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Contents

Editorial 4

Impact of Inflation on Bank Lending Rates in Bangladesh

Emon Kalyan Choudhary 5

Stock Market Returns on Newsweek 500 Green Companies: Analysis of Broad
Market Indices in US

Vimala Sanjeevkumar 15

Public Policy Imperatives for Curbing Honour Killings in India

Akshey Kumar 36

Corporation as a Vehicle of Tax Planning: Emerging Scenario

Mandavi Singh 41

Editorial

We are happy to launch the inaugural issue of Journal of Politics & Governance (JPG). This journal is aimed at creating a body of knowledge around the contemporary critique of the pervasive concerns of people across the globe through an inter-disciplinary lens. Hopefully, JPG will emerge as a leading intellectual forum for candid discussion on issues drawn from politics, governance, economics, society, public affairs, trade, environment, international relations, etc.

In this issue, we are publishing four papers. Themes of the papers are diverse ranging from impact of inflation on bank lending rates to return on green stocks, honour killing and taxation. You are welcome to send us your valuable feedback as well as your contributions for forthcoming issues. You may also like to discuss any specific idea with the editor for developing a paper for this journal.

–Swamy Narayan

Impact of Inflation on Bank Lending Rates in Bangladesh

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Abstract

Ever since Irving Fisher (1930) provided the relationship between the expected inflation and interest rates, considerable attention has been paid to the issue. Many financial controversies and literatures have analyzed this relationship. In Bangladesh context, very less study has been done in this regard as interest liberalizations are of recent past. This study is done with an objective to unearth the influence of inflation on lending rate of commercial banks in Bangladesh. The period 2002-2011 has been considered for study. The inflation and lending rate satisfy Dickey Fuller Test. Later, the dependent variable lending rates is regressed with the independent variable inflation. The obtained residuals are again subjected to Augmented Dickey Fuller test. The result shows that the residuals are stationary, and the co-integration test proves that during the period of study, there is no significant relationship between the rates and inflation.

Keywords: Inflation rate, Interest rate, Co-integration

Introduction

Inflation is a key factor in things that affect interest rates. When a surge in inflation occurs, a corresponding increase in interest rates takes place. Over time, prices of things tend to steadily increase. Therefore the value of money decreases. Lenders are very aware that inflation will erode the value of their money over the time period of a loan, so they increase interest rates to compensate for the loss. This is how lenders are able to stay visible over time with multiple borrowers and multiple outstanding loans. Adjustments are made to interest to recoup the loss made when money loses value.

Whenever there is any news on interest rates, it is accompanied by inflation. It is a known fact that there exists a relationship between interest rates and inflation. But, the extent to which one affects the other for different time periods is not certain. The well-known Fisher hypothesis, introduced by Irving Fisher in 1930 maintains that the nominal interest rate is the sum of the constant real rate and the expected decline in the purchasing power of money. Starting with Fisher and extending to the present, this seemingly simple and intuitive hypothesis has found limited empirical support. Fisher hypothesis provides the relationship between the expected inflation and interest rates. Fisher's hypothesis is that the nominal interest rate (R_t) can be taken to be the sum of real rate of interest (P_t) and the rate of inflation anticipated by the public (Π_t). Previous studies show that there is a positive relationship between interest rates and inflation (*Research department, National Bank of Poland*). Studies have shown that Fisher hypothesis is true in

Bangladesh and that there is a long run relationship between interest rates and inflation rates, and interest rates can be modeled considering expected inflation and other macroeconomic variable to arrive at a more valid model of forecasting interest rates.

Fisher hypothesis is the proposition by Irving Fisher that the real interest rate is independent of monetary measures, especially the nominal interest rate. The Fisher equation is

$$r_r = r_n - \pi^e.$$

This means, the real interest rate (r_r) equals the nominal interest rate (r_n) minus expected rate of inflation (π^e). Here all the rates are continuously compounded. For simple rates, the Fisher equation takes form of

$$1 + i = (1 + \rho) \times E(1 + \pi)$$

If r_r is assumed to be constant, r_n must rise when π^e rises. Fisher Effect: The one for one adjustment of the nominal interest rate to the expected inflation rate.

To understand the relationship between money, inflation and interest rates it is important to understand nominal interest rate and real interest rate. The nominal interest rate is the interest rate you hear about at your bank. If you have a savings account, for instance, the nominal interest rate tells you how fast the number of dollars in your account will rise over time. The real interest rate corrects the nominal rate for the effect of inflation in order to tell you how fast the purchasing power of your savings account will rise over time. An easy estimation of the real interest rate is the nominal interest rate minus the expected inflation rate (Note that this estimate is unwise when looking at compounded savings.)

Real interest rate = Nominal Interest Rate - Expected Inflation Rate

Nominal Interest Rate = Real interest Rate + Expected Inflation Rate

If inflation permanently rises from a constant level, let's say 4%/yr., to a constant level, say 8%/yr., that currency's interest rate would eventually catch up with the higher inflation, rising by 4 points a year from their initial level. These changes leave the real return on that currency unchanged. The Fisher Effect evident that in the long-run, purely monetary developments will have no effect on that country's relative prices (Kwong, Mary; Bigman, David; Taya, Teizo-2002)

Interest rate: An interest rate is the rate at which interest is paid by a borrower for the use of money that they borrow from a lender. Interest rates are normally expressed as a percentage rate over the period of one year.

Nominal interest rate: The rate of interest before adjustment for inflation. Suppose 'A' deposits Tk. 100 with a bank for 1 year and they receive interest of Tk.10. At the end of the year their balance is Tk. 110. In this case, the nominal interest rate is 10% per annum.

Real interest rate: The real interest rate is the nominal interest rate minus the inflation rate. It is a measure of cost to the borrower because it takes into account

the fact that the value of money changes due to inflation over the course of the loan period. Except for loans of a very short duration, the inflation rate will not be known in advance.

Purchasing power: It is the number of goods and or services that can be purchased with a unit of currency. Currency can be either a commodity like gold or silver, or fiat currency like Taka. As Adam Smith noted, having money gives one the ability to "command" others' labor, so purchasing power to some extent is power over other people, to the extent that they are willing to trade their labor or goods for money or currency.

Inflationary expectations

According to the theory of rational expectations, people form an expectation of what will happen to inflation in the future. They then ensure that they offer or ask a *nominal interest rate* that means they have the appropriate real interest rate on their investment. The international Fisher relation predicts that the interest rate differential between two countries should be equal to the expected inflation differential. Therefore, countries with higher expected inflation rates will have higher nominal interest rates, and vice versa.

Literature Review

The empirical research conducted in Bangladesh suggests that there does not exist any co-movement of inflation with interest rates and the relationship between the variables is also not significant. The inflation premium, equal to expected inflation that investors add to real-risk free rate of return, is ineffective. (Md. M Alam, K. A Alam and MD. G. S. Uddin, 2008). William J Crowder and Dennis L Hoffman (2007) recognize that the persistence in nominal interest rates and inflation can be modeled under the unit root hypothesis. A fully efficient estimator that separates estimation of long run equilibrium relationship from nuisance parameters is applied. The study finds considerable support for the tax-adjusted Fisher effect. It reveals a long run relationship between interest rates and inflation. However, it also finds that the short term interest rates may not be good predictors of future inflation.

Evans, Martin and Karen Lewis (1995) observes co-integration between nominal interest rates and inflation in a sample of post war data and applies the DOLS estimator to estimate the long run response of nominal interest rates with respect to inflation. They support their case with Monte Carlo evidence. They conclude that the Fisher hypothesis is generally consistent with postwar data once we recognize that agents have been forced to form expectations from an inflation process that has undergone several structural changes in the post war period and that their results simply suffer from small sample bias. Liu and Adedeji (2000), Ubide (1997), Leheyda (2005), and Khan and Schimmelpfennig (2006) have recorded clear ideas about the determinants of inflation in developing countries.

Most of the studies stress money supply as the major source of inflation in the respective economies. Taslim (1982) attempted to analyze the inflationary process

in Bangladesh in light of the structuralize monetarist controversy using the data for FY60 to FY80. The author systematically tested both the views in the context of Bangladesh as well as a hybrid model considering both views together. Martin Evans and Karen Lewis (1995) characterize the shifts in inflation by a Markov switching model. They argue that rational anticipations of infrequent shifts in the inflation process induce significant small sample biases in estimates of the long-run Fisher relationship. These small sample biases may create the appearance of permanent shocks to the real rates even when none are truly present. They examine the long-run relationship between nominal interest rates and inflation and are unable to reject the hypothesis that in the long-run nominal interest rates reflect expected inflation one-for-one

Need and Importance

Level of inflation always has a bearing on the interest rates. The interest rate is a key financial variable that affects decisions of consumers, business firms, financial institutions, professional investors and policy makers. Timely forecasts of inflation rates can therefore provide valuable to financial market participants. Forecasts of interest rates can also help to reduce interest rate risks faced by individuals and firms. In Bangladesh context the relationship between anticipated inflation changes and returns were not of much concern due to administered interest rate mechanism. Since the economic reforms and the liberalization of capital market the interest rates are market determined. The earlier findings report that no relationship between interest rates observed at point of time and rates of subsequently observed inflation exist. However the general finding is that there are relationships between current rates of interest and past rates of inflation. If interest rates are not adjusted for changes in inflation then the real rate of return decreases. Expected price changes have a bearing on the purchasing power, thus on the level of consumption also. Hence interest rate determination in Bangladesh context also needs focus.

Research Methodology

This study has been carried out on the basis of secondary data collected from the official web sites of Bangladesh Bank and Bangladesh Bureau of Statistics to check the relationship between inflation and bank lending rate for the last 10 years from 2002 to 2011. The stationarity of data have been tested by using augmented dickey fuller and further processed these data to test the relationship between the variables (inflation and bank lending rate) by using Engel-Granger Co-integration technique.

Augmented Dickey–Fuller test (ADF) is a test for a unit root in a time series sample. It is an augmented version of the Dickey–Fuller test for a larger and more complicated set of time series models. The augmented Dickey–Fuller (ADF) statistic, used in the test, is a negative number. The more negative it is, the stronger the rejection of the hypothesis that there is a unit roots at some level of confidence.

The testing procedure for the ADF test is the same as for the Dickey–Fuller test but it is applied to the model

$$\Delta y_t = \alpha + \beta t + \gamma y_{t-1} + \delta_1 \Delta y_{t-1} + \dots + \delta_{p-1} \Delta y_{t-p+1} + \varepsilon_t,$$

where α is a constant, β the coefficient on a time trend and p the lag order of the autoregressive process. Imposing the constraints $\alpha = 0$ and $\beta = 0$ corresponds to modeling a random walk and using the constraint $\beta = 0$ corresponds to modeling a random walk with a drift.

By including lags of the order p the ADF formulation allows for higher-order autoregressive processes. This means that the lag length p has to be determined when applying the test. One possible approach is to test down from high orders and examine the t-values on coefficients. An alternative approach is to examine information criteria such as the Akaike information criterion, Bayesian information criterion or the Hannan-Quinn information criterion.

The unit root test is then carried out under the null hypothesis $\gamma = 0$ against the alternative hypothesis of $\gamma < 0$.

$$DF_\tau = \frac{\hat{\gamma}}{SE(\hat{\gamma})}$$

Once a value for the test statistic is computed it can be compared to the relevant critical value for the Dickey–Fuller Test. If the test statistic is less (this test is non-symmetrical so we do not consider an absolute value) than (a larger negative) the critical value, then the null hypothesis of $\gamma = 0$ is rejected and no unit root is present.

The intuition behind the test is that if the series is integrated then the lagged level of the series (y_{t-1}) will provide no relevant information in predicting the change in y_t besides the one obtained in the lagged changes (Δy_{t-k}). In that case the $\gamma = 0$ null hypothesis is not rejected.

