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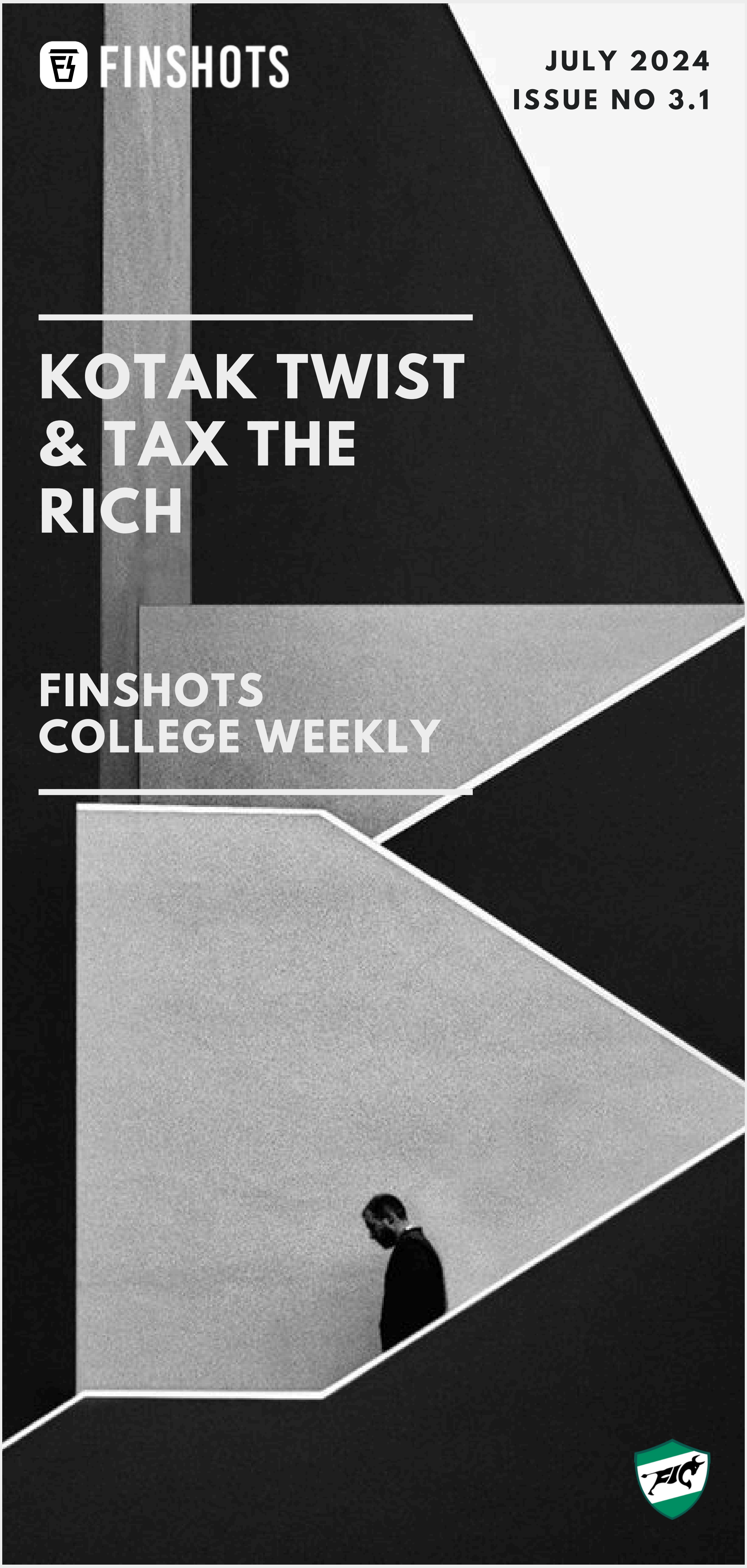

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KOTAK TWIST & TAX THE RICH

FINSHOTS COLLEGE WEEKLY

Finshots College Weekly - Kotak Twist & Tax the Rich

In this week's newsletter, we talk about why Kotak Mahindra Bank has suddenly found itself stuck in the Adani versus Hindenburg row, a new proposal to tax billionaires, Jeetu bhaiya and more.

