Child Rights and Tax Justice in India: Tackling DTAAs and P-Notes

Abdul Muheet Chowdhary is a Legislative Aide to a Member of Parliament (India) and a former consultant to the United Nations Information Centre for India and Bhutan. Views expressed are personal.

Introduction

India has the world's largest child population at 442 million,[1] which is also 39% of the country's population[2]. Of this approximately 58% do not complete primary school, 90% do not complete school at all and only 10% go on to join college.[3]

It is no surprise that a significant number of school dropouts end up as child labourers. India has 10.12 million[4] children belonging to the age group 5-14 years who are engaged in child labour. 80% of these work in rural areas, doing hard labour in agriculture (as cultivators), or in household industries, most of which are home-based[5]. This has several negative effects and the net result is that they are trapped in a vicious circle of poverty and live wretched and miserable lives full of pain and sorrow. Indian Nobel Laureate Kailash Satyarthi has spent his life campaigning against this phenomenon.

This is a clear violation of their rights to education and against exploitation. This is aided and abetted significantly by the role of **tax abuse**, where unjust laws and policies of the government of India have resulted in massive amounts of foregone tax revenue. This revenue could have and should have been used by the government to fulfil its constitutional, legal and moral responsibilities in upholding these rights of children.

This essay seeks to make a case for addressing this injustice. It seeks to use human rights law to address the wrongs in India's tax system. Specifically, it focuses on two aspects of the tax system -
i) the Double Taxation Avoidance Agreements (DTAA) with Mauritius and Singapore
ii) the use of Participatory Notes (henceforth referred to as P-Notes)

The plaintiff in this case would be anyone who can represent the children of India as a whole, such as an NGO or a public spirited person. The defendant is the Union of India represented through the Cabinet Secretary.

The essay has been broadly modelled on the format of a Public Interest Litigation (PIL), a form of legal intervention in the Indian judicial system which enables citizens to request the High Courts or the

[1] Child Rights and You. *Statistics on Underprivileged Children*. http://www.cry.org/rights-to-know/statistics-on-children-in-india.html
[2] Haq Centre for Child Rights. *Mainstreaming Children in the Union Budget 2016-17: The 'Mantra' of Inclusive Development.* http://haqcrc.org/blog/union-budget-must-not-ignore-social-security-children-2/
[3] Teach for India. India's Education Crisis. Retrieved March 12, 2016, from http://www.teachforindia.org/about-us/india-education-crisis
[4] Child Rights and You. *Statistics on Underprivileged Children*. http://www.cry.org/rights-to-know/statistics-on-children-in-india.html
[5] Ibid.

Supreme Court to issue a writ. Nevertheless the PIL has only been used as a guideline and the scope of the essay is sufficiently broad so it could be useful for litigation in regional or international legal forums.

Child rights violations in India

The aforementioned statistics regarding child labour and child education are a clear violation of i) Constitutional provisions ii) Domestic legislations iii) International obligations.

Constitutional provisions

Part III of the Indian Constitution contains the Fundamental Rights. Two of these specifically address the needs of children.

Article 21A states, "Right to education.—The State shall provide free and compulsory education to all children of the age of six to fourteen years in such manner as the State may, by law, determine."

Article 24 states, "Prohibition of employment of children in factories, etc.—No child below the age of fourteen years shall be employed to work in any factory or mine or engaged in any other hazardous employment."

The guardianship of the Fundamental Rights has been given to the Supreme Court which can enforce them through writs, as per Article 32. Dr BR Ambedkar called Article 32 the 'heart and soul of the Constitution'.

Part IV contains the Directive Principles of State Policy. Unlike the Fundamental Rights, these are non-justiciable but nonetheless have heavy legal and moral value. The provisions specifically relating to child labour and child education are as follows.

Article 39, "Certain principles of policy to be followed by the State.—The State shall, in particular, direct its policy towards securing—
(*e*) that the health and strength of workers, men and women, and the tender age of children are not abused and that citizens are not forced by economic necessity to enter avocations unsuited to their age or strength;
(*f*) that children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment."

Article 45, **"**Provision for early childhood care and education to children below the age of six years.—The State shall endeavour to provide early childhood care and education for all children until they complete the age of six years.'

