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Contents

Article
The Income Declaration Scheme, 2016 - An analysis 2

Notifications and Circulars 6

Ratio Decidendi 6

News Nuggets 10

April
2016

Article

The Income Declaration Scheme, 2016 - An analysis

By **Lakshmi Pavan**

Background

Last year, the Indian Government introduced a scheme for voluntary declaration of undisclosed foreign income and assets for resident taxpayers under the Black Money Act[1]. A similar scheme is proposed by the Finance Bill, 2016 referred as 'Income Declaration Scheme, 2016' ('IDS, 2016'). This article, discusses the possible benefits available to the taxpayers under the IDS, 2016 comparing the provisions of (a) Black Money Act; (b) Existing penal provisions under Section 271(1)(c) of the Income Tax Act, 1961 and (c) Proposed penal provisions under Section 270A.

Comparison 1: Declaration under Black Money Act v. IDS, 2016

The Black Money Act[2] is a declaration scheme under which all resident taxpayers can declare the undisclosed foreign income and assets. On such undisclosed income and assets, the tax payer was required to pay up to 60%[3] as both tax and penalty under that scheme. However, the officer designated had received 638[4] declarations only amounting to Rs 3,770 crores of undisclosed foreign income and assets by the end of compliance window (i.e., 30th September, 2015). Hence, one can conclude that this declaration Scheme was not successful[5].

Now a new scheme has been designed to declare any '*undisclosed income*' vide the Finance Bill, 2016 for persons who have not paid full taxes in the past and are required to pay tax, surcharge and penalty totalling to 45% of such *undisclosed income* declared. Though the declaration scheme under Black Money Act is closed, for academic purpose, let us compare and find out which of these schemes is beneficial.

Under IDS, 2016, the declaration of any 'undisclosed income' (i.e., domestic* or foreign** undisclosed income and assets) can be made as against 'undisclosed foreign income' under Black Money Act. IDS, 2016 is to a certain extent beneficial to both Government and declarants of the unaccounted income whether sourced in India or outside India.

Under IDS, 2016, the 'declarant'[6] can be resident or non-resident; this is a point of inclination towards this scheme. In addition, the liability to be discharged under IDS, 2016 is only 45% of undisclosed income, which is lower than the liability under the Black Money

* In case of all assessess

** In case of assessess whose income is not chargeable to tax under Black Money Act

1 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

2 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

3 30% as tax and 30% as penalty

4 Press Release dated 1 October 2015

5 View of the author

6 See Clause 179(a) of the Finance Bill, 2016 for the definition

Act (i.e., 60% of undisclosed foreign income and asset). The declarant under IDS, 2016 shall be granted immunity from penalty from all the laws for the time being in force and prosecution under the provisions of Income-tax Act and Wealth-tax Act, including Benami Transactions (Prohibition) Act, 1988. Similar type of immunity was granted for declaration made under the Black Money Act.

As the liability to be discharged under the IDS, 2016 is lower, it obviously appears to be more beneficial.

Comparison 2: Declaration under IDS 2016 v. Sections 271 & 276C

Any wilful attempt to evade tax under the current provisions of the Act attracts penalty under Section 271 and prosecution under Section 276C. Penalty will be levied for concealing the particulars of income or for furnishing inaccurate particulars of income and it would be ranging from 100% to 300% of the amount of tax sought to be evaded. Prosecution proceedings can be initiated for a wilful attempt to evade tax, penalty or interest and this may lead to imprisonment ranging from 3 months to 7 years along with fine.

However, under the IDS, 2016, the penalty will be just 25% of the tax evaded (i.e., 25% of 30%) and the declarant will be deemed to be immune from all prosecution proceedings under the Income-tax Act and Wealth-tax Act.

A snapshot of the provisions under the existing law and IDS, 2016 is given below:

Particulars	S. 271(1)(c)	IDS, 2016
Basic Tax Rate	30% *(assuming a company)*	30%
Surcharge	7%	25% of 30%
Education Cess	3%	-
Penalty	100%-300%	25% of 30%
Prosecution	Yes, but compoundable	Immunity granted

The impact of above provisions in monetary terms is explained below:

Particulars	S. 271(1)(c)		IDS, 2016	
Tax evaded income		1,000,000		1,000,000
Basic Tax Rate	30%	300,000	30%	300,000
Surcharge	7%	21,000	25% of 30%	75,000

Particulars	S. 271(1)(c)		IDS, 2016	
Education Cess	3%	9,630	-	-
Total tax payable		**330,630**		**375,000**
Penalty	100%	330,630		
	300%	991,890	25% of 30%	75,000
Total liability - Minimum		**661,260**		
Total liability - Maximum		**1,322,520**		**450,000**

The total liability to be discharged under IDS, 2016 is thus lower than total liability to be discharged considering the provisions of Section 271(1)(c).