A model that includes a constant and a time trend is estimated using sample of 50 observations and yields the DF_τ statistic of -4.57 . This is more negative than the tabulated critical value of -3.50 , so at the 95 per cent level the null hypothesis of a unit root will be rejected (Elliott, G., Rothenberg, T. J. & J. H. Stock, 1996)

Hypothesis on stationarity of data

Null hypothesis: H_1 : Time Series Data is Stationary

Alternative hypothesis: H_0 : Time Series Data is Non Stationary

Result and Discussion

Testing of stationarity

For interest rates

Null Hypothesis: D(t-series) has a unit root		
Exogenous: Constant		
Lag Length: 0 (Automatic Based on AIC, MAXLAG=0)		
	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-4.273113	0.014674
Test critical values:		
	1% level	-4.581538
	5% level	-3.321041
	10% level	-2.801304

Interpretation

The data is stationery at 5% critical value.

For inflation rate:

Null Hypothesis: D(tseries) has a unit root		
Exogenous: Constant		
Lag Length: 0 (Automatic Based on AIC, MAXLAG=0)		
	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-4.320802	0.013827
Test critical values:		
	1% level	-4.581538
	5% level	-3.321041
	10% level	-2.801304

Interpretation

The data is stationary at 5% critical value.

Co-integration

Since interest rate and inflation data series are proved to be Stationary, now test for co integration is executed to evaluate if these two are linearly related. *Engel-Granger Co-integration* technique is utilized in this study due to its simplicity and reliability. The residuals obtained are tested for Stationarity using ADF test. If this residual series is proved to be stationary then it can be said that a relationship exists between interest rates and inflation over a long term.

Regression

A regression of interest rate on inflation is run using both MS Excel and SPSS. The output of the regression is as follows.

Output	Interest rate on inflation
Observations	10.000
Sum of weights	10.000
DF	9.000
R ²	0.147
Adjusted R ²	0.025

Analysis of variance:					
Source	DF	Sum of squares	Mean squares	F	Pr > F
Regression	1	6.405	6.405	1.209	0.308
Residual	8	37.082	5.297		
Total	9	43.486			
<i>Computed against model Y=Mean(Y)</i>					

Model parameters:						
Source	Value	Standard error	t	Pr > t	Lower bound (95%)	Upper bound (95%)
Intercept	4.769	3.041	1.568	0.161	-2.426	11.964
5.4	0.497	0.452	1.100	0.308	-0.573	1.568

Observation	Pred(9.65)	Residual
Obs1	7.654	1.836
Obs2	6.311	0.569
Obs3	7.555	-2.625
Obs4	7.754	1.816
Obs5	8.251	2.859
Obs6	8.350	-0.980
Obs7	9.678	0.562
Obs8	8.082	-3.692
Obs9	8.405	-0.345
Obs10	8.734	-0.187

Next, we check the stationarity of the residuals obtained. If the residuals are stationary, then the two variables are said to co-integrate with each other. i.e., there exists a relationship between inflation and interest rates.

The results obtained are as follows;

Null Hypothesis: D(tseries) has a unit root			
Exogenous: Constant			
Lag Length: 0 (Automatic Based on AIC, MAXLAG=0)			
		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.773237	0.032243
Test critical values:	1% level	-4.801997	
	5% level	-3.403396	
	10% level	-2.841690	

Findings

The above results show that there is stationary at 5% critical value. Hence, there might be some relationship between the two. However, also keeping in view the regression statistics, i.e., the values of F-test and significance of the test, it can be said that there is no significant relationship between interest rates and inflation.

Conclusion

This paper has attempted to study the existence of relationship between interest rates and inflation. The data has been tested for stationarity and then put to further use. The stationarity was tested using the Augmented Dickey Fuller test (ADF) which revealed that the data was stationary for interest rate and inflation. The persistence of a relationship between interest rates and inflation was tested using the Engle Granger co-integration test. This test involves running a regression of long term interest rates on inflation. The test throws up a list of residuals. These residuals are then tested for stationarity, the result of which proves the existence of a relationship. This test showed feeble relationship between the two for the particular study period. From the above ADF and Granger co-integration test, it can be said the there is no significant relationship between interest rates and inflation during the period of study .i.e., from 2002 to 2011.

Scope for Further Study

This research showed the effect of inflation on interest rates. Apart from inflation, there are other factors which influence interest rates, so further research can be done on other factors like deferred consumption, alternative investments, risk of investment, liquidity preference etc.

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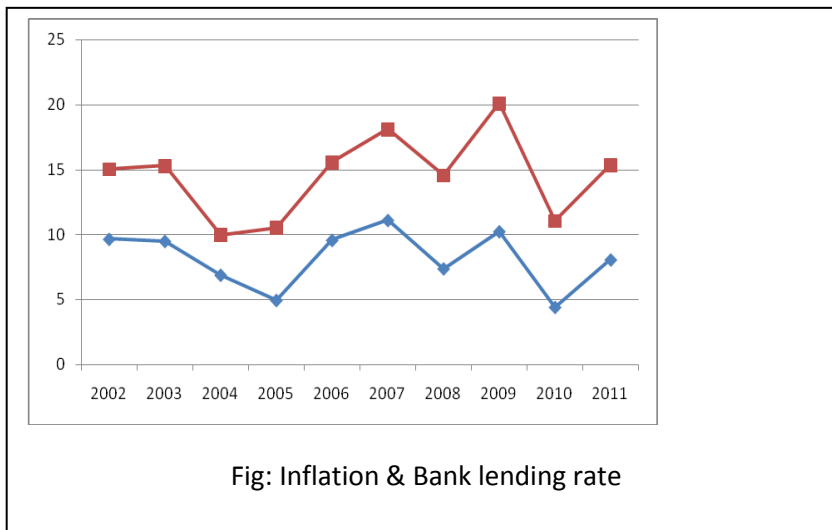
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Appendix

Interest rates and inflation rates from 2002 to 2011

Year	Interest rate	Inflation rate
2002	9.65	5.40
2003	9.49	5.80
2004	6.88	3.10
2005	4.93	5.60
2006	9.57	6.00
2007	11.11	7.00
2008	7.37	7.2
2009	10.24	9.87
2010	4.39	6.66
2011	8.06	7.31

Source: Bangladesh Bank and Bangladesh Bureau of Statistics



Stock Market Returns on Newsweek 500 Green Companies: Analysis of Broad Market Indices in US

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Abstract

“Going green” is no longer a fringe topic. Going green is about sustainability. Corporations exhaust resources, pollute the environment, generate large amount of waste and engage themselves in tons of unsustainable practices. These practices become an expense to the nation. Businesses are finding ways to protect the environment, particularly through developing standards and green certification programs. Some corporations are responding to the requirements of consumers to buy products with less impact on the environment. Interestingly, investors are also prepared to put their money into green businesses because they see that sustainable practices are actually more profitable in the long term. Recent developments in technology have made it easier to protect the environment, and many businesses have learned that a sustainable supply chain is a valuable asset. This paper examines whether the market returns of those companies that are ranked as “green companies” by Newsweek meet the broad market returns.

Keywords: Sustainability, Green practices, Green ranking

Introduction

With the growth in corporate responsibility efforts over the last two decades has come an increasing number of questions about whether and how investors value these initiatives. The recent financial crisis has brought improved attention to the investor perspective and potentially an opportunity to increase the consideration of companies’ social and environmental performance in investment analyses. Many companies have also begun asking how they can evolve their communications on Environmental, Social, and Governance factors to these mainstream investors. In the past few years, topics in global warming and climate change have moved high on the international agenda. There is new impetus for U.S. companies to make energy-efficient, or green, choices. To improve the quality of living, the perception of “green investing” is costly has changed. People are calling for corporations to make changes and some are even willing to pay more for corporations to produce greener products.

Green Building

Companies are taking green building and the subsequent savings in energy, natural resources, and money seriously. The savings to companies can be large.

Green Energy

Technology advances are also leading U.S. corporations to increase the amount of alternative energy they use. And government incentives are making alternative energy, such as solar and wind power, economically feasible. Companies are also finding less expensive ways to incorporate green energy

Green Operations

Businesses are serious about reducing the amount of energy they use to run their operations. The focus for most companies today is developing a “sustainable” supply chain — one that is robust enough to support itself and actually improve the environment. By moving toward a sustainable green supply chain, companies will uncover new opportunities to reduce costs.

Rise of Corporate Stakeholders

In recent years, U.S. corporations have reduced environmental emissions and in response to pressures from governments, investors, environmental groups, customers, and employees are developing pollution prevention strategies. Increasingly, corporate leaders see that managing environmental issues effectively can be a significant source of competitive advantage and sustainable growth. The bottom line is that most American corporations now believe they can create a significant source of competitive advantage and sustainable growth by having effective environmental management. Being “green,” is seen as good business.

Power of Stakeholders

The key to modern corporate motivation is a company’s concern for building rapport with its stakeholders. Government policy makers, customers, environmental groups, investors, and employees constitute major stakeholders and exert pressures on shaping a firm’s environmental strategy. To reach out to these groups, companies use public disclosure and consultations about their activities and their impacts on the environment.

Government: Government regulation is a major driver of environmental policy. Exponential growth in environmental laws forces companies to anticipate and make investments to meet new requirements even before the laws are passed.

Customers: Customers, both as voters and as buyers of products and services, have a significant impact on environmental policy. According to a *USA Today*/Gallup Poll conducted in March 2007, more than 8 in 10 Americans consider that a company’s environmental record should be an important factor in deciding whether to buy its products.

Environmental Groups: Environmental organizations are using their power to develop tough regulations and also to extend the areas regulated. In addition, these organizations can take other actions that encourage companies to be green.

Investors: Poor environmental performance can increase costs, because companies that produce large quantities of waste tend to have a higher number of spills and hazardous waste sites, and serious compliance problems. Investors can hold corporations accountable for environmental performance by speaking directly with corporate management, filing shareholder resolutions, and voting against the management. If they are still not satisfied, they can withdraw their investment by selling their stocks. In recent years, shareholders have been successful in convincing major banks to consider the environmental risks of projects they consider financing, persuading computer manufacturers to increase the number of computers they recycle, and encouraging public utilities to invest in renewable energy.

Employees: Employees bear most of the impact of poor environmental practices. Attracting employees to work in unsafe surroundings is expensive, and workers and their unions often pressure companies to reduce pollution. If employees are ignored, they often respond by changing jobs or by mobilizing public support. Costs can also rise because of higher employee turnover. Companies respond by providing employee training on environmental health and safety and on environmental management systems.

Consumers Demand Green

Consumers seem to be recognizing what their consumption does to the environment. These consumers are smart, and they want the companies with which they do business to be smart as well. That means creating products that help consumers organize their lives, achieve personal and business success, look their best, feel their best and also that help them lower their carbon footprint. In today's world it is difficult not to be aware of the impact we are having on our limited resources. And it is that concern that has companies catering to consumers' desires to be less offensive to the environment. Indeed, "green" is the new buzzword making its way into the mainstream via commercials, television shows, company dossiers, and conferences. The environmental initiative has made its way to an industry infamous for depleting forests and gobbling up green spaces.

Corporate Executives on Going Green

Steve Ballmer, MICROSOFT CEO: Explaining that PCs and other technology still consume far too much electricity, Ballmer said: "The lowering of energy consumption is as important for us as new uses of software and IT for the environment." (2008, CeBit Technology Show in Hannover, Germany) [http://www.news.com/Ballmer-Microsoft-is-thinking-green/2100-1_1392_3-6233152.html?tag=item]

Steve Jobs, APPLE CEO: It is generally not Apple's policy to trumpet our plans for the future; we tend to talk about the things we have just accomplished. Unfortunately this policy has left our customers, shareholders, employees, and the industry in the dark about Apple's desires and plans to become greener. Our stakeholders deserve and expect more from us, and they're right to do so. They

want us to be a leader in this area, just as we are in the other areas of our business. So today we're changing our policy." (Apple Web site) [<http://www.apple.com/hotnews/agreenerapple/>]

Jeffrey Immelt, General Electric Chairman and CEO: "We looked across our company and recognized that a focus on environmental technology could be a big business initiative for the company. The concept we worked on at the time was this notion that green is green. In other words, the time had come that, through technology, we felt like we could create a good business initiative to focus on conservation and greenhouse gas emission reduction and do good business at the same time." (2007, interview with VerdeXchange News) [<http://www.verdexchange.org/node/82>]

The Greenest Big Companies in America

When David Roberts was growing up near the oilfields of West Texas in the early 1960s, it never got dark and the oilfields were lit 24/7 by the gas flares used to burn off natural gas, a by-product of oil drilling. The flares released massive amounts of CO₂, and over time, oil companies halted that harmful practice in the U.S. But gas flares remain the norm in the developing world—and today Roberts oversees a team at Marathon Oil that's trying to end the practice. In 2007, Marathon opened a \$1.5 billion liquid-natural-gas plant in Equatorial Guinea to capture the natural gas that once went up in smoke. The plant is one factor that helped Marathon, No. 100 in Newsweek's Green Rankings, cut its CO₂ emissions by 40 per cent between 2004 and 2008—and the plant earns a profit.

