reverse-engineering drugs and vaccines freed from patent protections.

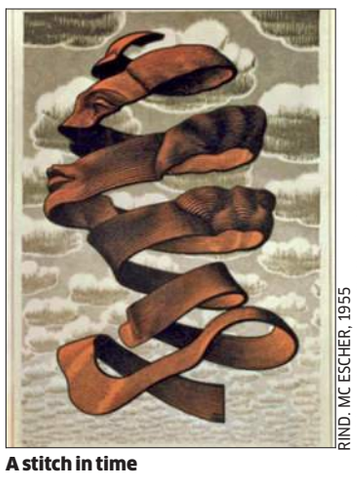
But these strengths alone will not be enough to take the country forward. Today, rapid advances in genetics, nanotech and biotech are revolutionising the fundamentals of the industry. A whole new era of discovery and innovation lies before us.

But before India can capitalise on its potential, it will need to work on its key weaknesses. Today, too many promising leads fail to make it to market because of the missing link between discovery and development.

Since neither the public nor the private sector can go it alone in such a complex, high-cost, high-risk environment, a bridge will need to be created between academia, industry and government — the triple helix of medical innovation.

In the US, early stage incubators at universities such as Stanford, Cornell, MIT and Harvard serve as hubs for the development of new drugs and medical devices. After this, the country's vibrant venture capital market takes the prototypes forward.

Its investment in startups helps validate the prototypes for efficacy, safety and consistency, and takes the product to the market. In Israel and South Korea, government-led initiatives draw in the private sector, and large pharma companies take the pioneering work of small industries forward.



RIND. MC ESCHER, 1955

A stitch in time

India, too, is now seeking to strengthen this value chain. Five years ago, GoI set up the Biotechnology Industry Research Assistance Council (Birac) with this explicit purpose. Since then, Birac has supported a number of startups, and fostered collaboration within the biopharma innovation ecosystem. Birac is now focused on promoting a more collaborative R&D environment and leveraging the expertise of local and international players, from both the public and private sectors, to take the industry forward.

Specifically, Birac aims to foster talent in research and nurture next-generation technical skills among scientists, researchers and others across the different stages of product development. It also seeks to improve the success rate of promising leads, accelerate the development of new products, and equip the industry to carry out the full spectrum of validation activities.

Clinical trials are currently a critical bottleneck. It will be important to provide companies with advanced shared facilities to conduct these trials, link clinical trial units with networks of expert advisers and international bodies so that they comply with the best global standards, and strengthen all the institutions involved in the adoption of global innovations, technologies and licensing models.

Recently, the World Bank joined hands with Birac to help scale up its efforts across the industry. Initiatives such as this, in which an industry goes beyond 'Make in India' to 'Innovate in India', will hopefully pave the way for private investors to follow, and raise the industry's long-term competitiveness.

Ahmad and Sole are country director and senior private sector specialist respectively, World Bank, India

POST-DEMONETISATION ECONOMY

Exorcising DeMo's Demons

Arvind Virmani

From the GDP data now available, one can estimate that demonetisation reduced GDP growth by about 1.2% in the first half of 2017. This estimate accounts and adjusts for the decelerating trend in quarterly GDP growth since mid-2015-16.

This GDP growth deceleration is due to the following factors:

▶ Monetary policy has not only been tight for the last two years but has tightened further over the last 18 months due to sharply falling inflation. The direct negative effect of rising real interest rates has been strongest on manufacturing and construction. Another consequence of high real rates relative to global rates is excessive capital inflows into debt. This results in the appreciation of the real effective exchange rate (Reer) of the rupee, which, in turn, results in loss of competitiveness and the worsening of net exports of manufactured goods.

▶ Then, there is the return of the economy from deflation to inflation in manufacturing and other internationally tradable goods. The deflation results in leads and lags in input and output prices that result in overestimation of the value added in manufacturing and other goods. The return to normal inflation, however, reverses these effects on inputs and outputs, so that average growth measure values would have prevailed in the absence of a deflation episode.

▶ Though public sector bank (PSB) non-performing assets (NPAs) were incurred largely during 2009-13, after the global financial crisis, tighter regulations on NPAs and their disclosure to the public were introduced in 2014-16. These forced banks, companies and capital markets to evaluate risks more carefully, worsening credit/investment in 2015 and 2016.

So what specific policy changes can help revive growth? The following reforms should be accelerated:

FILE PHOTO

Well, it should bottom out in July

▶ GoI must refocus on subsidy reform, and put the savings from reduction in corruption and administrative efficiency into public goods infrastructure investment.

▶ GoI should expeditiously complete already launched reforms in the bankruptcy law, rules and procedures, and the clean-up of the NPAs in PSBs.

