Exploring Provisions

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Imposition of tax on undisclosed foreign income and asset stashed abroad- A journey that began in 2011

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PREFACE

Black money stashed abroad has been a topic of hot debate ever since the Hon'ble Supreme Court of India passed an order dated 04.07.2011 in the Ram Jethmalani & Other vs. Union of India [Writ Petition (Civil) No. 176 of 2009]. Directorate of Criminal Investigation (DCI) has been created as an attached office of the Central Board of Direct Taxes (CBDT) to combat the menace of black money/ to track financial transactions relating to illegal / criminal activities, including illicit cross-border transactions. Further in the instant case, the Hon'ble Supreme Court has ordered creation of a Special Investigation Team (SIT) with the responsibilities and duties of investigation, initiation of proceedings and prosecution, whether in the context of appropriate criminal or civil proceedings, relating to cases involving stashing of unaccounted money in foreign banks by Indians or other entities operating in India as well as the cases relating to Hassan Ali Khan group. Special Investigation Team (SIT) is constituted in May 2014, Chaired and Vice-Chaired by two former judges of the Hon'ble Supreme Court, inter alia, to deal with issues relating to black money stashed abroad.

Purpose of this Document

This Tax Alert throws light on the nuts and bolts of the new black money law

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I. Introduction

Black money or "black income", which is income on which taxes payable have been evaded, can be classified into two categories: domestic and foreign. The finance minister has clarified that the new law has nothing whatsoever to do with domestic black money (which is much greater than the quantum of foreign black money held by Indians, as we shall note).

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cases relating to Hassan Ali Khan group. Special Investigation Team (SIT) is constituted in May 2014, Chaired and Vice-Chaired by two former judges of the Hon'ble Supreme Court, inter alia, to deal with issues relating to black money stashed abroad.. Also several amendments were made through the Finance Act, 2012 to deal with the Menace of Black Money such as

a) Introduction of General Anti Avoidance Rules to counter Aggressive Tax Avoidance Schemes
b) Introduction of compulsory reporting requirement in case of assets held abroad.
c) Allowing for reopening of assessment upto 16 years in relation to assets held abroad.
d) Tax collection at source on purchase in cash of bullion or jewellery in certain cases.
e) Tax collection at source on trading in coal, lignite and iron ore.
f) Increasing the onus of proof on closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value.
g) Taxation of unexplained money, credits, investments, expenditures etc., at the highest rate of 30 per cent irrespective of the slab of income.
h) Introduction of a reporting mechanism for assets and bank accounts in a foreign country.

In May 2012 a white paper on black money was tabled before the parliament. This document seek a serious attempt at putting together a framework for addressing the issue of black money, its generation and strategies for recovering illicit wealth. International agreements such as DTAAs/TIEAs do not have provisions for repatriation of undisclosed assets. Hence old treaties were renegotiated for exchange of information including banking information, new tax information exchange agreement/DTAA were signed with appropriate clauses for exchange of information .The status of progress made in each case of renegotiation is noted in this paper. Besides the parliament also took note of list of Countries that have signed and ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters with India. In terms of the share of Top Investing Countries FDI Equity inflows Mauritius turned out to be the favorite with 41.8% share in capital flows to India. Illicit FDI flows chart is also placed before the house. The report further pointed out liabilities of Swiss banks towards Indians at a level of Rs. **9,295 crore as on 31st December 2010 down from Rs. 23,373 crore in December 2006**.

The Government is bound by the treaty provisions under which information is received. As per the international standard, tax information exchanged under DTAAs/TIEAs is protected by the confidentiality clause of the respective DTAA/TIEA under which information is received. The confidentiality provisions of these DTAAs/TIEAs generally allow disclosure or use of information only for tax purposes. In other words the confidentiality clause of the respective DTAA/TIEA under which information is received in most of the cases does not

allow sharing of information with other law enforcement agencies. India has been trying to renegotiate its DTAAs or conclude new DTAAs/TIEAs by excluding the confidentiality clause but has not met with much success. The report admits to this fact on page 68. As a matter of fact in all those cases where information was received fast track assessments have been made on the directions of SIT and no sooner thereafter penalty and prosecution is also launched by the Government under Income tax Act provisions.

Information flow on undisclosed bank accounts and assets from other jurisdictions under various treaties but the provisions of the Income tax Act, 1961 especially those under section 68 and section 69 series are found to be difficult in their application. Even reopening u/s 147 fail for technicalities and even penalties often fail to sustain at the end. It is in keeping with this difficulty that a new law called 'THE BLACK MONEY (UNDISCLOSED FOREIGN INCOME AND ASSETS) AND IMPOSITION OF TAX ACT, 2015' is passed by the parliament to make provisions to deal with the problem of the Black money that is undisclosed foreign income and assets, the procedure for dealing with such income and assets and to provide for imposition of tax on any undisclosed foreign income and asset held outside India and for matters connected therewith or incidental thereto. The Black money (Undisclosed foreign income and assets) and Imposition of tax Act, 2015 is drafted in a manner to be most simple to administer yet act as a strong deterrent and curb the menace of black money stashed abroad by Indians. It is claimed that the wording of the penal

provisions is kept simple to leave almost no scope for differing interpretation of the Courts. And that perhaps is why a new legislation is thought proper than the existing Income tax Act, 1961.