Lastly, under the Fundamental Duties for citizens Article 51 (k) states "It shall be the duty of every citizen of India who is a parent or guardian to provide opportunities for education to his child or, as the case may be, ward between the age of six and fourteen years."

Domestic legislations

To give legislative grounding to the above Constitutional provisions, several laws have been passed by the Indian Parliament.

The Factories Act (1948), Merchant Shipping Act (1958), Apprentices Act (1961), Motor Transport Workers Act (1961) and Beedi And Cigar Workers (Conditions Of Employment) Act (1966) all prohibit the employment of children below the age of 14 and have several provisions for the safety and rights of working adolescents. To fill in the remaining gaps, the Child Labour (Prohibition and Regulation) Act was passed in 1986.

To eliminate the menace of child labour and to ensure that the relevant constitutional provisions were complied with, the Supreme Court gave a large number of directions in the landmark 1997 *M.C Mehta* v *State of Tamil Nadu & Ors* case.[6] An important directive was that employers are to pay a compensation of Rs. 20,000 for employing a child below 14 for hazardous work in contravention of this Act.

The Right of Children to Free and Compulsory Education Act, 2009 describes the procedure for operationalising the Constitutional obligation for providing free and compulsory education to all children between the age of six and fourteen. Section 12 (1) (c) of this Act states that 25% of school intake shall be exclusively for students from disadvantaged groups. Even private schools are obliged to comply with this. This was challenged in the courts and finally the Supreme Court in *Pramati Educational Trusts & Ors vs Union of India*[7] (2012) upheld this provision, although private, minority schools were exempted. The case reaffirmed the authority of the State to fulfil its obligations under the Right to Education.

International obligations

India is a signatory to the Convention on the Rights of the Child (CRC) and has ratified both its accompanying Optional Protocols. With regard to child education and child labour, the following are the relevant articles from the CRC.

Article 28 provides the right to free and compulsory primary education and access to secondary and higher education.

Article 32 provides the right to protection from economic exploitation and makes it obligatory on States to regulate employment in a manner that protects children.

Thus there are several legal provisions which safeguard children's rights to education and against child labour, respectively. However as is evident, the Government of India (henceforth, referred to as the defendant), is not just responsible for abdicating its duties, but doing so on a grand scale.

Role of tax abuse in rights violations

The most objective statement of a government's commitments is the Annual Financial Statement, ie the Budget. It is an occasion to "put the money where the mouth is" and show in concrete terms where priorities lie. Over the years, the defendant has consistently made inadequate allocations in the Union

[6] AIR 1997 SC 699. http://ncpcr.gov.in/show_img.php?fid=520
[7] Writ Petition (Civil) No 416 of 2012. http://supremecourtofindia.nic.in/outtoday/41505.pdf

Budget to the sectors involving the relevant rights. In fact, despite children being nearly half the country's population, they receive less than 5% of total budgetary allocations.[8]

Since India's independence, this 5% threshold has never been crossed.[9] Analysing budget data for the last five years reveals that overall allocation for children has actually reduced by 27% from 4.45% in 2008-09 to 3.26% in 2015-16.[10] Child protection specifically receives the lowest share and on average since 2012-13 it has received only 0.04% of total allocation.[11] The table below shows the details[12].

Sectoral Share in Union Budget (as % of total allocation)				
Year	Child Health	Child Education	Child Development	Child Protection
2012-13	.18	1.10	3.44	.04
2013-14	.16	1.10	3.34	.03
2014-15	.16	1.06	3.26	.04
2015-16	.13	.51	2.58	.04

It is evident from the table above that the allocation is far too meagre given the scale of the problem being faced. As far back as 1966, the Kothari Commission on education recommended that at least 6% of GDP be allocated to education.[13] However this goal has never been achieved. The 2015-16 budget saw an allocation of just 3.8% instead. Within this, the government's flagship programme for primary education, Sarva Shiksha Abhiyan, witnessed a 21% reduction in allocation between 2014-15 and 2015-16 and for the same period the Integrated Child Development Services (ICDS) scheme received a staggering 54% reduction.[14]

