

# EMERGING RISKS IN TAX

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## Tax regimes are changing

The world of taxation is seeing unprecedented upheaval. Not just in India, which ushered in GST last year and is looking to have a new income-tax law soon, but across countries old precepts of taxation are being revisited, revamped or replaced. Tax authorities, armed with increasing number of information exchange agreements, global reporting standards and power of computing and data analytics, are pursuing taxpayers with more vigour.

The need for this change was gaining attention as the world trade came to be dominated by multinational enterprises. Owing to their sprawling operations and markets spread across the globe and because tax systems of countries were rarely aligned or talking to each other, the multinationals were able to cut their tax bill by exploiting tax arbitrage opportunities and tax disclosure requirements, helped by the willingness of some jurisdictions to offer them a 'havenly' abode. The abuse was exacerbated when internet started taking over the world, facilitating remotely controlled yet seamless operations, circumventing traditional barriers to trade and blurring national borders. These developments threw taxmen in a tizzy. The basic rules of taxation (like place of residence and place of source of income) carried forward from the 20<sup>th</sup> century were proving to be inadequate to address the challenges of taxation in the burgeoning global and digital economy. For instance, where should a company providing computer reservation system to airline industry be taxed if its users are all over the world, its computer server located in Germany and the corporate headquarters based in Spain? Or how can a search engine company be forced to pay tax in India, without having any physical presence or staff on ground in India even though Indian users could access its global website from here, using telecommunication infrastructure provided by a third party? How was it possible to catch and tax a Luxembourg based online retailing company for its sales to UK-based buyers when it didn't have a single shop there? The old tenets were simply not geared to determine taxation in the new technology-driven reality of business.

## Final straw that broke the back

Financial crisis of 2008 made governments around the world take serious note of their taxman's growing haplessness. Governments needed money to fund bailouts and provide stimulus to reeling economies without running dangerously high budget deficits. Tax revenues had to be upped and quickly. International intra-group arrangements of multi-national companies came under intense scrutiny. Head honchos and tax

consultants were summoned and grilled in senate and parliamentary committee hearings. Laws like Foreign Account Tax Compliance Act (FATCA) were passed and multilateral agreements such as Common Reporting Standard (CRS) for automatic exchange of information on bank accounts were signed. Some countries introduced new levies such as diverted profit tax to counter the use of aggressive tax planning techniques of multinational enterprises to divert profits to low tax jurisdictions. There was a concerted effort to tackle the menace of base erosion and profit shifting (BEPS). Action plan was drawn up and agreed upon to plug the loopholes in the present tax systems. A multilateral Instrument (MLI) was signed that can now potentially override thousands of loophole-ridden bilateral tax treaties between countries. Events like panama papers leak and their revelations about rampant tax evasion by the high and the mighty have only strengthened the popular support for the war against tax evasion and avoidance.

While all of this was happening on the world scene, India saw its fair share of tax action internally too. The much celebrated Vodafone case, the Supreme Court's landmark judgment on it and the anti-climax of parliament's retrospective amendment of the law are all the developments that took place in less than last 10 years. In last 4 years alone, India saw a couple of black money unearthing schemes, hugely disruptive actions such as demonetization (one of the stated objectives of which was to hit tax evaders), changes to much-abused provisions of tax treaties with Mauritius and Singapore, deregistration of thousands of shell companies suspected of being used for money laundering and tax evasion purposes.

## What should you watch out for

On the backdrop of these momentous changes in the tax

landscape in a short span of time, what should directors of the board of Indian companies expect in the coming years? Is their personal exposure under tax law in case of contravention by the companies they oversee? Here is a quick guide –

#### *New income tax law is coming*

The central government (the present one as well the previous) has clearly been keen on replacing the 57-year old tax law that has become unwieldy and complex. It deserves to slip into retirement soon. However, any change brings uncertainty and turbulence for a while, like GST is causing presently (for instance, with respect to anti-profiteering provisions). If all goes as per the plan, new direct taxes code may be the biggest tax reform of the next government that will assume office in May 2019. In a year's time from now, you might be looking at a draft of the new proposed law. If the recent tax related activism globally is any indication, in all probability it would be safe to assume that the company under your charge would face more rigorous reporting and compliance requirement (like under the GST regime). You may soon want to re-examine your company's processes that deal with income-tax matters.