It's a small example of how the economic case for going green is becoming more compelling. Economists view environmental damage as a classic "externality"—a cost that impacts society but isn't imposed on producers or consumers. But with scientific consensus that carbon emissions threaten our climate, there's growing political will to curb them, particularly with the global powers set to meet in Copenhagen in December. The Obama administration is pushing for a cap-and-trade system that would turn companies' emissions into a bottom-line cost. Smart companies are working to better understand—and cut—those emissions ahead of new regulations.

The inaugural Newsweek Green Rankings recognizes those efforts. For more than a year, the magazine worked with leading environmental researchers KLD Research & Analytics, Trucost, and CorporateRegister.com to rank the 500 largest U.S. companies based on their actual environmental performance, policies, and reputation. Ranking companies based on sustainability is a huge challenge. Some industries are far dirtier than others: a typical financial-services company exacts a smaller environmental toll than even the best-run utility or mining company. Also, many corporations are secretive about key environmental data, if they track the numbers at all. Even among companies that do report green data, there's no uniform standard, so their numbers often aren't comparable.

Despite those obstacles, the members worked hard to design a ranking system that makes sense. More than half of companies' overall Green Scores are based on their environmental policies and reputation, industry-neutral metrics that help even the playing field for companies in carbon-intensive businesses. To overcome limited corporate emissions numbers, Newsweek used data from Trucost, which has created a widely acclaimed system for estimating emissions of companies that fail to provide them. "One of the purposes of this is to improve the transparency of corporations...and encourage them to provide an even higher level of disclosure," says Thomas Kuh, KLD's managing director.

Many of the companies that finished in Top 100 are recognized leaders in sustainability. Intel, No. 4 in Newsweek's ranking, recently launched an initiative in which every employee's annual bonus is tied, in part, to how well the company does in meeting sustainability goals. Wal-Mart, No. 59, recently announced plans to create a Sustainability Index that will help consumers better understand which products sold in its stores are greener than others. Rankings inevitably provoke controversy and Newsweek hope is to open a conversation on measuring environmental performance an essential first step toward improving it.

Green Rankings 2009: Methodology

Newsweek collaborated with three research partners to compile the rankings: KLD Research & Analytics, which tracks environmental, social and governance data on companies worldwide and served as lead partner; Trucost, which specializes in quantitative environmental performance measurement; and CorporateRegister.com, the world's largest online directory of social responsibility, sustainability and environmental reporting. The goal was to assess each company's actual resource use and emissions and its policies and strategies, along with its reputation among its peers. The 500 companies included in the ranking are the largest U.S. companies as measured by revenue, market capitalization and number of employees. The companies are broken out into 15 sectors, based on the FTSE/Dow Jones Industry Classification Benchmark (ICB).

The GREEN SCORE for each company is based on three components: The ENVIRONMENTAL IMPACT SCORE, based on data compiled by Trucost, is a comprehensive and standardized quantitative performance measurement that captures the total cost of all environmental impacts of a corporation's global operations. Over 700 variables are summarized in the EIS. This figure is normalized against a company's annual revenues, so that companies of all sizes and industries can be compared.

The GREEN POLICIES SCORE, derived from data collected by KLD, reflects an analytical assessment of a company's environmental policies and performance. Its scoring model captures best-in-class policies, programs and initiatives, as well as regulatory infractions, lawsuits and community impacts, among other indicators. The REPUTATION SCORE is based on an opinion survey of corporate social responsibility (CSR) professionals, academics and other environmental experts

who subscribe to CorporateRegister.com. CEOs or high-ranking officials in all companies on the Newsweek 500 list were also invited to participate.

KLD, Trucost and CorporateRegister.com scored each company according to their specific methodologies, and then converted the results to Z-scores, a widely accepted statistical technique that measures how well a firm compares to the average score of the collective group. The overall Newsweek Green Score was calculated as the weighted sum of the three component Z-scores: 45 percent for the Environmental Impact Score, 45 percent for the Green Policies Score, which takes into consideration sector differences, so that various industries can be judged against each other and 10 percent for the Reputation Score, which also reflects sector analysis. The rankings also contain a column reporting each company's emissions of greenhouse gases (GHGs)—a reflection of the importance of GHGs as a key component in a corporation's environmental footprint. The GHG data for the rankings comes from Trucost. Newsweek.com contains additional GHG data reported by companies to KLD, Trucost and the Carbon Disclosure Project, which collects GHG data on over 2,500 companies worldwide.

This methodology and weightings were created in consultation with an independent advisory panel. The panel's members include: Daniel Esty, Hillhouse Professor of Environmental Law and Policy at Yale University; Marjorie Kelly, Senior Associate at the Tellus Institute and co-founder of Business Ethics; John Steelman, Climate Centre, National Resources Defense Council; Wood Turner, executive director of Climate Counts; and David Vidal, Global Corporate Citizenship Research Director, the Conference Board. Newsweek's editorial partner on the Green Rankings project is ASAP Media. Founded by journalists and editors Peter Bernstein and Annalyn Swan, ASAP Media specializes in magazine, book and web content development.

Environmental Impact Score

Four of the major elements that contribute to the overall EIS score (and which are broken out into separate columns) are: greenhouse gas emissions (including nine gases in total, with carbon dioxide the most important in many cases), water use (including direct, purchased and cooling), solid waste disposed, and acid rain emissions (sulphur dioxide, nitrogen oxide and ammonia), all normalized by revenue. All data included in the four columns comes from Trucost based on: standardized company reported data, fuel/resource use, and production based company estimates. Additionally, separate columns on toxic waste emissions and emissions normalized against a company's annual revenues are included. Emissions data is derived from the Toxic Release Inventory, a U.S. Environmental Protection Agency database of information on toxic chemical releases and waste management activities.

Green Policies Score

The main elements incorporated in the GPS score are: climate change policies and performance, pollution policies and performance, product impacts, environmental stewardship and environmental management.

Reputation Score

The opinion survey, which was done exclusively for Newsweek, went out to 13,000 CorporateRegister.com users, of whom 6,600 are located in the U.S. and 6,400 are based internationally. Of those surveyed, 4,500 were identified as "sector specialists"—those having a specific working knowledge of environmental issues within their industry—and were only asked to score their sector peers. Additionally, CEOs or high-ranking officials in all companies on the Newsweek 500 list were invited to participate. CEO scores were given a weight of "3," sector specialists a weight of "2," and other participants a weight of "1." Any scores given to a company by its own employees were disregarded.

The survey asked respondents to rate companies as "leaders" or "laggards" in five key "green" areas: green performance, commitment, communications, track record and ambassadors. There were a total of 808 respondents or a six percent response rate, a far higher response than is typical of most public opinion polls reported in the media.

Z-scores

For presentation purposes, KLD mapped the overall Green Score, the Green Policies Score and the Reputation Survey Z-scores to a 100 point scale, with the Environmental Impact Score mapped to a 100 point scale using Trucost's underlying environmental impact ratio scores. It is important to note that because of the mapping to a 100-point scale, a 45-45-10 weighting applied to each individual component will not result in the overall Green Score.

Need for the Study

With the recent drive to try and preserve the environment and reduce harmful emissions companies are increasingly realizing that going green could be a new way for companies to save or even make things greener. The trend toward going green is extending beyond the most obvious polluters, and reaching companies ranging from big Wall Street firms to technology mainstays. The average person might believe that the worldwide push to "go green" is coming solely from politicians and concerned citizens.

In fact, this is not the case! In recent years, many big-name companies have realized their way towards more sustainable and eco-friendly business practices. Companies ranging from retailing titan Wal-Mart to investment firm Goldman Sachs are jumping on the green bandwagon and pledging to make tangible changes that go beyond the public relations-oriented "green washing" of years past. Most business leaders now recognize that they need to take new measures to reduce their companies' effects on the environment.

Thus this study focuses on analysis whether the market returns of those companies that are ranked as "green companies" by Newsweek meet the broad market returns.

Objectives of the Study

To assess whether companies that embrace eco-friendly practices gives a stock market return lesser than the returns given by the broad market.

- To find out the stock market returns for each of the company that is ranked by the Newsweek in a 1 year, 2 year, 3 year, 4 year & 5 year time frame.
- To find out where the annual stock return of the companies at least meet the broad market return.
- To find out the average returns given by the following clusters for a 1 year, 2 year, 3 year, 4 year & 5 year time frame
 - ✓ Top 50 companies
 - ✓ Top 100 companies
 - ✓ Top 250 companies
 - ✓ All 500 companies in the list
- To calculate the returns for the indices mentioned below for a 1 year, 2 year, 3 year, 4 year & 5 year time frame.
 - ✓ Dow Jones Industrials (DJI)
 - ✓ Dow Jones Composite (DJA)
 - ✓ S&P 500 (GSPC)
 - ✓ NYSE Composite (NYA)
 - ✓ NASDAQ Composite (IXIC)
 - ✓ Dow Jones Wilshire (DWC)
 - ✓ Russell 3000 (RUA)
- To find out the average returns given by the following clusters for a 1 year, 2 year, 3 year, 4 year & 5 year time frame
 - ✓ 1-100 companies
 - ✓ 101-200 companies
 - ✓ 201-300 companies
 - ✓ 301-400 companies
 - ✓ 401-500 companies
- To compare and contrast the average returns of the cluster and the returns of the indices for a 1 year, 2 year, 3 year, 4 year & 5 year time frame.

Review of Literature

Asset Management Working Group (AMWG), the United Nations Environment Programme Finance Initiative and Mercer. (2007) "Demystifying Responsible Investment Performance; A Review of Key Academic and Broker Research on ESG Factors".

"There is already explicit evidence and acknowledgment of the materiality of ESG factors and its influence in driving business strategy. Addressing ESG factors appears to be currently centered on improving risk management, mainly for large caps. The opportunity side is largely viewed through a thematic lens, mainly for small and mid-caps, with a primary focus on environmental aspects."

Larson, Andrea. (2008) "Screening Investments of Stakeholders: Socially Responsible Investing in the United States". Vol., pp. 1-16,. Available at SSRN: <http://ssrn.com/abstract=909027>. Accessed: Nov. 13, 08.

The goal of socially responsible investing (SRI) is to provide capital to the companies that are socially and environmentally responsible and to deny capital to the ones that are not. SRI involves integrating personal values and societal concerns with investment decisions so as to promote greater corporate responsibility. This technical note discusses the concept and three key strategies of SRI: screening, shareholder advocacy, and community investment. It also traces recent developments in SRI, from the 1960s to 2003. The note gives students an understanding of the rapid growth and performance of socially and environmentally screened investment funds.

Statman, Meir. (2007) "Socially Responsible Investors and Their Advisors". Santa Clara University - Department of Finance. Available at SSRN: <http://ssrn.com/abstract=997085> Accessed: Nov. 14, 2008.

This article presents four financial advisors who advise socially responsible investors. They tell about the life experiences that have drawn them to socially responsible investing and offer lessons about serving socially responsible clients. Socially responsible investors are not only screening their investment choices, but some are also actively involved in changing the behavior of the firms in which they do invest. "We try to find good companies that we can help improve. Clients might be happy to hold a company that's great on human rights but has a lot of work to do on its environmental record as long as they know we're working with the company to improve its record. So our activism complements our investment process".

Dupre, Denis and Girerd-Potin, Isabelle. (2004) "The Philosophical, Ethical and Economic Foundations of Ethical Investment". Available at SSRN: <http://ssrn.com/abstract=497223>. Accessed: Nov. 13, 08.