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The Adani Hindenburg saga just got a Kotak twist

Last year, Hindenburg Research, the US-based research firm and short seller, dropped a bombshell report accusing the Adani Group of stock price manipulation and accounting fraud.

It claimed that Gautam Adani and his family made a fortune of over $120 billion. And that over $100 billion of it came in the past 3 years, through an unusual 800% rise in the stock prices of Adani's 7 listed companies.

They say that this happened through shady tactics, such as creating fake shell companies in offshore tax havens like Mauritius, which allegedly funnelled money out of India and back in as foreign investments, faking a huge foreign interest in Adani stocks.

This report obviously blew up and had a resounding impact on the Adani group companies. To put things in perspective, Adani's wealth alone dropped by more than $80 billion in the month after the report. And at one point his conglomerate even lost over $150 billion in market value.

Now, market regulator SEBI felt that these allegations obviously had to be looked into. At the same time, it also wanted to investigate the accusers to make sure there wasn't any foul play. So it issued a show cause notice to Hindenburg and a few others accusing them of spreading misleading information that led to panic selling of Adani stocks in 2023.

It was particularly miffed that Hindenburg was not a registered Research Analyst (RA). Which meant that it couldn't have gone about publishing such reports in the first place.

And it's Hindenburg's response to this notice that has revived the chatter around the Adani-Hindenburg saga, albeit with a new twist.

For starters, it blamed SEBI for trying to protect Indian conglomerates like Adani and stifle their whistleblowing efforts.

But Hindenburg's most shocking claim? That SEBI was covering up Kotak Mahindra Bank's involvement in short-selling Adani shares. Wait... What?

Let's explain.

See, if Hindenburg had to short sell Adani stocks, it had to depend on a foreign or offshore fund. For the uninitiated, short selling simply involves borrowing shares you think will drop in price, selling them at the current price, and then buying them back cheaper, so that you can return the shares and keep the difference. For example, if you borrow and sell shares at $50 each and buy them back at $40, you make $10 per share.

And to do this, Hindenburg partnered with Kingdon Capital Management, a US hedge fund. But offshore funds wanting to trade in India must register as a foreign portfolio investor (FPI) with SEBI. And that could take at least a month since getting an FPI license required investors to submit documents like KYC (Know Your Customer) details and other information on who the ultimate beneficial owner would be.

But remember that we're talking about December 2022. And Kingdon probably had just a few days to do this because it had to short Adani stocks well before Hindenburg published its report.

So instead of going the long route, Kingdon simply decided to take the help of a readymade structure that was already in place. Courtesy: Kotak Mahindra International (KMIL), a Kotak Mahindra bank subsidiary. KMIL advised Kingdon to take over a sub fund of K-India Opportunities Fund Ltd (KIOF), a Mauritius-based fund it managed and one which was already registered with the SEBI since 2022. Kingdon then subscribed to KIOF's shares a few days before Hindenburg published its sensational report, got KIOF to short sell Adani stocks and ultimately made a whopping $22 million (or over ₹180 crores).

But here's the thing. SEBI isn't making a fuss about that. And Hindenburg now wants answers as to why it mentioned the entire structure in its notice but downplayed Kotak's role by not fully disclosing its name. Instead, it used the acronym KMIL to camouflage Kotak and protect its market reputation. And that, Hindenburg believes, is another effort by the market regulator to shield influential Indian businessmen from scrutiny.

But guess what? Kotak says that it facilitated these Adani stock transactions for Kingdon Funds. And that it had no idea of Kingdon's nexus with Hindenburg Research.

So yeah, that's the long and short of it.

Will that put pressure on SEBI to further investigate Kotak Bank's involvement in the Hindenburg-Adani saga and take action?