#### **New anti-avoidance concepts could bite**

Even before replacing the statute entirely, parliament has already made several changes to the old law in the last few years, making available sharper teeth or wider traps to the taxman.

General Anti Avoidance Rule (GAAR) has been incorporated in the law with effect from 1 April 2018. GAAR gives power to the tax officer to treat certain arrangements entered into by your company as impermissible for tax purposes. While the actual use of this rule is not observed yet, tax practitioners expect this to become a fertile ground for disputes in the coming years. If your company is about to enter into any transaction or take step that might appear lacking in commercial substance or is unusual, and results in obtaining a tax benefit, it may be picked up for scrutiny. Be prepared to spend more time in evaluating and approving proposals that look like tax structuring.

The concept of Place of Effective Management (PoEM) is brought in to catch foreign companies in the Indian tax net if they are effectively controlled and managed from India. This can increase your group's tax outflow in here in respect of your overseas subsidiaries that do not have active business, even if they do not actually remit any profits to India. The detailed rules in this regard are still work-in-progress but this new tax provision promises to add to complexity, and therefore the litigation risk.

#### **Newly visible information can be used for questioning**

More information that will now be visible to Indian tax officers due to country-by-country reporting mandate under transfer pricing provisions will be keenly analysed by them. Expect more questions and attempts to boost the tax base in India on the basis of that information. Intangibles could be the new battleground, for garnering more share of tax for India. DEMPE will be the buzzword. It stands for Development-Enhancement-Maintenance-Protection-Exploitation of intellectual property (IP). If an Indian company has a role in one or more of DEMPE functions for a particular IP, the taxman here would want a

commensurate income from that IP to be offered to tax in this country, even if the ownership lies elsewhere. Indian tax officer is getting more savvy with data analytical tools and rich data generated by deposits after demonetization and the GST network.

#### **Appellate commissioners likely to grow even more unsympathetic**

Many law-abiding tax payers already feel that they get a raw deal from the first level appellate commissioners who are more prone to tow the revenue's line even when the taxpayer has a sound case. If recent press reports are to be believed, the Government is mulling over linking CIT(A)'s performance appraisal to the number of orders they pass in favour of the department. This is really bad news for honest taxpayers whose appeals on genuine grounds are now even more likely than before to not get a fair treatment at least until the tribunal level.

#### **Penalty and prosecution**

The penalty provisions of the income-tax law have been changed recently, replacing the concepts of 'concealment' and 'inaccurate furnishing of details' to 'underreporting' and 'misreporting'. While the changes appear to be well-intentioned, the actual understanding of these and implementation by field formations would be key in making future penalty proceedings fairer. Also, in last few years, there has been a marked increase in tax officers' propensity to initiate or threaten to initiate prosecution against principal officers of companies, which can include directors. This partly was due to the government's desire to send a strong signal on its anti-black money actions. Unfortunately, it is also the honest and law-abiding taxpayers with no mala fide tax claims who often end up taking bullets during such measures.

#### **Personal risks for directors?**

A principal officer of a company can be held liable for that company's contraventions under Indian income-tax law. A director, if she is connected with the management or administration, is covered by the definition of the term principal officer. Where an offence has been committed by a company and it is proved that it was committed with the consent or connivance of, or is attributable to any neglect on the part of any director, such director shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Where any tax due from a private company under liquidation in respect of a tax year cannot be recovered, then, every person who was a director of the private company at any time during the relevant tax year shall be jointly and severally liable for the payment of such tax. However, in case he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company, such dues cannot be recovered from him.

Tax officers have power to enforce attendance of any person and examining him on oath. They can also require any person to furnish information in relation to any tax proceedings. Failure to attend or furnish information as required can result in a penalty. ■