Even the Integrated Child Protection Scheme (ICPS) was not spared the slash and has been given inadequate allocations, with Rs. 4 billion sanctioned in budget 2015-16. A Parliamentary Standing Committee noted that the majority of Child Welfare Committees and Juvenile Justice Boards that have been constituted are not functional, stating that the reasons could be 'lack of funds, inadequate facilities and trained manpower.'[15]

The standard response of the government is that there are inadequate resources. This reasoning was deployed right from 1947, when India's Constituent Assembly debated the form of the future Constitution. Free and compulsory education was listed for inclusion as a fundamental right. When the sub-committee examined the proposal, one of the members, M Ruthnaswamy, asked, 'Is this a justiciable right? Supposing the government have no money?' (sic). To this, two eminent members, Alladi Krishnaswamy Iyer and Govind Ballabh Pant, stated that it be made non-justiciable instead.[16]

[8] Haq Centre for Child Rights. *Mainstreaming Children in the Union Budget 2016-17: The 'Mantra' of Inclusive Development.* http://haqcrc.org/blog/union-budget-must-not-ignore-social-security-children-2/
[9] Ibid.
[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] JBG Tilak. *On Allocating 6 Per Cent of GDP to Education.* Economic and Political Weekly. February 18, 2006. http://nuepa.org/libdoc/e-library/articles/2006jbgtilak_1.pdf
[14] Haq Centre for Child Rights. *Mainstreaming Children in the Union Budget 2016-17: The 'Mantra' of Inclusive Development.* http://haqcrc.org/blog/union-budget-must-not-ignore-social-security-children-2/
[15] Department Related Parliamentary Standing Committee on Human Resources Development. *264th Report, Juvenile Justice (Care and Protection) Bill, 2014.* February 2015. http://164.100.47.5/newcommittee/reports/EnglishCommittees/Committee%20on%20HRD/264.pdf
[16] Nalini Juneja. *Correcting a historical injustice.* The Hindu. May 14, 2014. http://www.thehindu.com/opinion/lead/correcting-a-historical-injustice/article6005953.ece

Thus free and compulsory education was transferred to Chapter IV of the Constitution, the non-justiciable Directive Principles of State Policy.

This reasoning has now run its course. The excuse of 'lack of resources' was finally given its burial in 2002 when free and compulsory education was made a fundamental right under the Constitution. Justice KS Radhakrishnan of the Supreme Court stated in the *Society for Unaided Private Schools of Rajasthan* vs *Union of India & Ors* (2010) case that, 'The State has necessarily to meet all expenses of education of children of the age 6 to 14 years, which is a constitutional obligation under Article 21A of the Constitution. Children have also got a constitutional right to get free and compulsory education, which right can be enforced against the State, since the obligation is on the State.'[17]

Thus given the constitutional and moral obligations upon the State to discharge its duties, it would stand to reason that the State would take all possible steps to raise as much tax revenue as possible so there would be adequate resources. It is thus perplexing that it in fact introduced laws and policies which encouraged tax abuse, resulting in loss of potential revenue. While there are several such measures, the focus of this essay is on two of them: i) Double Taxation Avoidance Agreements with Mauritius and Singapore ii) Participatory Notes.

Double Taxation Avoidance Agreements with Mauritius and Singapore

India has signed DTAAs with both Mauritius and Singapore. Article 13 of both agreements deals with capital gains. As per this article, capital gains on sale of assets by a company can only be taxed in the country where the company is registered. Short term capital gains are taxed at 10% in India and are completely exempt in both Mauritius and Singapore. Corrupt companies establish shell companies in either country from where they carry out their operations. They escape paying capital gains taxes in this manner in both countries.

This agreement has also encouraged the practice of 'round tripping'. For example, money is sent to Mauritius/Singapore from India through tax abuses such as trade misinvoicing, payments to shell companies overseas and direct cash transfer through an illegal network known as 'hawala'. This is a direct violation of section 3 of the Prevention of Money Laundering Act, 2002 and section 3 of the Foreign Exchange Management Act, 1999. Under the former it is a criminal offence and under the latter it is a civil offence. Once it reaches Mauritius/Singapore , the money gets laundered and comes back to India in the form of 'Foreign Direct Investment' (FDI).