This paper is theoretical in nature, and offers a good overview of the conceptual underpinnings of ethical investment within a historical context, addressing the traditional Marxist-Capitalism debate in relation to ethical investing. It also relates John Rawls' theory of justice, and Amarty Sen's capabilities and entitlements theory to a discussion on investment decisions. The author makes bold statements about the transformed role of the nation state, alluding to the hollowing out of the state. This certainly invites empirical research to test this statement. Although it offers an interesting argument for the future of SRI initiatives, it makes for good background reading rather than a seminal piece shaping the future of SRI from a policy perspective.

Research Methodology

The study primarily focuses on those companies that are ranked green by the Newsweek. The suitable approach for the study falls under the category of Exploratory/Descriptive study. The study is categorized under exploratory study

because there is not much research done on this topic and review of literature related to the study is not available. It can be classified under Descriptive study because certain analysis has been done and conclusion has been drawn from them.

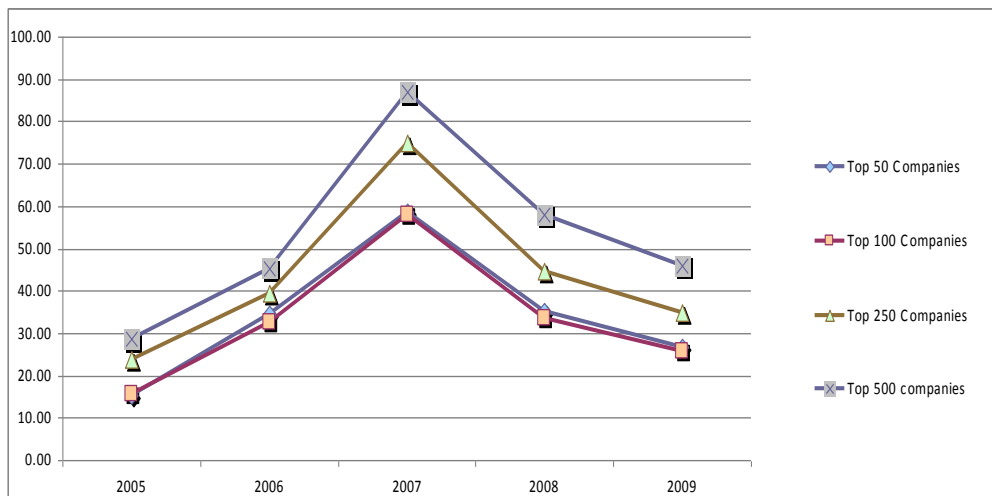
The population for the study includes all the companies listed in the US Stock Exchanges. The Sample of 500 companies is considered for the study. These companies are ranked as “green companies” by the Newsweek during the year 2009. The sampling technique followed can be categorized into Non-Probability - Purposive Sampling because the information is obtained from a specific person/organization. The study consists of only secondary data. No primary data were collected for this study. The data was collected from Newsweek’s website and the Daily adjusted closing share price of the sample was collected from the Yahoo website. (Yahoo Finance)

The following tools were used for analysis

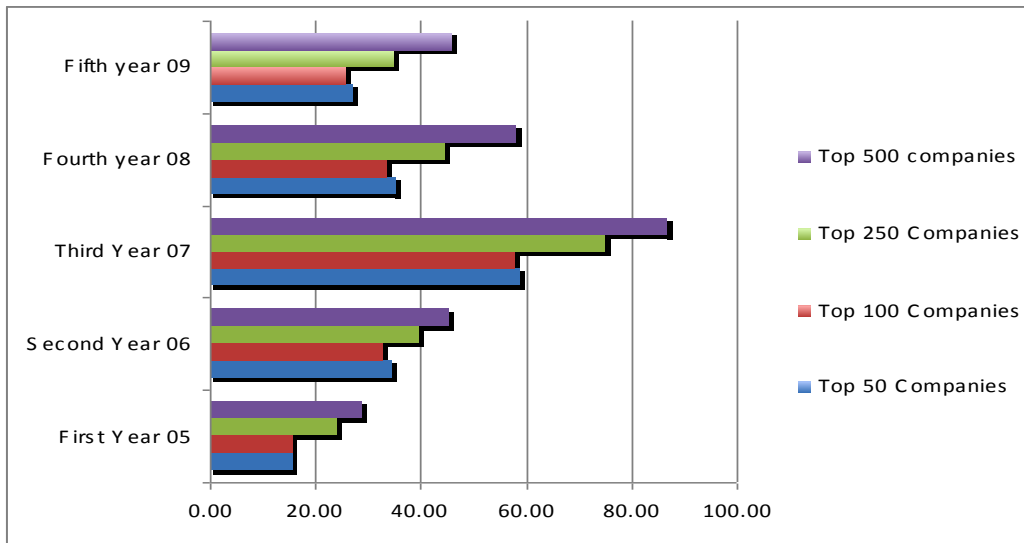
$$\text{Return} = \frac{\text{Ending price} - \text{Beginning price}}{\text{Beginning price}} \times 100$$

Analysis and Interpretation

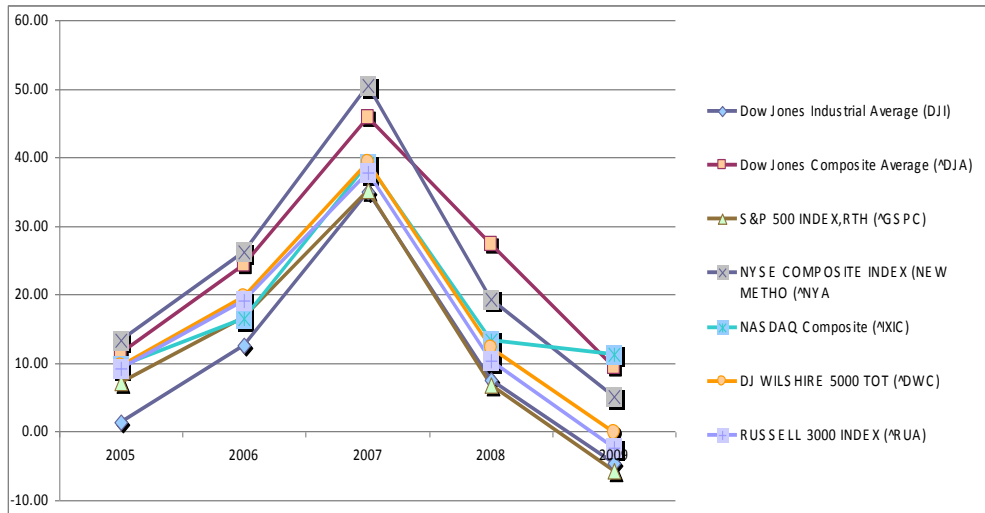
Graph No 1: Average Returns (In %) for the Top Companies



Graph No 1a: Average Returns (In %) for the Top Companies



Graph No 2: Average Returns (In %) for the Indices



Graph No 2a: Average Returns (In %) for the Indices

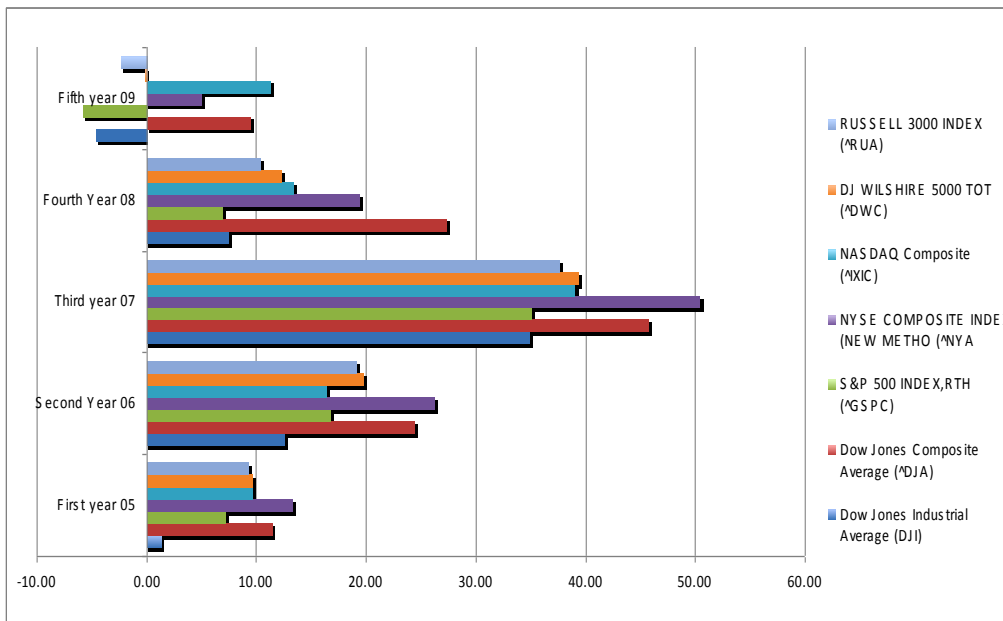


Table No 1: Comparison of the Dow Jones Composite Average (DJA) against Top Companies

Dow Jones Composite Average (DJA)	11.45	24.41	45.75	27.33	9.46
Top 50 Companies	15.39	34.57	58.71	35.08	26.86
Top 100 Companies	15.70	32.69	57.83	33.53	25.80
Top 250 Companies	23.84	39.48	74.94	44.53	34.95
Top 500 companies	28.82	45.31	86.92	58.07	45.97

Table No 1a: The Performance of the Dow Jones Composite Average (DJA) against Top Companies

Top 50 Companies	3.9433679	10.161060	12.956845	7.755896	17.3998
	7	7	7	8	6
Top 100 Companies	4.2539368	8.2760154	12.071532	6.203460	16.3349
	4		6	2	
Top 250 Companies	12.394695	15.063268	29.186466	17.20169	25.4814
	5	2	2	6	3
Top 500 companies	17.377354	20.898951	41.162786	30.74709	36.5105
	6	2	9	4	6

The above table shows the performance of the top companies against the Dow Jones Composite Average. The performance table depicts the % by which the top companies have outperformed the Index.

Table No 2: Comparison of the S&P 500 Index against Top Companies

S&P 500 INDEX	7.16	16.71	35.11	6.89	-5.72
Top 50 Companies	15.39	34.57	58.71	35.08	26.86
Top 100 Companies	15.70	32.69	57.83	33.53	25.80
Top 250 Companies	23.84	39.48	74.94	44.53	34.95
Top 500 companies	28.82	45.31	86.92	58.07	45.97

Table No 2a: Performance of the S&P 500 Index against Top Companies

Top 50 Companies	8.227227	17.86149	23.60485	28.19527	32.58783
Top 100 Companies	8.537795	15.97645	22.71954	26.64283	31.52287
Top 250 Companies	16.67855	22.7637	39.83447	37.64107	40.66939
Top 500 companies	21.66121	28.59939	51.81079	51.18647	51.69852

The above table shows the performance of the top companies against the S & P 500 Index. The performance table depicts the % by which the top companies have outperformed the Index.

Table No 3: Performance of the NYSE Composite Index (NYA) against Top Companies

Top 50 Companies	2.097262	8.340657	8.22825	15.70554	21.80801
Top 100 Companies	2.407831	6.455611	7.342937	14.1531	20.74305
Top 250 Companies	10.54859	13.24286	24.45787	25.15134	29.88958
Top 500 companies	15.53125	19.07855	36.43419	38.69674	40.91871

The above table shows the performance of the top companies against the NYSE Composite Index. The performance table depicts the % by which the top companies have outperformed the Index.

Table No 4: Comparison of the NASDAQ Composite (IXIC) against Top Companies

NASDAQ Composite (IXIC)	9.65	16.48	39.04	13.42	11.29
Top 50 Companies	15.39	34.57	58.71	35.08	26.86
Top 100 Companies	15.70	32.69	57.83	33.53	25.80
Top 250 Companies	23.84	39.48	74.94	44.53	34.95
Top 500 companies	28.82	45.31	86.92	58.07	45.97

Table No 4a: Performance of the NASDAQ Composite (IXIC) against Top Companies

Top 50 Companies	5.737514	18.09572	19.67008	21.66477	15.57607
Top 100 Companies	6.048083	16.21068	18.78477	20.11233	14.51112
Top 250 Companies	14.18884	22.99793	35.8997	31.11057	23.65764
Top 500 companies	19.1715	28.83361	47.87602	44.65597	34.68677

The above table shows the performance of the top companies against the NASDAQ Composite. The performance table depicts the % by which the top companies have outperformed the Index.