II. Good bye to old elements of discretion, satisfaction, minimum – maximum syndrome

The penalty provisions of section 41 under Chapter IV of 2015 Act do not provide for any satisfaction pre-condition as in the existing 1961 Act that the person concerned has concealed the income or particulars thereof. Also there is no discretion to levy or not to levy penalty much less a provision for levy of minimum penalty as in the existing Act. The provisions of Chapter IV therefore do not give any scope for much interpretation.

III. New elements

1. Separate assessment

There shall be a separate assessment of any undisclosed income in relation to foreign income and assets on receipt of information. Such income will henceforth not be taxed under the Income-tax Act but under the stringent provisions of the proposed new legislation. Likewise what has been already taxed under Income tax Act , 1961 would not be included under the new law. Section 4 & 10

2. Scope and application

The Act will apply to all persons resident in India.

Provisions of the Act will apply to

a) undisclosed foreign income
b) undisclosed foreign assets
c) undisclosed financial interest in any entity.

3. Rate of tax

Undisclosed foreign income or assets shall be taxed at the flat rate of 30 percent. No exemption or deduction or set off of any carried forward losses which may be admissible under the existing Income-tax Act, 1961, shall be allowed. Ss. 3 and 5

IV. Proceedings

Proceedings before tax authorities shall deem to be judicial proceedings for the purposes of section 196 of the Indian Penal Code (sec 9) and every tax authority shall be deemed to be a civil court for the purposes of section 195

V. Penalties

5.1 Type 1 penalty

The penalty for non-disclosure of income or an asset located outside India will be equal to three times the amount of tax payable thereon, i.e., 90 percent of the undisclosed income or the value of the undisclosed asset. This is in addition to tax payable at 30%. (sec 41)

5.2 Type 2 penalty

Failure to furnish return in respect of foreign income or assets shall attract a penalty of Rs.10 lakh. (sec 42)

5.3 Type 3 penalty

Rs. 10 lakh penalty where although the assessee has filed a return of income, but he has not disclosed the foreign income and asset or has furnished inaccurate particulars of the same. (sec 43)

5.4 Penalty payable when tax in default

Under section 44 the assessee is liable to pay a further penalty equivalent to the amount of tax in arrears. The draftsmen have forgotten to provide a safeguard here on the lines of section 221 of the Income tax Act viz., reasonable opportunity and good cause factor. In the absence of discretion provision this tends to be very harsh. Further sub-section (2) specifically provides that the penalty shall not cease to be leviable on an assessee merely by reason of the fact that before the levy of such penalty, the assessee has paid the tax, and puts the position beyond doubt that notwithstanding the fact that the tax and interest has already been paid by the assessee, the assessee will still be liable for penalty under section 44.

5.5 Penalty for certain defaults

Further under section 45 a penalty of a sum which shall
not be less than fifty thousand rupees but which may extend to two lakh rupees is leviable in the following scenarios:

a) failure to answer any question put to him by a tax authority in the exercise of its powers under this Act without reasonable cause;
b) failure to sign any statement made by him in the course of any proceedings under this Act which a tax authority may legally require him to sign without reasonable cause;
c) failure to attend or produce books of account or documents at the place or time, if he is required to attend or to give evidence or produce books of account or other documents, at certain place and time in response to summons issued under section 8 without reasonable cause.

VI. Prosecutions

6.1 Type 1

The punishment for willful attempt to evade tax in relation to a foreign income or an asset located outside India will be rigorous imprisonment from three years to ten years. In addition, it will also entail a fine. (sec 51)

6.2 Type 2

Failure to furnish a return in respect of foreign assets
and bank accounts or income will be punishable with rigorous imprisonment for a term of six months to seven years. (sec 49)

6.3 Type 3

Rigorous imprisonment for a term of six months to seven years for cases where although the assessee has filed a return of income, but has not disclosed the foreign asset or has furnished inaccurate particulars of the same. The above provisions will also apply to beneficial owners or beneficiaries of such illegal foreign assets. (sec 50)

6.4 Type 4

Abetment or inducement of another person to make a false return or a false account or statement or declaration under the Act will be punishable with rigorous imprisonment from six months to seven years. This provision will also apply to banks and financial institutions aiding in concealment of foreign income or assets of resident Indians or falsification of documents. (sec 53)

VII. Safeguards

The principles of natural justice and due process of law have been embedded in the Act by laying down the requirement of mandatory issue of notices to the person against whom proceedings are being initiated, grant of opportunity of being heard, necessity of taking the evidence produced by him into account,

recording of reasons, passing of orders in writing, limitation of time for various actions of the tax authority, etc.