Mauritius and Singapore were the top two sources for FDI, going by the most recent data. They together accounted for 57% of total inflows during April - December 2015. Singapore accounted for $10,985 million while Mauritius accounted for $6,105 million, out of the total investment of $29,443 million.[18]

[17] WRIT PETITION (CIVIL) NO.95 OF 2010. Page 129. http://judis.nic.in/supremecourt/imgs1.aspx?filename=39251

[18] Department of Industrial Policy and Promotion, Government of India. *Fact Sheet on Foreign Direct Investment (April 2000 - December 2015).* http://dipp.nic.in/English/Publications/FDI_Statistics/2015/FDI_FactSheet_OctoberNovemberDecember2015.pdf

These two countries have been favourite destinations for tax evasion. In the 15 year period between 2000-2015, they were the top two sources and 34% and 16% of the total FDI into India was from Mauritius and Singapore respectively, valued at $93.6 and $43.2 billion[19].

Given such immense amounts of money, one can only estimate how much tax revenue has been lost. The scale of loss has forced even the defendant to take notice and a Joint Working Group has been setup to review the DTAA between India and Mauritius. However no such steps have been taken towards Singapore.

Further, regarding the DTAA with Mauritius, there has been no concrete progress whatsoever and the defendant has informed the Parliament that 'no timeline can be provided for the finalisation of an agreement in the negotiations.'[20]

Participatory Notes

The money laundering process is greatly eased by a financial instrument known as Participatory Notes, or P-Notes. These are Overseas Derivative Instruments (ODI) that have Indian stocks or derivatives as their underlying securities, with the holder entitled to capital appreciation from such investment while being assured of complete confidentiality. In simple terms, they allow for black money to be brought back to India and invested in the stock market while allowing the investor to remain anonymous.

P-Notes are issued by Foreign Portfolio Investors (FPI) registered with the Securities and Exchange Board of India (SEBI). Initially they could be issued fairly easily, and became a widely used instrument by tax abusers for money laundering. Corrupt businessmen, politicians and bureaucrats would use it to launder their money stashed abroad. It was even used for terror financing. At their peak in 2007, the value of P-Notes constituted well over 50% of the outstanding assets in the custody of FPIs.[21]

A Special Investigative Team (SIT) constituted by the Supreme Court to look into the issue of black money noted the role of P-Notes in tax abuse. It observed that the outstanding value of P-Notes at the end of February 2015 was Rs. 2,715 billion. The top five locations of end beneficial owners of the P-Notes were in Cayman Islands (31.31%), USA (14.20%), UK (13.49%), Mauritius (9.91%) and Bermuda (9.10%).[22]

The SIT observed, "It is clear from above than a major chunk of outstanding ODIs invested in India are from Cayman Islands--31.31%. This translates to roughly Rs 85,006 crore (850 billion). The Cayman Islands had a population of 54,397 in 2010. It does not seem conceivable that a jurisdiction with a population of less than 55,000 could invest Rs 85,000 crore in one country."[23]

Such blatant abuse finally forced SEBI to tighten the regulations regarding their issue. Presently, P-Notes are governed by Clause 22 of the SEBI (FPI) Regulations, 2014. The revised regulations have

[19] Ibid.
[20] Unstarred question number no. 573 tabled on 1 March 2016 in the Rajya Sabha, Parliament of India. Reply by Jayant Sinha, Minister of Finance, to Dr. Chandan Mitra, MP.
[21] FPI Monitor. *Value of Offshore Derivative Instruments (ODI)/Participatory Notes (PNs).* Accessed on 11-4-2016. https://www.fpi.nsdl.co.in/Reports/ReportDetail.aspx?RepID=28
[22] Press Information Bureau. *Recommendations of SIT on Black Money as Contained in the Third SIT Report*. http://pib.nic.in/newsite/PrintRelease.aspx?relid=123677
[23] Ibid.

barred Category II and Category III FPIs from issuing P-Notes and Clause 22 (3) states, "Foreign portfolio investors shall fully disclose to the Board any information concerning the terms of and parties to off-shore derivative instruments such as participatory notes, equity linked notes or any other such instruments, by whatever names they are called, entered into by it relating to any securities listed or proposed to be listed in any stock exchange in India, as and when and in such form as the Board may specify."