Table No 5: Comparison of the DJ WILSHIRE 5000 TOT (DWC) against Top Companies

DJ WILSHIRE 5000 TOT (DWC)	9.64	19.76	39.32	12.28	-0.09
Top 50 Companies	15.39	34.57	58.71	35.08	26.86
Top 100 Companies	15.70	32.69	57.83	33.53	25.80
Top 250 Companies	23.84	39.48	74.94	44.53	34.95
Top 500 companies	28.82	45.31	86.92	58.07	45.97

Table No 5a: Performance of the DJ WILSHIRE 5000 TOT (DWC) against Top Companies

Top 50 Companies	5.74807968 3	14.811941 9	19.3953 1	22.8031 8	26.9556 6
Top 100 Companies	6.05864856 1	12.926896 6	18.51	21.2507 4	25.8907
Top 250 Companies	14.1994072	19.714149 4	35.6249 3	32.2489 8	35.0372 3
Top 500 companies	19.1820663 2	25.549832 3	47.6012 5	45.7943 7	46.0663 6

The above table shows the performance of the top companies against the DJ WILSHIRE 5000 TOT. The performance table depicts the % by which the top companies have outperformed the Index.

Table No 6: Comparison of the RUSSELL 3000 INDEX (RUA) against Top Companies

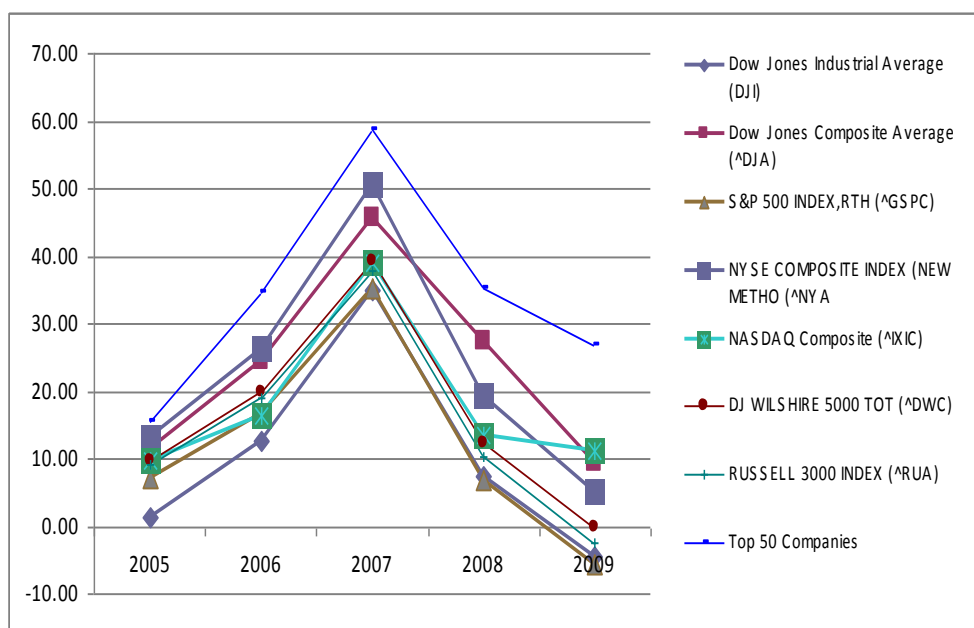
RUSSELL 3000 INDEX (RUA)	9.25	19.07	37.72	10.37	-2.36
Top 50 Companies	15.39	34.57	58.71	35.08	26.86
Top 100 Companies	15.70	32.69	57.83	33.53	25.80
Top 250 Companies	23.84	39.48	74.94	44.53	34.95
Top 500 companies	28.82	45.31	86.92	58.07	45.97

Table No 6a: Performance of the RUSSELL 3000 INDEX (RUA) against Top Companies

Top 50 Companies	6.139332	15.50503	20.98734	24.71535	29.22525
Top 100 Companies	6.449901	13.61998	20.10203	23.16292	28.16029
Top 250 Companies	14.59066	20.40723	37.21697	34.16115	37.30681
Top 500 companies	19.57332	26.24292	49.19329	47.70655	48.33594

The above table shows the performance of the top companies against the Russell 3000 Index. The performance table depicts the % by which the top companies have outperformed the Index.

Graph No. 3: Top 50 Companies



It can be inferred from the above graph that the top 50 companies has outperformed all the indices for the period ranging 2005-2009.

Table No 7: Comparison of the Top 50 Companies against the Indices

Top 50 Companies	15.39	34.57	58.71	35.08	26.86
Dow Jones Industrial Average (DJI)	1.30	12.58	34.90	7.52	-4.55
Dow Jones Composite Average (DJA)	11.45	24.41	45.75	27.33	9.46
S&P 500 INDEX, RTH (GSPC)	7.16	16.71	35.11	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.29	26.23	50.48	19.38	5.06
NASDAQ Composite (IXIC)	9.65	16.48	39.04	13.42	11.29
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.76	39.32	12.28	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.07	37.72	10.37	-2.36

Table No 8: Comparison of the Top 100 Companies against the Indices

Top 100 Companies	15.70	32.69	57.83	33.53	25.80
Dow Jones Industrial Average (DJI)	1.30	12.58	34.90	7.52	-4.55
Dow Jones Composite Average (DJA)	11.45	24.41	45.75	27.33	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.71	35.11	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.29	26.23	50.48	19.38	5.06
NASDAQ Composite (IXIC)	9.65	16.48	39.04	13.42	11.29
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.76	39.32	12.28	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.07	37.72	10.37	-2.36

Table No 9: Comparison of the Top 250 Companies against the Indices

Top 250 Companies	23.84	39.48	74.94	44.53	34.95
Dow Jones Industrial Average (DJI)	1.30	12.58	34.90	7.52	-4.55
Dow Jones Composite Average (DJA)	11.45	24.41	45.75	27.33	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.71	35.11	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.29	26.23	50.48	19.38	5.06
NASDAQ Composite (IXIC)	9.65	16.48	39.04	13.42	11.29
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.76	39.32	12.28	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.07	37.72	10.37	-2.36

Table No 10: Comparison of the Top 500 Companies against the Indices

Top 500 companies	28.8 2	45.3 1	86.9 2	58.0 7	45.9 7
Dow Jones Industrial Average (DJI)	1.30	12.5 8	34.9 0	7.52	-4.55
Dow Jones Composite Average (DJA)	11.4 5	24.4 1	45.7 5	27.3 3	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.7 1	35.1 1	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.2 9	26.2 3	50.4 8	19.3 8	5.06
NASDAQ Composite (IXIC)	9.65	16.4 8	39.0 4	13.4 2	11.2 9
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.7 6	39.3 2	12.2 8	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.0 7	37.7 2	10.3 7	-2.36

Table No 11: Comparison of the Top 1-100 Companies against the Indices

Top 1 - 100	15.7 0	32.6 9	57.8 3	33.5 3	25.8 0
Dow Jones Industrial Average (DJI)	1.30	12.5 8	34.9 0	7.52	-4.55
Dow Jones Composite Average (DJA)	11.4 5	24.4 1	45.7 5	27.3 3	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.7 1	35.1 1	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.2 9	26.2 3	50.4 8	19.3 8	5.06
NASDAQ Composite (IXIC)	9.65	16.4 8	39.0 4	13.4 2	11.2 9
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.7 6	39.3 2	12.2 8	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.0 7	37.7 2	10.3 7	-2.36

Table No 12: Comparison of the Top 101-200 Companies against the Indices

Top 101 – 200	32.4 4	45.8 0	91.5 1	54.8 8	44.9 2
Dow Jones Industrial Average (DJI)	1.30	12.5 8	34.9 0	7.52	-4.55
Dow Jones Composite Average (DJA)	11.4 5	24.4 1	45.7 5	27.3 3	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.7 1	35.1 1	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.2 9	26.2 3	50.4 8	19.3 8	5.06
NASDAQ Composite (IXIC)	9.65	16.4 8	39.0 4	13.4 2	11.2 9
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.7 6	39.3 2	12.2 8	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.0 7	37.7 2	10.3 7	-2.36

Table No 13: Comparison of the Top 201-300 Companies against the Indices

Top 201 - 300	29.9 6	45.7 2	88.6 4	61.0 3	46.9 6
Dow Jones Industrial Average (DJI)	1.30	12.5 8	34.9 0	7.52	-4.55
Dow Jones Composite Average (DJA)	11.4 5	24.4 1	45.7 5	27.3 3	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.7 1	35.1 1	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.2 9	26.2 3	50.4 8	19.3 8	5.06
NASDAQ Composite (IXIC)	9.65	16.4 8	39.0 4	13.4 2	11.2 9
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.7 6	39.3 2	12.2 8	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.0 7	37.7 2	10.3 7	-2.36

Table No 14: Comparison of the Top 301-400 Companies against the Indices

Top 301 - 400	28.08	49.14	97.40	57.97	44.35
Dow Jones Industrial Average (DJI)	1.30	12.58	34.90	7.52	-4.55
Dow Jones Composite Average (DJA)	11.45	24.41	45.75	27.33	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.71	35.11	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.29	26.23	50.48	19.38	5.06
NASDAQ Composite (IXIC)	9.65	16.48	39.04	13.42	11.29
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.76	39.32	12.28	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.07	37.72	10.37	-2.36

Table No 15: Comparison of the Top 401-500 Companies against the Indices

Top 401 - 500	38.92	53.64	100.12	84.44	68.27
Dow Jones Industrial Average (DJI)	1.30	12.58	34.90	7.52	-4.55
Dow Jones Composite Average (DJA)	11.45	24.41	45.75	27.33	9.46
S&P 500 INDEX,RTH (GSPC)	7.16	16.71	35.11	6.89	-5.72
NYSE COMPOSITE INDEX (NEW METHO (NYA)	13.29	26.23	50.48	19.38	5.06
NASDAQ Composite (IXIC)	9.65	16.48	39.04	13.42	11.29
DJ WILSHIRE 5000 TOT (DWC)	9.64	19.76	39.32	12.28	-0.09
RUSSELL 3000 INDEX (RUA)	9.25	19.07	37.72	10.37	-2.36

Findings

- The pattern of returns from the green rated companies is similar to the market returns except the fact that they outperform the indices.
- The Top 50,100,250 and 500 companies have outperformed the various indices like_Dow Jones Industrials (DJI), Dow Jones Composite (DJA) , S&P 500 (GSPC) NYSE Composite (NYA) , NASDAQ Composite (IXIC) , Dow Jones Wilshire (DWC) Russell 3000 (RUA).

- It is also found that the cluster of 1-100, 101-200, 201-300, 301-400 and 401-500 has also outperformed the broad market return and gives better average returns than any indices selected for comparison, which indicates that a group of green rated companies perform better than the indices.
- It was found that the average return of top companies 401-500 is more than all others top companies (i.e. 1-100, 101-200, 201-300, 301-400) in the list, which tells us that companies ranked the last 100, perform financially better than first 400.
- It can be supported by fact that most of high profit making companies such as Chesapeake Energy, Diamond Offshore Drilling, and Occidental Petroleum are ranked in the last 100.
- As most group of ranked companies perform better than the indices compared in the study, it can be said that the companies present in indices are not able to match the returns that the green rated companies of Newsweek fetches.
- The average returns of all companies (i.e. 1-100, 101-200, 201-300, 301-400, 401-500) starts decreasing in fourth and fifth year, 2008 and 2009 respectively due to global “slowdown” , which affected all the companies listed in the stock market.

Recommendations

- Investors are demanding green products which have a lesser amount of impact on the environment and are willing to pay extra. Thus there lies a huge potential for companies that manufacture green/ eco-friendly products.
- Multiple Portfolios can be constructed using portfolio models like Markowitz model, CAPM model, MPT model etc. from the top 500 ranked companies.
- Investor who wants to invest in hardcore green companies can invest in the top 100 companies though they do not give higher returns when compared to the other companies in the list.
- Green companies are now gaining greater consumer acceptance and investors can invest their money in green businesses because sustainable practices are profitable in the long term.