Well, we'll only have to wait and see.

Will Gabriel Zucman's billionaire tax work?

A few months ago, French Economist Gabriel Zucman made waves when he addressed the Finance Ministers of G20 nations at Brazil's São Paulo.

His pitch?

A global minimum tax on billionaires to ensure that they don't get away with not paying their fair share of taxes.

You see, taxing rich people is a conundrum for countries globally. That's because it's hard to figure out how much money they make.

A significant portion of what they earn comes from capital gains on investments which are often taxed at rates that are much lower than regular income tax. Even the rest of their income may simply never get taxed because they manage to park their money in tax havens, route it through shell companies that often escape taxes or trusts that are exempt from it.

In fact, they have at least $7 trillion hidden away in offshore accounts in tax havens outside their country. That's 8% of the global household financial wealth! So, 80% of what the world's wealthiest own ends up being hidden from governments.

This explains why they end up paying a measly 0.3% of their wealth in annual taxes, costing global governments a whopping $200 billion in lost tax revenue every year.

The end result is that a small fraction of the global population end up owning a majority of the world's wealth. Over the last four decades in fact, this wealth has only grown at an average rate of 7.5% after taxes every year. So governments naturally have less to spend on development. And this massive wealth inequality simply strips the world's majority of the privilege to economically uplift themselves.

So when Zucman proposed this new approach, everyone was interested. And since Brazil assumed the G20 presidency last year, it asked him to chalk out a blueprint on how countries could go about practically taxing the rich. And he did.

A few days ago he came up with a simple plan. If countries find it so hard to estimate how much their billionaires earn every year, just ask them to slap a new wealth tax on these folks. All they have to do is track the individuals that own $1 billion or more in assets like real estate, equities or company ownerships and get them to pay a minimum annual tax, equal to 2% of that wealth.

Doing that globally, he says, could actually raise close to $250 billion every year from about 3,000 taxpayers or even an extra $140 billion if you include the tax on centimillionaires or folks earning $100 million or more.

Here's the thing though. Plans like these sound good only on paper. And getting approval from countries that represent the G20 can be a tall order.

But Zucman has a solution to that too. He says that this doesn't really need any global consensus. It's simply something that will work as an additional tax policy that would complement what a country already has in place.

And that's why Brazil wants to keep his proposal open for debate at the G20 meeting this month.

But it seems like the debate has kicked off even before the meeting because the proposal seems to be receiving a lot of flak from some powerful G20 nations already.

For starters, the US has baulked at the plan. And its reasons seem genuine. Nine of the top ten richest people in the world belong to the US. And wealth tax like this could upset them. They could simply choose to spend their wealth instead of investing in businesses, research, and development. It also fears that this could encourage the wealthy to move to other countries and accumulate assets there. And that might actually backfire on its economic growth.

Not just that. Nodding to this plan could pan out badly for the Biden administration which currently helms the US government and wants to win another term in the country's elections which are just a few months away.

In 2021 the Biden-led US government made a bold proposal to tax corporations at a global minimum tax rate. The idea is to tax all overseas income at a minimum tax rate of 15% and eliminate loopholes that allow companies to shift profits to tax havens.

Meaning, if you're a US company trying to book your profits in a country like Ireland that boasts a lower tax rate of 12.5%, then the US will simply walk in and collect the extra 2.5% on your overseas income. And that will make sure that these companies pay their fair share of taxes.

And it's not just the US. Germany, which has many family owned businesses, feels that a wealth tax like this could disproportionately affect these businesses, triggering layoffs and economic uncertainty. In fact, the country had to do away with wealth taxes in the past because of the challenges that came with implementing it.

So yeah, Zuckman's proposal isn't flawless. And without the political will of developed nations, especially the US, it's unlikely that other countries will adopt it. And it'll be exciting to see whether the proposal to implement a global minimum tax on billionaires attracts other G20 nations.

And that's all for today folks! If you learned something new, make sure to subscribe to Finshots for more such insights :)

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