This has led to a gradual reduction in the value of P-Notes over time and as of January 2016 their notional value is Rs. 2,313 billion.[24] However that is still an immense amount and the attendant dangers of terror financing still remain. The defendant has unfortunately made it clear that they will not be banned anytime soon despite repeated requests from the Parliamentary Opposition as well as civil society. The Finance Minister responded to the SIT's observations stating there would be no adverse reaction while the Finance Minister of State has stated that the existing framework is 'robust'.[25]

A PIL was filed in the Delhi High Court terming P-Notes illegal.[26] The petitioner stated that the circulation of P-Notes was prohibited under the provisions of the Prevention of Money Laundering Act, 2002, the Foreign Exchange Regulation Act, 1999 and under SEBI Guidelines. Unfortunately, this case was dismissed by the Delhi High Court.
Thus P-Notes, despite their role in money laundering, possible terror financing and obvious role in tax abuse, are here to stay.

Regressive taxation to compensate
The UN Special Rapporteur on extreme poverty and human rights insightfully observed that "tax abuse by corporations and high networth individuals forces Governments to raise revenue from other sources: often regressive taxes, the burden of which falls hardest on the poor... Increasing the tax burden on the poor will erode their incomes, running counter to efforts to reduce inequality."[27] This is exactly what happened in India's case. To raise revenue for education, the defendant levied an education cess and secondary and higher education cess in 2004 at the rate of 2% of income which was later subsumed into service tax which has now been increased to 14%. In other words, the defendant resorted to the regressive method of increasing indirect taxes to finance its educational obligations.

Remedies Sought

The use of P-Notes and the DTAAs signed with Mauritius and Singapore have resulted in significant revenue loss to the exchequer. This has meant reduced resources for the defendant to discharge its moral and legal responsibilities to society. In particular is its failure to uphold the rights of children to free and compulsory education and against exploitation. Thus there is a clear causal link between the decisions that enabled tax abuse and the failure of the State to discharge its child rights obligations. These decisions are entirely wilful. Not only have they led to acts of omission by the defendant, they

[24] Securities and Exchange Board of India. *Outstanding Notional Value of Offshore Derivative Instruments (ODIs) Vs Assets Under Custody (AUC) of FPIs/deemed FPIs.* Accessed on 11-4-2016. http://www.sebi.gov.in/cms/sebi_data/commondocs/ODI2016_h.html
[25] The Hindu. *P-Notes norms strict and robust: Sinha***.** http://www.thehindu.com/business/participatory-notes-strict-and-robust-says-mos-finance-jayant-sinha/article7944527.ece
[26] Writ Petition (Crl) No. 153 of 2015. *Manohar Lal Sharma, Advocate v. Reserve Bank of India & Ors.*
[27] Report of the Special Rapporteur on extreme poverty and human rights, Magdalena Sepúlveda Carmona. Para 60. http://www.rightingfinance.org/wp-content/uploads/2015/03/Read-full-report1.pdf

have been complemented by regressive taxation in the form of the education cess that has added to the tax burden on the average citizen.

The plaintiff prays that the Hon'ble Court in public interest may be pleased to -

a) Direct the Union of India to ban the issuance of P-Notes.
b) Direct the Union of India to prevent further entry of FII fund flows that do not disclose the owners of the funds.
c) Direct a court-monitored investigation to disclose the owners of the P-Note funds presently circulating in the Indian markets.
d) Direct the Union of India to ensure that every Indian citizen disclose details of assets held abroad as well as direct or indirect shareholdings in foreign companies.
e) Direct the Union of India to prepare a public registry of beneficial ownership of companies, trusts and other corporate structures.
f) Direct the Union of India to repeal Article 13 of the Double Taxation Avoidance Agreements signed with Mauritius and Singapore.
g) Issue such other writ, direction or order under Article 32 of the Constitution, which the Hon'ble Court may deem proper given the facts of the case.

Conclusion

The above mentioned measures would plug some of the tax abuse loopholes and would significantly boost the defendant's tax revenue. This could then be used to stringently enforce its obligations to child education and child labour. The needless wastage of children's lives, lost only due to human greed, could be diminished somewhat and their harsh lives could find some succour.