Conclusion

It is understood from the study that the corporations in the USA have started realizing the need for going green. It is evident that the top ranked 500 green companies have outperformed the broad market return. Many companies have understood that environmental issues are a vital part of a company’s economic well-being. Multiple Portfolios’ can be constructed for the investors who are interested in investing in hardcore green companies.

From the analysis done it can be concluded that a new wave of environmental investors is looking at environmental protection as an opportunity, and they are investing in market sectors that are eco-friendly and are responsible. Investors now have a greater chance of making money by investing in these green

companies and the new technologies. Companies seem to be positive and are focusing on sustainability as it reduces cost and also helps to protect the environment. Many citizens throughout the world are demanding environmentally friendly products and it can be concluded from the study that the future of sustainability looks green.

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Public Policy Imperatives for Curbing Honour Killings in India

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Abstract

Rising incidence of honour killing in India has caught the attention of academics, civil society, media, and policy makers in recent times. Media reports have generated a nation-wide debate on the medieval phenomenon of honour killing in information age and knowledge society of 21st century. This paper explores the socio-psychological roots of honour killings. The author has also discussed crucial public policy imperatives that might stop honour killings in the country in due course of time.

Keywords: Honour killing, Public policy, India

Introduction

Honour killings is the meting out a brutal and barbaric death to a woman of the family desiring to marry against the wishes of the parents, having extra-marital and pre-marital relations, entering into a wedlock within the same gotra or outside one's caste or with a close relation from a different caste in the belief that it has brought a dishonour of alarming proportions upon the family, class or community. The All India Democratic Women's Association (AIDWA) which has launched a crusade against such oppressive acts and had submitted a draft of the standalone legislation for the Union Minister of Law and Justice had defined expressions, 'dishonour' and 'perceived to have brought dishonour' as acts of any person adopting a dress code which is unacceptable to his or her family or caste or class or community or caste panchayat, choosing to marry within or outside the *gotra* or caste or class or community against the wishes of his or her family or caste or community or caste panchayat and engaging in certain sexual relations which are unacceptable to his or her family or caste or class or community or caste panchayat. And the proviso states that all members of a body or group of the caste or class or community or caste panchayat, ordering the commission of any act by which death is caused, shall be deemed guilty of having committed such an act by virtue of their association with such caste panchayat or body or group of the caste or class or community.

Honour Killings – a global phenomenon

Honour Killings have been in vogue in various orthodox and socially backward communities and groups in many countries including Pakistan, Bangladesh, India, Turkey, Jordan and the Palestinian territories. The United Nations Population Fund had approximated that 5000 woman around the globe fall prey to killings in such manner. In Pakistan, a recent report by the Human Rights Commission of Pakistan stated that 64% women were mercilessly killed in the name of honour in 2009 up

by 13 per cent from 2008 when 574 such killings were reported. And such heinous killings were committed for a wide range of offences – marital infidelity, pre-marital sex, flirting, etc. In Turkey, June 2008 report by Human Rights Directorate reported that in Istanbul alone, there was one honour killing very week and over 1000 mere killed during the last five years. In the Iraq city of Basra, there were 47 killings in 2006. In the Gaza strip and the West Bank, it is believed that 3-4 women are killed every month in the name of saving honour. In the Hindu Kingdom of Nepal, the caste system is so deeply rooted and there have been instances of father-in-law threatening to kill the son-in-law because he belonged to another caste.

And such killings are not merely restricted to Middle East or South Asia alone. Developed countries (United States of America, Great Britain, Canada, Germany, Sweden and other parts of Europe) have also been a witness to such honour killings. On the basis of information that surfaced in response to the Iranian and Kurdish Women's request, it transpired that figures provided by 39 of 52 regional British constabularies reported 2823 honour attacks in 2010 and that such acts were prevalent among sections of South Asian immigrants.

India – a mute spectator to honour killings

In India, exploitation of women stems from deep-rooted social values and societal prejudices and there have been cold-blooded murders in the name of saving family pride. There have been in vogue barbaric and feudal practices and brutal murders by bigoted persons with feudal mind-set in the hallucinating belief that inter-community marriages and relationships will break society. Such oppressive, tyrannical, and draconian acts not only smack of male chauvinism but result in unabashed trampling of women's rights to live honorably.

Honour killings have of late become increasingly commonplace in many parts of the country-particularly in Haryana, Western Uttar Pradesh, Rajasthan and some parts of Bihar and Tamil Nadu. NGO Shakti Vahini in an analysis stated that sordid incidents of honour killings have been reported from all over the country and that in ninety per cent of the cases, the perpetrators of crime were from the girl's family. A study commissioned by the National Commission for Women found that seventy two percent of 326 cases documented over the year 2009-10 involved couples that entered into inter-caste marriages. Among the incidents that have rocked the nation in the recent past included the brutal killing of a young couple (Manoj and Babli) in Kaithal (Haryana) in June 2007 where the two were dragged out of the Haryana roadways bus, forced to drink poison by girl's family and bodies found in the canal with both their hands/feet tied and that of Nirupnama Pathak a journalist who had fallen in love with class-mate Priyabhanshu Ranjan was killed (June 2010) by her mother in Jharkhand because the boy was from a different caste.

Women folk have been subjected to such truant practices because of medievalism, male chauvinism, influence of religion, social control and fear of being ostracized from the society, rigid caste system, stereotyped mindset, lack of formal

governance in the rural areas and the preservation of perceived purity of their lineage.

In Haryana, *khap panchayats* (known as *katta panchayats* in Tamil Nadu) have been in existence for centuries framing laws for the community's benefit and protection. Over the years, *khaps* (social bodies) have emerged as an alternative dispute redressal mechanism in the villages. They opine that boys and girls in the same *gotra* are like brothers and sisters. These self-appointed courts issue dictates (*fatwas*) and act like kangaroo courts outside the judicial system. These panchayats harass and intimidate those who dare disobey them. They slap illegal fines, ostracize the kin of the bride and the bride groom, indulge in beatings and kill them, even hit with shoes, torture the young couples and urinate upon them. The politically influential *jats* wield extra-constitutional authority and throw veiled threats of reprisals. When the sessions court (March 2010) imposed death sentence on five people for their role in the Manoj-Babli murder treating it as belonging to the rarest of the rare category, there were talks of *mahapanchayat* (Kukurshetra – 12.10.10) threatening cutting off water supply to Delhi unless the Hindu Marriages Act, 1955 was amended to ban same *gotra* and same village marriages. The *khap* heads also openly, unabashedly and brazenly called for donations to support those who had been found guilty of the murder. These councils have behaved in a manner showing utter disregard to the law of the land.

These feudal practices are no doubt a slur on the nation and all public policy initiatives need to be geared to stem the rot. There is the imperative need for comprehensive and concerted actions instead of piece-meal solutions or indulging in dilly-dallying to placate influential sections and political bigwigs to garner votes. It has to be understood clearly that in any civilized society, the rule of the law must prevail and there can be one and only one source of authority- the State. And no other institution customary, feudal or traditional can or should dare to take the law into its own hands. There is the need for decisive government interventions as there can be no excuse to sanction senseless killings.

The political will

There is an impression that the political will to adopt a heads on approach to deal with the menace is lacking. There should be no glorification of those guilty of committing crimes in the name of honour. But eyeing vote banks, Bhupinder Singh Hooda, Haryana Chief Minister is on record opposing a law against honour killings. Similarly, *khaps* are backed by another Jat leader, Om Prakash Chautala, former Chief Minister. And to cap all, Navin Jindal, a pro-active young parliamentarian from the ruling Congress, is supportive of the *khaps'* 'banning' same-gotra marriages. The country would demand political leaders of all hues to sink their personal differences and egos and rise to the occasion to pave the way for all possible initiatives to ensure that the rule of law prevails and none is spared, however powerful he is. This will send a signal to the prospective law breakers.

The law-makers' positive approach

The law-makers owe it to the people to have a stringent law in place which appropriately and adequately punishes the guilty so that recurrence of this heinous crimes is nipped in the bud. There are conflicting views regarding the shape of the provisions to come. Some are of the view that the Indian Penal Code should be amended (adding a clause to Section 300) to deal with acts of harassment in the name of 'honour'.

There is another school of thought which rightly favours a standalone new comprehensive law to deal with such crimes. The All India Democratic Women's Association (AIDWA) has submitted a comprehensive draft law that makes private parties culpable for violation of fundamental rights in crimes and killings committed in the name of 'honour'. Some of the provisions of the said draft are contentious and are not likely to be approved. At least, the law-makers have been given a food for thought. And it would not be inappropriate to mention here that a panel headed by Women and Child Development Secretary too advocated (January 2012) in favour of a new comprehensive law to provide protection to couples from being charged with false cases of kidnapping and abduction on couples choosing their own partners.

The High Standards of Judiciary

The Indian judiciary is mature enough and has not shied away from judicial activism if need be. It has extended the contours of Articles 21 of the Constitution of India which provides that the State shall not deprive a person of his life and personal liberty except according to the procedure established by law. The Supreme Court has through a plethora of historic judgments upheld the right of life – a quality of life – to the persons. A bench of Supreme Court Justices H.S. Bedi and J.M. Panchel awarded (August 4, 2010) life sentence to three of accused who had caused the death of six persons of a family in a case of 'honour' killing in village Lakhanpur district Farrukhabad – Uttar Pradesh (10-11.8.1991). The Bench said,

“There is no manner of doubt that killing of six persons and wiping out almost the whole family on the flimsy ground of saving the honour of the family, would fall within the 'rarest of the rare' principle evolved by the Supreme Court and, therefore, the trial court was perfectly justified in imposing the capital punishment to the respondents. However, this court also noticed that the incident had taken place about 20 years ago. Further, the High Court had acquitted the respondents by a judgment dated April 12, 2002. Thereafter, nothing adverse against any of the respondents is reported to this court. To sentence the respondents to death after that acquittal in 2002 will not be justified on the facts and circumstances of this case.”

In another landmark judgment (April 2011), a bench of Justices Markandey Katju and Gyan Sudha Mishra, while dismissing the appeal filed by one Bhagwan Dass challenging life imprisonment awarded to him by a Delhi Sessions Court for killing his daughter as she was allegedly in an incestuous relationship with her cousin despite being married, directed courts to view such cases as the rarest of the rare

category for awarding death penalty to the convicts. It added that honour killing or inflicting atrocities on couples is wholly illegal and has to be ruthlessly stamped out. There is nothing honourable in such killings and in fact they are nothing but barbaric and shameful acts of murder committed by brutal, feudal-minded persons who deserve harsh treatment. Only this way we can stamp out such acts of barbarism. It further stated that it was necessary as a deterrent for such outrageous, uncivilized behaviour and that all those planning to perpetuate 'human' killings should know that gallows awaited them. And then there was the punch of the Supreme Court and entering the domain of public policy. It said that the District Magistrates and Superintendents of Police would be held directly liable for the administration's failure to stop '*khap panchayats*' from acting like kangaroo courts.

Mention may also be made of a case where Delhi High Court had once dismissed a public interest litigation (PIL) seeking amendment in the law to ban same *gotra* (sub-caste) marriages calling the petition 'a waste of time'.

The Police developmental role

The police are the most visible executive arm of the State. The police must shun colonial moorings and play an active and developmental role in ridding the society of social evils. It must be governed by the rule of law and uphold it without fear or favour. Active policing and preventive measures will surely help. There is no doubt about it.

Role of Civil Society

Last but not least, the role of the civil society is crucial. The opinion builders, the men who matter in various sections of the society, the moral leaders, the media, the NGOs have a duty to the society to educate the community, and raise strong voice against such practices. The religious preachers in the course of discourses, should condemn such inhuman acts where precious lives are lost in the name of fake honour. They must help change the mindset of the people. Violence against women, especially violence in the name of honour, and the dictates of *khap panchayats* must be one of their main areas of intervention.

[Note: The author has quoted court judgments from media reports published in The Times of India and Hindustan Times and benefitted immensely from the comprehensive coverage on honour killing in these newspapers while writing this essay.]