VIII. Right of appeal

The right of appeal has been protected by providing for appeals to the Income-tax Appellate Tribunal, and to the jurisdictional High Court and the Supreme Court on substantial questions of law.

Exemption to bank accounts with a maximum balance of upto Rs.5 lakh at any time during the year

To protect persons holding foreign accounts with minor balances which may not have been reported out of oversight or ignorance, it has been provided that failure to report bank accounts with a maximum balance of upto Rs.5 lakh at any time during the year will not entail penalty or prosecution. Other safeguards and internal control mechanisms will be prescribed in the Rules.

IX. One time compliance opportunity

Chapter VI provisions of the Act also provides a onetime compliance opportunity for a limited period to persons who have any undisclosed foreign assets which have hitherto not been disclosed for the purposes of Income-tax. Such persons may file a declaration u/s 59 before the specified tax authority within a specified period, followed by payment of tax at the rate of 30 percent and an equal amount by way of penalty. Such persons will not be prosecuted under the stringent provisions of the new Act. It is to be noted that this is not

an amnesty scheme as no immunity from penalty is being offered. It is merely an opportunity for persons to come clean and become compliant before the stringent provisions of the new Act come into force.

Those who do not avail of the one time opportunity may get trapped under the new law if the department holds information in their case. The new law has no provision for any kind of settlement scheme either.

X. Income tax papers can be used against assessee under the new Act

By virtue of section 84 of the new law the income tax officer is empowered to use any information that come to his notice from any statement or return made or furnished under the provisions of Income tax Act or obtained or collected for the purpose of the said Act.

This is again very harsh for instead of reopening a matter under Income tax Act there would be a fresh proceedings initiated under the new Act based on such information receipt. In a way the income tax reopening provisions would get redundant in the days to come for some and concealments of foreign incomes would be dealt with under the new law.

XI. Amendment of PMLA

The Act also proposes to amend Prevention of Money Laundering Act (PMLA), 2002 to include offence of tax evasion under the proposed legislation as a scheduled offence under PMLA.

XII. Fundamental flaw

The draftsmen have overlooked the fact that it is only enabling them to collect tax from select few who hold the status of resident assessee's on or after 1.4.2016. In other words the Act provides immunity to every other person who had been resident assessee prior to 1.4.2016 but acquired the status of non-resident status after 1.4.2016.

What about persons who have amassed huge black money in foreign destinations since the time of coming into force of the Income tax Act 1961 or even perhaps after 1922 Act as they would escape the provisions of the new Act having application only in case of assessee resident on or after 1st day of April 2016 (A Y 2016-17 onwards). It is failing to achieve the desired purpose of collecting taxes from each and every black money holder. And that perhaps is because of ill conceived definition of the term 'assessee' under this Act.

So the Act is deficient to the extent that it provides amnesty to large section of black money holders and therefore do violate the constitutional rules. Thus there is an urgent need to plug this loophole. The solution to this is very simple.

The entire purpose of framing the bill cum act is derailed by ill drafting of definition of assessee by the framers of this Act. And without losing much time immediate amendment must be made to change the definition of the term 'assessee' to rope in every person who had been a resident in India anytime after 1.4.1961 i.e. the date of coming into force of the Income tax Act. For instance the new definition of 'assessee' could be drafted like this:

(2)"assessee" means every person, who had been a resident in India on or after 1.4.1961, other than not ordinary resident in India within the meaning of clause (6) of section 6 of the Income tax Act, by whom tax in respect of undisclosed foreign income and assets, or any other sum of money, is payable under this Act and includes every person who is deemed to be assessee in default under this Act.

Thus with this kind of definition in place a person who had been a resident in India in the past can be asked to explain the assets or source of income held in foreign jurisdictions no matter that he has acquired the status of non-resident in current fiscal. And in his failing to prove the source he can be penalized and prosecuted under the new legislation.

Here one might challenge on the pretext that the new act was not there in the past so he cannot be tried. This would need some bit of master minding stroke by including a new section making this proposition practical.

XIII. Conclusion

More importantly every black money earned has a definite trail and therefore the Act must be sufficiently full proof to catch not just few who are residents assessee's on or after 1.4.2016 and leave some who have remained resident assessee in the past but have turned nonresidents in current fiscal. Only by such amendment in the definition of 'assessee' can the Government realize full potential to earn taxes on black money stashed abroad. And in my view there is a total lapse or complete overlooking on this aspect in the drafting of the Act

itself. Before we set stage for get set go it is ardently desirable to bring amendment to the definition of 'assessee' in the Act as early as possible.

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