Comparison 3: Declaration under IDS 2016 v. Section 270A

The Finance Bill, 2016 has proposed to rationalize the existing penalty provisions so as to bring objectivity, certainty and clarity to the provisions. Accordingly, it is proposed that with effect from 1st April, 2017 penalty shall be levied under the newly inserted Section 270A. It provides for levy of penalty in cases of under reporting and misreporting of income.

The proposed Section 270A seeks to provide that the tax officer may levy penalty if a person has under reported his income, cases, where income assessed is greater than the income determined under Section 143(1); or where income assessed is greater than the maximum amount not chargeable to tax, if no return of income has been furnished; or where income reassessed is greater than the income assessed or reassessed immediately before such re-assessment; etc.

Penalty in any of the above referred cases shall be equal to 50% of the amount of *tax payable* on under-reported income. However, in case of any misreporting of income, the penalty will increase from 50% to 200% of the amount of *tax payable* on under-reported income. Moreover, under the new scheme of penalty provisions, the *tax payable* shall be determined using the tax rates prescribed under Section 270A(10).

A snapshot of the provisions under the proposed Section 270A and IDS, 2016 is given below:

Particulars	Section 270A	IDS, 2016
Basic Tax Rate	30%[7]	30%
Surcharge	7%	25% of 30%

[7] s. 270A (10) provides the tax rate applicable on the under-reported income

Particulars	Section 270A	IDS, 2016
Education Cess	3%	-
Penalty	50%[8] / 200%[9]	25% of 30%
Prosecution	No / Yes	Immunity granted

The impact of above provisions in monetary terms is explained below:

Particulars	Section 270A		IDS, 2016	
Under reported income		1,000,000		1,000,000
Basic Tax Rate	30%	300,000	30%	300,000
Surcharge	7%	21,000	25% of 30%	75,000
Education Cess	3%	9,630	-	-
Total tax payable		**330,630**		**375,000**
Penalty	50%	165,315		
	200%	661,260	25% of 30%	75,000
Total liability - Maximum		**495,945**		
Total liability - Maximum		**991,890**		**450,000**

The total liability under IDS, 2016 is lower than total liability to be discharged under the proposed Section 270A.

Concluding remarks

One should also ensure that the declaration of undisclosed income should not form part of any proceedings pending under the following categories:

- Notices under Section 142(1) or 143(2) or 148 or 153A or 153C were received;
- Search or survey was conducted and the time-limit for issuance of notice was not expired;
- Information regarding such income was received from foreign countries;
- Cases covered under the Black Money Act; or
- Persons notified under Special Court Act; or

8 s.270A(7) applies where there is under-reporting of income but not misreporting of income

9 s. 270A(8) provides higher penalty for misreporting of income

- Cases covered under IPC, the Narcotic Drugs and Psychotropic Substances Act, the Unlawful Activities (Prevention) Act, the Prevention of Corruption Act.

IDS, 2016 is definitely a beneficial scheme for the eligible tax payers to declare the income which was not offered to tax earlier. However, one should note that the *immunity from prosecution* granted is only under Income-tax Act and Wealth-tax Act, but not under Foreign Exchange Management Act.

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Notifications and Circulars

Electronic Verification Code for e-filing of appeals to Commissioner (Appeals)

Recently, CBDT had introduced electronic filing of appeals to Commissioner (Appeals). By Notification No. 5/2016 dated 6-4-2016, the procedures, data structure and standard of EVC (Electronic Verification Code) have been laid down. After verification of the identity of the person furnishing the form, EVC would be generated on the e-filing website of the department. Where the verifier represents an entity – HUF, firm, AOP, etc., he should be registered as the Principal Contact of the entity in the e-filing website. One EVC can be used to validate one form of the assessee irrespective of the assessment year.

Ratio decidendi

Section 94A(1) empowering government to specify notified jurisdictional area is constitutionally valid: Section 94A(1) of the Income-tax Act, 1961 empowers the Central Government to specify any country as a notified jurisdictional area and hence deny certain treaty benefits to persons who enter into transactions with persons located in such notified jurisdictional area, tax amounts deemed to be income and seek withholding of tax. The Madras High Court examined recently challenge to the constitutional validity of the above provision and also the notification of Cyprus as a notified jurisdictional area. The petitioner had agreed to buy share and debentures from a company located in Cyprus. By Notification No. 86/2013 dated 1-11-2013, Cyprus had been notified as jurisdictional area since it did not honour its obligation to furnish information and the petitioners were asked to show cause as to why they should not be treated as assessee in default since withholding tax had not been deducted on the payments.