Corporation as a Vehicle of Tax Planning: Emerging Scenario

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Abstract

The current system of international taxation, based upon residence-based taxation, source-based taxation and separate entity accounting, has been found inadequate and outdated, even amounting to “*fiscal imperialism*” by developed countries. From automatic information exchange between transacting countries, to differential reserve requirements for dealings with offshore businesses, from greater transparency in accounting, to introduction of ‘Limitation on Benefits’ clauses into tax treaties, to greater pressure on low-tax jurisdictions to cooperate-- there are a great number of proposed measures. OECD has been pressing for international cooperation to enforce a uniform global tax system, which abolishes harmful tax practices, including tax havens. This paper provides a critique on corporation as a vehicle for tax planning especially in the backdrop of Vodafone judgment and proposed Direct Tax Code.

Keywords: Corporation, Tax Planning, Direct Tax Code

Introduction

“Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.”ⁱ

A crisis has emerged in international taxation jurisdictions, spurred largely by the creation and manipulation of offshore subsidiaries by Transnational Companies [TNCs], who blithely exploit the loosely-coordinated tax treaty systems and tax haven intermediaries to maximize their profits, without facing the “fair share” of their worldwide tax burden. Therefore, tax authorities globally have become more aggressive in dragging the overseas M&As by offshore TNCs which own Indian assets under the tax net.

The question that arises is whether Indian tax department does really have the legal authority to combat subversive stratagems of tax avoidance and tax evasion under the Income Tax Act, 1961 [hereinafter, ITA], the recently tabulated Direct Tax Code Bill, 2009 [hereinafter, DTC] and more importantly, as per the judicial precedent of the *McDowell* Ruling.

It becomes necessary then to analyze these dubious methods of tax planning in light of the above.

The Existence of *McDowell* Ruling

Tax Frustration & Mounting Pressure on Tax Authorities: Tax frustration occurs mainly in the form of “Tax Avoidance” (legal but undesirable activities which exploit loopholes in the tax system while still running parallel to the purpose of the law), and “Tax Evasion” (illegal activities that involve elements of concealment). Tax avoidance may be unethical, but is permissible, and has generally become a euphemism for ‘creative tax planning’; tax evasion is not.

Both activities have been reported to significantly reduce the corporate tax revenues collected by Developing Countries [DCs] to the tune of around US\$ 35-160bn (See Table Below). Tax evasion and tax avoidance, thus, considerably weaken revenue mobilization.

Table 1: Estimation of tax losses

Line		Low-income countries	Lower-middle-income countries	Upper-middle-income countries	Developing country total
[1]	Ratio of total trade volume to tax revenues	6.50	6.18	5.85	
[2]	Corporate tax rate	Per cent 31.2	30.2	25.0	
[3]	Tax/GDP ratio	Per cent 13.6	16.1	17.6	
[4]	Total tax revenues	US\$bn 158.0	531.5	638.6	
[5]	Tax lost to false invoicing and abusive transfer pricing	Per cent of current tax revenues 14.2	13.1	10.2	
[6]		US\$bn each year 22.4	69.6	65.3	157.3bn

It is no wonder, then, that large emerging economies like India, China and Brazil, have now been taking aggressive steps to strengthen India’s tax jurisdiction and evoke the tax-responsibility of TNCs.

The McDowell Ruling: The difference between Tax Evasion and Tax Avoidance was first explained by Lord Tomlin in *IRC v. Duke of Westminster*ⁱⁱ:

“Avoidance of tax is not tax evasion and, it carries no ignominy with it, anybody can so arrange his affairs so as to reduce the burden of tax to minimum. A citizen therefore has every right to dispose of his capital and income so as to attract upon himself the least amount of tax.”

This rule of permitting legal reduction in the tax liability through tax avoidance schemes (by so arranging commercial affairs that charge of tax gets distributed) was carried forth in many cases in India, until finally the *McDowell* case loomed up. In *McDowell & Co. Ltd v. CTO*ⁱⁱⁱ, the central question was whether a manufacturer could enter into an agreement with the buyer wherein the buyer pays off the excise duty (instead of the manufacturer) in return for distillery pass, without including this excise duty as part of the price consideration. The manufacturer defended the exclusion of the excise duty on the basis of his legal right to tax planning (by tax avoidance).

Relying on the cases of *CIT v. A. Raman*^{iv} and *CIT v. B.M. Kharwar*^v, the Supreme Court [SC] observed that:

“Tax planning may be legitimate provided it is within the framework of law; colourable devices cannot be part of tax planning...”^{vi}

The SC also invoked the power of the tax authorities to ‘pierce the corporate veil’ by going behind the apparent to find out the real motive of a transaction, and thereby apply the McDowell dictum if it appears a transaction is non-genuine, collusive, a sham or a facade made up just to escape tax liability.

Then Justice Chinnappa Reddy came in to deliver his tirade against the ‘immoral’ tax-avoidance schemes, explaining how even the law in UK (where the principle of allowing tax avoidance originated) had changed from the pro-avoidance stance (*Westminster’s case*^{vii}) to the anti-avoidance position (*W.T. Ramsay Ltd. v. IRC*^{viii} and *Burmah Oil*^{ix} and *Furniss v. Dawson*^x). He likened the *Westminster* principle to ‘ghosts of the past [which] stand in the path of justice, clanking their medieval chains’ and opined that they should be ‘exorcised’ in India too.^{xi}

Reddy's judgment has contributed confusion rather than clarity. His statement was merely the dissenting opinion, and not the majority rule, yet it completely blurred the demarcation between legal tax avoidance and illegitimate tax evasion for almost two decades. In fact, the ratio of the *McDowell* majority decision has been wrongly interpreted in numerous cases, mainly due to the vitriolic attack by Reddy, which has been incessantly used as a magic wand by the high-handed tax authorities to drag even the most lawful tax-planning acts of honest assesses within the pale of taxability on basis of mere suspicion.

Azadi Bachao Aandolan case: The Correct Interpretation of McDowell Ruling: It was the celebrated case of *Azadi Bachao Aandolan*^{xii} in 2002 which finally cleared the mists surrounding the *McDowell* ruling. The ruling in the case was the validity of the India-Mauritius double taxation avoidance treaty as a legitimate method of international tax-planning, which provided that an entity resident in Mauritius could not be denied tax benefits. As was noted by the SC in that case:

“We are afraid that we are unable to read or comprehend the majority judgement in *McDowell* as having endorsed this extreme view of Chinnappa Reddy, J., which, in our considered opinion, actually militates against the observations of the majority of the Judges which we have just extracted from the leading judgment of Ranganath Mishra, J.”^{xiii}

Thus, the *Westminster* principle is very much alive and kicking despite the previous hiccups of *McDowell*. Merely because an arrangement has the effect of reducing tax liability, it cannot be that the arrangement is a sham or a colorable device^{xiv}.

The Corporation as a Vehicle for Tax Planning

How Tax Havens are used by TNCs: Most TNCs are now controlling companies through a multi-layered and convoluted holding-subsidary corporate structure, making use of low-tax jurisdictions. For example, Royal Dutch Shell has several subsidiaries in Bermuda; General Motors in Barbados; ExxonMobil in the Bahamas; and Ford Motor in the Cayman Islands.

This is done by establishing an intermediate 'holding company' in a tax haven, which in turn owns some or all of the parent's subsidiaries or 'operating companies' in other locations. All subsidiary profits go to the holding company, and the holding company transfers these to the parent through intra-company loans. In M&A deals, the holding company's shares are purchased, which naturally vests the acquirer with control in the operating companies as well.

The 'Benefits' of Locating Intermediaries in Tax Havens: The use of havens for tax escape purposes has been increasing and shows potential for serious abuse. It is reported that 60% of all global trade is routed through tax havens. Some of the most prominent tax havens have been: the Bahamas, Bermuda, Cayman Islands, Hong Kong, Luxembourg, Monaco, Belgium, the Netherlands, Netherlands Antilles, Panama, Singapore, and Switzerland.

Generally, a tax haven is characterized by: (1) low tax rates; (2) rigid commercial secrecy laws; (3) flourishing banking and communications sectors; (4) lack of foreign currency controls; (5) aggressive self-promotion as a tax haven.

The commercial secrecy laws of tax havens make tax avoidance schemes viable by allowing the taxpayer to conceal his ownership interests in business entities. For example, Adobe, whose Irish subsidiaries had a turnover of US\$ 2.6bn in 2005, paid just 0.5% tax of US \$5m, taking advantage of the confidentiality status of an 'unlimited company' in Ireland.

The Separate Legal Personalities of Shell Companies: The rule of separate legal personality of corporations, as first enunciated in *Salomon v Salomon*^{xv}, can be overlooked by Courts if there is reason to believe that the company has been established for a reason that hides the real purpose of the controller, such as in situations of corporate fraud^{xvi} and avoidance of legal obligations^{xvii}, like tax avoidance. Shell corporations have to be understood in this respect. In such cases, the Courts can 'pierce the veil' to determine if the corporate personality is being blatantly used as a cloak for fraud or improper conduct. There are two approaches to do so—either by applying the principal and agent construction^{xviii}, or by disregarding the separate juristic personalities of entities.

There are currently two recourses to the Judiciary if it seeks to favour the taxman and declare subsidiaries located in tax havens as illegitimate tax planning:

- A. *By disregarding all the intermediaries*, including the subsidiary and shell companies, all the economic activities of the controlling company get 'aggregated', and a clear determination can be made with regard to vendor and purchaser in a deal and thus, identify the taxpayer. This method of piercing the veil would, however, mean that the tax benefits of any Double Taxation Avoidance Agreement [DTAA] would not be available. This approach would, thus, conflict with the *Azadi Bachao* ruling.
- B. *By treating the different intermediaries engaged in the convoluted transaction as Agents of the controlling company*, respect would be showed to the separate legal personality of each corporate entity, which has even

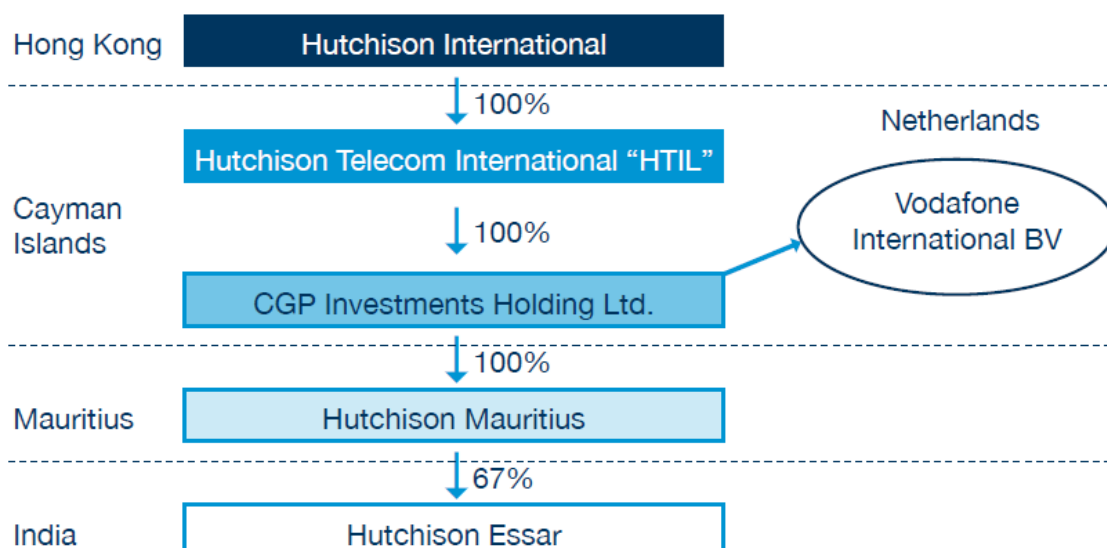
been recommended by the OECD^{xix}. However, under this approach, the tax authorities would have to show that the income arose through a “business connection” between the ‘controller’ and the ‘agent’, involving (1) arising income (2) real relationship between vendor-purchaser (3) continuity of transactions (4) partial business conduction in Source country (5) habitual exercise of authority in controller’s name—all difficult to exhibit. Yet, proving the agency relationship between Parent company and subsidiary would keep the doors open for any DTAA tax benefits.