▶ To get the full benefits of the goods and services tax (GST) and minimise costs, the GST Council must undertake a drastic simplification of the tax to a three-slab system with one base rate, and basic food, health and education as exempt sectors, and 6-12 surcharges.

▶ Reform the export-import (Exim) policy in agriculture and textiles, and impose a uniform 10% import duty on all manufactures and minerals. Suspend the electronics agreement for 3-5 years if possible, either through export processing zones (EPZs) or free trade zones (FTZs), or other temporary mechanisms for 5-10 years. Provide an opportunity to labour-intensive industries and exit supply chains to shift base from China to India.

▶ Two consecutive normal monsoons have provided an opportunity to eliminate all export controls and quantitative restrictions (QRs) on agricultural commodities, and reduce export duties to zero immediately.

If GoI wants to help farmers on a longer-term basis, it should also repeal the Essential Commodities Act and the Agricultural Produce Market Committee, approve all genetically modified seeds recommended by the Genetic Engineering Appraisal Committee and induce holdout states to join the national e-market for all agricultural products. The remaining impediments to FDI in food retailing of agricultural and related products should also be removed.

▶ Education is one of the remaining heavily controlled sectors of the Indian economy. The Centre can make a start by replacing controls on higher education with modern, rational regulation, based on asymmetric information and moral hazard problems faced by users.

▶ Reform of labour and land, the two most distorted markets, have multiple dimensions. Each of them is badly riddled with controls, distortions and corruption. A phased programme of labour and land reform can be drawn up and implemented step by step over the next five years.

The negative effects of demonetisation on GDP are largely over. Because of fears of getting shortchanged on input credit from GST, there was an inventory drawdown in June, and a possible slowdown in production even before that. Both these will be offset in August and Q2 of 2017-18.

On balance, the economy should bottom out in July. But the speed of recovery will depend on reforms and monetary policy.

The writer is president, Forum for Strategic Initiative

the speaking tree

Ego, Soul & Challenges

NAYASWAMI JYOTISH

At the level of the ego, there will always be clashes. Group dynamics get particularly tricky because, with people at different levels of maturity, the clashing of egos can get particularly turbulent. It is useless to expect others to be more mature than they are so that they fit better into the pattern of your own expectations. At the level of mass karma, such as nations have, generally the best we can do is to choose our battles and strictly monitor our own behaviour to make sure it is righteous. Use common sense and do what seems appropriate, but don't become overly attached to the results. If you base your well-being on unrealistic hopes, you are destined to tread a long, muddy road of frustration and anger.

Now, from the level of the soul: spiritual progress might be defined as the soul becoming detached from the delusion of separation from God. We should embrace whatever helps us accomplish that goal even though it may feel unpleasant. God creates an enormously entrancing drama, with grand scenes of good and bad, victories and losses. Our job is to take the road less travelled: to choose resolutely that pathway that leads away from ego and toward soul freedom. Some useful tools to guide us include meditation, prayer, staying calm, acting with sincerity and truthfulness and remaining content. In a calm state, try to awaken your intuition. Acting with complete sincerity and truthfulness will enlist the laws of dharma to empower your actions.

Chat Room

Hate Controls Our Souls

Something evil has entered our souls. Hate is destroying the Indian ethos. All of our glitzy achievements cannot hide the corrosion of our soul and the decay of values, which made India the epicentre of spirituality in spite of its grinding poverty. The murder of Gauri Lankesh and the ugly reactions that followed show how far we have travelled on the path of hate, where murder is not merely justified but gloated over by many in the social media. The aspersions cast on the character of a slain writer is simply unacceptable.

ANTHONY HENRIQUES
By email

India Must Rise to the Occasion

India may not have been a signatory to the 1957 UN convention on refugees or its 1967 protocol that laid down obligations of a host state for those who seek refuge in its territory. But as an aspiring state seeking a prominent place among the comity of nations, it cannot shun its moral responsibility when it comes to playing host to Rohingya Muslims as a stateless community fleeing Myanmar, fearing oppression and persecution. Adoption of a humanitarian approach towards Rohingyas is the need of hour.

M JEYARAM
Sholavandan

Stronger Bond With the Child

Apropos 'Blue Whale a Challenge' by Acharya Gyansagar Muni (Sep 7), nuclear family is today's reality, and we have to live with it. What we can do is assign weekends as no-gadget days and interact with family members or teenagers with an open heart to understand their emotional needs, as talking to someone in an open way can release a lot of stress. The Blue Whale issue again proves that technology is a double-edged sword and parents need to communicate dos and dont's to the children and keep a watch on their behaviour.

BAL GOVIND
Noida

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