The petitioners urged the provisions of the treaty would be paramount and the Parliament cannot enact a law which would be inconsistent with the treaty. Also while Section 90 of the Act enables the government to enter into treaties with other countries, Section 94A(1) providing that the government may specify any country as a notified jurisdictional area is inconsistent with the same. They contended that as per Article 51 (c) of the Constitution of India, the government should honour international treaties and as per the Supreme Court decision in *Union of India* v. *Azadi Bachao Andolan* [2004 (10) SCC 1], provisions of such an agreement would operate, even if inconsistent with the provisions of the Income Tax Act. The petitioners contended that the power of the Parliament to make laws as provided under Article 245 is subordinate to the power to make laws to implement treaties as provided under Article 253. However the High Court observed that the fact that Article 253 confers power upon the Parliament to make any law for implementing any Treaty, coupled with the fact that Section 90(1) of the Income Tax Act enables the Central Government to enter into an agreement, would show that the Parliament is supreme.

The High Court of Madras held that the Supreme Court decision in *Azadi Bachao Andolan* did not deal with the question whether or not Parliament has the power to make a law in respect of a matter covered by a treaty and even if such question does arise, it cannot be said that the collective conscience of the people reflected by the Parliament would be subordinate to a treaty which is made by the Executive. As regards Section 90, it stated that this provision does not say that the law made by Parliament would stand eclipsed or excluded, to the extent it is inconsistent with the terms of the agreement. Further, applying the principle of '*Pacta Sunt Servanda*' or good faith in abiding by the terms of the treaty, it can be seen that Section 94A had been enacted to provide for a situation when the other party does not abide by the treaty. Thus the High Court upheld constitutional validity of the section as also the notification specifying Cyprus as notified jurisdictional area. [*T Rajkumar & Ors.* v. *UOI*, W.P.Nos.17241 to 17243 & 17407 to 17412 of 2015, Order dated 12-4-2016, Madras High Court]

Scrutiny based on AIR to be limited to AIR – AO cannot act without permission as envisaged in the Act: The Tribunal held that the department officers should follow the CBDT instruction strictly and in the instant case where in scrutiny was undertaken based on the Annual Information Report (AIR), the Assessing Officer cannot travel beyond the aspects covered under the AIR. The AO sought explanation as to source of funds of Rs. 25 lakhs which was explained/proved by the assessee as sale consideration of a flat. The AO further sought information as regards another sale transaction and proceeded to make additions on account of capital gains. The assessee successfully contended that scrutiny should be limited to the AIR as per CBDT Instruction No. F.No.226/26/2006-ITA.11 (Pt.) (APB-15) dated 8-9-2010, and the AO should have sought permission of the administrative Commissioner if he felt that there was potential escapement of income above Rs. 10 lakhs. [*Gurpreet Kaur* v. *ITO*, ITA No. 87 (ASR)/2016, ITAT, Amritsar, decision dated 23-3-2016]

Professional fee to common director/ owner when not deductible : At issue was the professional fee paid by the assessee to a foreign company in which the director of the assessee was director and also owner. The assessee claimed that though services were rendered by the same person the activity was carried out in different capacities. There was no evidence of any independent work done by the foreign company. The ITAT did not find force in the argument of different capacities and upheld the order of the lower appellate authority confirming disallowance of payment of professional fee. The assessee also contended that since the income of the foreign company has been offered to tax, it was a genuine transaction. However, the ITAT held that merely because an income has been taxed in the hands of recipient, it does not mean that it is a deductible expenditure in the hands of the person making the payment. [*Stock Traders Pvt. Ltd.* v. *Assistant Commissioner* – Order dated 5-4-2016 in ITA Nos. 2802, 2803 & 2088/Mum/03, ITAT, Mumbai]

Bills discounting charges not taxable as interest at hands of foreign AE : The foreign AE (in Singapore)discounted bills of the Indian AE and later realised payment on the same. The department contended that the 'discounting charges' were in the nature of interest and would be taxable. It was also argued that the Indian AE had not approached any bank for discounting of bills and the entire transaction was only a device to escape taxes. It was sought to distinguish the decision of the High Court of Delhi in *Cargill Global Trading India Pvt Ltd* (another entity of the group) holding that discounting charges are not interest and not taxable in India when no PE was established. Following the decision, the Tribunal also held that the discounting charges were not 'interest' since it did not relate to any debt and also the department could not question commercial expediency of the transaction which the AEs has entered into. [*Cargill Financial Services Asia Pte Ltd*. v. *ADIT*, dated ITAT, Delhi order dated 15-3-2016]