Shell Company in the Tax Haven: Does it Imply Tax Avoidance? Shell corporations frequently come under the scanner of tax authorities, as it is not the real owner and does not by itself fund the shares transferred in its name. However, as per the *Azadi Bachao* ruling, an intermediary company, otherwise qualified, cannot be disregarded as a sham or a ‘colourable device’ merely because it was purposely created and operated to avail legitimate tax benefits; such a creation could amount to permissible ‘creative tax planning’.

Despite this ratio, the recent *Vodafone* case and other international examples^{xx} have once again raised the issue of the relevance of the *McDowell/Azadi Bachao* ruling.

A possible test could be whether an intermediate corporate entity is the “beneficial owner” of passive income streams (usually dividends or interest) or a mere shell company.^{xxi} If the former, then it could be a body engaged in legitimate tax-planning. If the latter, then it clearly lacks economic substance and has been intended at tax evasion, and the Indian Court could deny tax benefits to the entity. The OECD and UN Model do not incorporate any requirement like beneficial ownership, so the situation remains tenuous.

The Vodafone Controversy: In 2007, Vodafone BV, a Dutch subsidiary of Vodafone, acquired all of the shares of CGP Investments, which was a subsidiary of the Hong Kong-based Hutchison Telecommunications International Ltd. (HTIL) in Cayman Islands (a tax haven), for a whopping \$11.2 billion. CGP in turn owned the Mauritius subsidiary of HTIL, which in turn had stake in the amalgamation, Hutchison-Essar Ltd. (HEL), in India. Through such a deal, Vodafone came to acquire 67% of HEL, thus forming the entity Vodafone-Essar (see Table below).



The tax department issued a show-cause notice to Vodafone under Sections 163 and 201 of ITA to pay capital gains tax of \$2 billion on the payment it made to HTIL. Vodafone filed a writ petition in the Bombay High Court challenging the notice on several grounds:

- i. The transaction occurred between two offshore non-resident entities [Vodafone BV and CGP] and therefore India does not have tax jurisdiction.
- ii. There is no law in India saying that the indirect transfer of shares outside India is exigible to tax.

In December 2008, the Bombay High Court ruled that *Vodafone could be held liable for a \$2 billion tax* based on the following reasoning:

- i. 33% of HEL was in the hands of the Essar group, an Indian company.
- ii. The underlying assets of the shares transferred were located in India.
- iii. By becoming a successor in interest in the former joint venture of HEL, Vodafone had acquired a controlling interest in an Indian company.
- iv. Vodafone had acquired a beneficial interest in the license granted by the Department of Telecommunications in India, which had been its primary objective.
- v. Vodafone acquired HEL's interests in India only with due approval from Foreign Investment Promotion Board, as per whose terms, Vodafone was bound to comply with all Indian laws.

The High Court relied on the American principle of the *"Effects Doctrine"* which recognizes the right of a State to impose liabilities upon even the persons not within its allegiance, for conduct outside its borders that has consequences within the borders of such State.^{xxii} Thus, since very purpose of the transaction was acquisition by Vodafone of the controlling interest held by HTIL in telecommunication sector in India, the transaction would certainly be subject to the municipal laws of India. Finally, applying the 'substance over form' approach under Sections 4, 5(2), 9(1)(i), and 47 of ITA, the High Court held Vodafone liable to capital gains tax in India.

Vodafone then filed a SLP before SC on the jurisdiction issue. The Supreme Court dismissed the same with a direction to tax department to decide the jurisdictional issues^{xxiii} based on the interpretation of the impugned agreement and in accordance with law, but has also allowed Vodafone the liberty to appeal to High Court. It is clear then, that the Vodafone legal battle is far from over.

The Relevance of *McDowell* Ruling

Azadi Bachao Ruling v. Vodafone Ruling: There are two crucial gaping holes in the judgment of the Bombay High Court, including the startling disregard to the hitherto relevant *McDowell* ruling, as the Court clearly sided with the tax authorities' intent to tax TNCs in India:

1. The High Court did declare CGP to be a 'shell company' whose shares were transferred as a mere mode or vehicle for transferring the assets situated in India. Whether or not such a shell company has 'economic substance' beyond tax escape and was permissible 'tax planning' was not expounded any further, the High Court preferring to look at the matter through the 'capital gain' angle of Section 9 of ITA. The judiciary also did not make any observations with regard to chargeability of tax on offshore transactions achieved through tax havens with which India has tax-treaties.
2. The High Court used the 'controlling interest' principle under Section 9 of ITA, but it is not clear whether the interest was direct or indirect. If the latter, then it becomes clear that Vodafone would incur no liability, as the selling entity is a resident of Mauritius and would be exempt from tax under the India-Mauritius Double Taxation Treaty.

Threatening the Mauritius Advantage Despite McDowell Ruling: The India-Mauritius Double Taxation Avoidance Convention [DTAC] has lately become a much abused treaty.^{xxiv} It has been manipulated by third-country residents to set-up wholly-owned companies ('GBC-1s') in Mauritius for routing investments into India and to extract income at reduced or nil rates of tax, also called "round tripping" or "treaty-shopping". The crux of the problem is that these GBC-1s are only shell companies with the purpose to avoid paying taxes in India. The benefits go to people who are not the rightful receivers of the tax benefits; this defeats the purpose of the treaty.

The *Azadi Bachao Andolan* case had clearly upheld the validity of the DTAC, but the Indian tax department has clearly disregarded this most important precedent. Currently, even the Mauritius advantage under DTAC has come under a serious threat.

Take the recent *Aditya Birla Nuvo* case, where the authorities have imposed tax on the company for purchasing Idea Cellular, the Mauritius-based subsidiary of the American AT&T company. The assessee cannot avail itself of the DTAC advantage, because Idea is a 'shell company' whose shares are owned by an American parent company. Such a divestment structure smacks of concealment or subterfuge, and is therefore not a legitimate tax planning tool. The Bombay High Court has temporarily stayed the tax claim until courts reopen after summer.

Similarly, E*Trade Mauritius, a wholly-owned subsidiary of a US based company, was taxed on its sale of shares in Indian company IL&FS Investmart to an HSBC-subsiary in Mauritius. This time, too, the authorities claimed that HSBC-Mauritius was a shell company and the original owner was the American parent.

Azadi Bachao Ruling Conflicting with the Direct Tax Code Bill [DTC]: Unveiled in August 2009, DTC has made some major changes in the taxation laws affecting M&A transactions, foreign investment, double taxation treaties and tax-planning schemes in India. The most crucial of these is the General Anti-avoidance Rule (GAAR) in Section 112, which clearly holds tax planning in legal contempt, contrary to the *Azadi Bachao* ruling.

GAAR Provision: This gives almost unbridled powers to CITs ‘to pierce the corporate veil’, and declare any transaction as “impermissible avoidance arrangement”^{xxv}, i.e. a sham, if there is a reason to believe that its sole purpose is to avoid tax in this country: (1) creates certain tax benefits; (2) results in abuse of the provisions DTC; (3) lacks commercial substance; or (4) lacks bona fide business purpose. The *Vodafone ruling* clearly runs parallel to GAAR.

Treaty Override Provision: Earlier, the tax treaties that India had forged with countries like Mauritius (about 75 in number) held sway over the existing specific tax laws of the country. But DTC proposes to override these in case of any conflict (*lex posterior derogat legi priori*).^{xxvi} On the other hand, another corresponding provision in DTC provides for the continuance of applicability of existing tax treaties even after DTC gets enforced. This has created a curious dichotomy, going both against and parallel to the *Azadi Bachao* ruling.

Article 51 of the Directive Principles of State Policy in the Constitution of India requires the State to foster respect for international law and treaty obligations; it would certainly come into conflict with the Treaty Override provision. It would also come into conflict with Articles 18 and 26, read with Articles 27 and 46, of the Vienna Convention on the Law of Treaties, which essentially provide that every treaty is binding on the signatories to it and they cannot invoke the provisions of its internal law as justification for its failure to perform a treaty.

The Residence Status of Foreign Companies In India: Under the DTC, a foreign company can be treated as a ‘resident’ in India if its place of control and management is wholly or even partly (unlike the current ITA) situated in India at any time in the financial year. ‘Partial’ control, has however not been quantified by DTC. This provision read with the Treaty Override and GAAR clauses, could result in double taxation for several foreign subsidiaries, joint ventures, and other resident companies of India, rendering several tax treaties futile and frustrating the *Azadi Bachao* ruling. Just like the *Vodafone ruling*, the DTC imposes a capital gains tax on ‘business capital assets’, intent on bringing offshore TNCs into the tax net.

Conclusion & Suggestions

The *Vodafone* judgment and DTC provisions, which essentially eclipse the *McDowell* ruling, could imply stringent scrutiny of corporate transactions, higher administrative costs, longer delays in clinching deals, heated litigation battles, inclusion of tricky safety clauses in M&A pacts, discouragement to private economic contracts, fall-out of foreign investment— indeed, tremors will be felt in every rung of the corporate scene.

The current system of international taxation, based upon residence-based taxation, source-based taxation and separate entity accounting, has been found inadequate and outdated, even amounting to “*fiscal imperialism*” by developed countries. From automatic information exchange between transacting countries, to differential reserve requirements for dealings with offshore businesses, from greater transparency in accounting, to introduction of ‘Limitation on Benefits’ clauses into tax treaties, to greater pressure on low-tax jurisdictions to cooperate— there are a great number of proposed measures. OECD has been pressing for international cooperation to enforce a uniform global tax system, which abolishes harmful tax practices, including tax havens.

However, these are changes that would have to be made by legislators and treaty negotiators, rather than judges. It is not possible for the judiciary to continuously churn out changes through interpretation of the currently inadequate tax laws. The *McDowell*, *Azadi Bachao* and *Vodafone* rulings will remain the will-o’-the-wisp of justice, unless backed by suitable law free of ambiguities and inconsistencies. Indeed, it is foremost the task of the legislature to “forge a sledgehammer capable of cracking open the corporate shell”^{xxvii}. Till then, the *McDowell* ruling will meander away, uncertain of its own relevance.

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Endnotes

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- ^{vii} 1936 AC 1.
- ^{viii} 1982 AC 300.
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- ^{xix} This principle is recognized by paragraph 5(7) of the OECD Model and paragraphs 5(5)(a), 5(5)(b) and 5(7) and 5(8) of the UN Model. Ibid.
- ^{xx} Examples include Chongqing case (where shell companies were held to lack economic substance as they own very small amount of capital and do not carry on any business activity other than owning the shares) and the Lone Star Funds case (where investments routed into Korea through shell companies in tax havens was alleged to be ‘tax evasion’).
- ^{xxi} *Indofood International Finance Ltd. v. JP Morgan Chase Bank*, [2006] S. T. C. 1195 (Eng C. A.) (concluding that a Dutch intermediary would not, despite the Indonesia-Netherlands tax treaty, be the beneficial owner of interest payments, as it is a ‘shell company’); *Prévost Car Inc v. Canada*, 2008 T. C. C. 231 (Tax Ct. of Can.) (concluding that a Dutch holding company would, according to Canadian and Dutch law, be the beneficial owner of dividend payments under Canada-Netherlands tax treaty, as it was more than a ‘conduit company’).

^{xxii} *Shyama Charan Agarwala v. Union of India*, (2002) 6 SCC 201; *Man Roland Druckmachinen AG v. Multicolour Offset Ltd.*, (2004) 7 SCC 447; *Assam Consolidated Tea Estates Ltd. v. ITO 'A' Wards*, 1981 ITR 699 (Cal).

^{xxiii} *Management of Express Newspapers vs. Workers*, AIR 1963 SC 569. (The question in regard to “the jurisdictional issue” should be decided by the Assessing Officer as a “preliminary issue” and the assessee shall be entitled to question that decision before High Court.)

^{xxiv} See O. E. C. D. Committee On Fiscal Affairs, *Double Taxation Conventions and the Use of Conduit Companies*, in INTERNATIONAL TAX AVOIDANCE AND EVASION: FOUR RELATED STUDIES 88 (O. E. C. D., 1987).

^{xxv} Section 113(3), The Direct Tax Code Bill, 2009.

^{xxvi} Section 258(8)(b), The Direct Tax Code Bill, 2009.

^{xxvii} *As per Devlin L.J.*, in *Bank voor Handel en Scheepvaart NV v Slatford*, [1953] 1 QB 248, at 278.