Hoarding structures not 'plant' for assessee engaged in outdoor advertising : The assessee claimed the depreciation should be allowed at higher rates on hoarding structures which were the tool of business and hence 'plant'. The department was of the view that the structures were 'building' and hence, depreciation was to be charged at 10%. The assessee argued that plant could include buildings and applying the functional test, the structure used for carrying on the business could be considered 'plant'. However, the ITAT held the structures to be buildings. [*Asian Advertising* v. *ITO*, I.T.A. No. 2349/ Mum/2013, ITAT, Mumbai decision dated 23-3-2016]

Payment for non-exclusive license to use data set is not royalty : At issue was the taxability of the consideration paid for purchase of data set and non-exclusive license to use the same by the assessee who was engaged in business of oil and exploration. The ITAT observed that definition of royalty under the Income Tax Act was more exhaustive as compared to definition under the tax treaties (Article 12(3) of India-US DTAA and Article 13 of India-UK DTAA, respectively). ITAT noted that under the Act, consideration for granting of licence for use of property also meant royalty but there was no such provision under the tax treaties. Evaluating the taxability under the India-UK DTAA, the ITAT held that since licence was granted to use certain data from time to time upon the terms and conditions as set out set in the license agreement and not the copyrighted material itself, the payment was not taxable as 'royalty'. [*GVK Oil & Gas Limited* v. *ADIT*, ITA.No.317 & 318/Hyd/2012, ITAT, Hyderabad Order dated 9-3-2016]

Guarantee commission on worldwide corporate guarantee when not taxable in India: The assessee had given corporate guarantee on behalf of its subsidiaries worldwide, to a French bank. Reasoning the income (guarantee commission) arose in India since the credit facility was extended by the Indian branch to the Indian entity, the department sought to tax the same as 'other income' as per Article 23.3 of the India-France DTAA. However, the ITAT held that income clearly arises in France because the guarantee has been given by the assessee, a French company to a French Bank, in France and income did not arise in India and hence it was not taxable in India.[*Capgemini SA* v. *ADIT*, ITA No.7198/Mum/2012, ITAT, Mumbai Order dated 28-3-2016]

AO bound by the directions of DRP : The petitioner, a partnership firm based in Mauritius sought relief from the subversion by an Assessing Officer (AO) of the order of the superior statutory authority namely the DRP (Dispute Resolution Panel). The international transactions of the assessee had been accepted to be at ALP. The AO passed a draft assessment order proposing additions. The petitioners urged that no variation had arisen based on the order of the TPO, that they were not body corporates and hence not eligible assessees as per Section 144C(15)(b) of the Income Tax Act, 1961. They filed their objections before the DRP which dismissed the proceedings *in limine*. However, the AO proceeded to pass the final assessment order stating that the DRP had not acted in accordance with the law. The Delhi High Court set aside the draft as well as the final assessment orders holding them to be *void ab initio* and reiterating that the AO was bound by the directions of the DRP. [*Espn Star Sports Mauritius* v. *UOI* W P.(C) 2384/2015 & CM No. 4277/2015, Order of Delhi High Court, dated 23-3-2016]

Continuing contract for provision of crew - Tax not based on vessel being in Indian waters : The assessee leased a vessel under a time charter agreement and also entered into a management contract for management of vessel and provision of crew to operate the vessel. It claimed that the income earned during the time the vessel was 'outside India' was not taxable since it did not accrue or arise in India. Deciding against the assessee, the ITAT held that since, contract for the provision of crew was a continuing contract, revenue was not earned for the period the vessel was out of the territorial waters of India was also taxable and the assessee could not offer income to tax on pro-rata basis based upon the number of days the vessel was stationed within 200 nautical miles from the Indian shore line. [*Siem Offshore Crewing AS* v. *ADIT*, I.T.A. No. 4542/Del/2013, ITAT, Delhi Order dated 11-3-2016]

News Nuggets

Information under Country-by-Country reporting to be available to the public in EU

The European Commission on 12-4-2016 made a decisive move towards making available to the public data furnished by multi-nationals under the Country-by-Country Reporting standards. As per the press release issued in this regard, this proposal focusses on corporate groups with a worldwide consolidated net turnover of more than EUR 750 million. As per the proposed Article 48b which is part of the amendments to Directive 2013/34/EU, report on income tax information shall be made accessible to the public on the website of the undertaking on the date of its publication. Member states may require branches, small and medium sized undertakings to publish the report on income tax information of that ultimate parent undertaking on an annual basis, where the consolidated net turnover of the ultimate parent undertaking exceeds the threshold. As per the EC, within the EU and for jurisdictions outside the EU which do not have good tax governance, the entities will have to make public details of tax paid, taxes due, profits before tax, number of employees and so on. This information is to help the public to know taxes paid with the EU and whether taxes have been shifted out of the EU.

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