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Black Money Tax Compliance Scheme

Grey Patches Remain

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There are a number of unclear areas in the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and the tax compliance scheme. These are bound to pose practical challenges and be prone to conflicting interpretations, leading to tedious and complicated disputes.

The much deliberated upon and talked about Black Money (Udisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (henceforth the act) and the tax compliance scheme have come into operation. Although the act was slated to come into effect on 1 April 2016, Section 3 of the act mentions its first assessment year will begin from 1 April 2016. This means that income and assets accrued from the financial year beginning 1 April 2015 come under its purview. Further, the one-time tax compliance scheme (henceforth the scheme) could not have come into existence, without the main act coming into operation. Once the legislature acknowledged this anomaly, it quickly swung into action and notified the act through removal of difficulty order.[1] This makes the act effective from 1 July 2015. The government notified the scheme the same day. Its scope and machinery was clarified through the Central Board of Direct Taxation (CBDT) compliance circular.[2] However ironically, this gave way to more confusion and the CBDT quickly issued another circular listing frequently asked questions (FAQ).[3] The circular lists 32 FAQs that address issues like procedural aspects of declaration and manner of valuation. Even after a series of clarifications many aspects remain unclear. These pose practical challenges and render the act vulnerable to conflicting interpretations which may lead to disputes.

The article identifies the grey areas under the scheme and briefly touches upon the automatic exchange of information regime, touted as a significant factor to ensure its success.

Stringent Deadlines

The declaration under the scheme must be made by 30 September 2015 before the designated principal commissioner of income tax or commissioner of income tax. The department will by 31 October 2015 ascertain if a competent authority has

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information—received before 30 June 2015 under the Double Taxation Avoidance Agreement (DTAA) or Tax Information Exchange Agreement (TIEA) with any other country—that corresponds with the declaration. However, the information provided by the department does not validate the declaration. In other words, the onus is entirely on the declarant to ensure if the declaration complies with the scheme's requirements. This is important because the scheme does not allow the option of making rectifications. So a declaration based on suppression of facts or a genuine technical error can be declared null and void and cannot be rectified. The declarant will then have to face the consequences under the act. Therefore, while the declaration window is extremely short, it requires extreme caution and diligence from the applicant.

However, the scheme allows a revised declaration only in respect of assets which have been duly declared but found ineligible for declaration because the government had prior information on such an asset. This is the only exception where the original declaration will stand disqualified and the applicant can make a revised declaration within 15 days of receipt of intimation from the designated officer.

Further, the FAQ specifies that inherited property from unexplained source of investment also needs to be declared under the scheme. Not only this, the declarant needs to disclose if such property has been sold off. This is a sticky situation because the scheme states that mere disclosure of foreign assets does not tantamount to explaining the source of investment. But it does not clarify what amounts to a satisfactory explanation. In a nutshell, there would be practical complications in undertaking this exercise—that would include valuing assets on the current date and seeking professional advice from consultants—in a short time frame.

Valuation Quagmire

Valuation of assets is the most contentious and dispute-prone area. The Black Money Rules[4] states that valuers recognised by the country in question undertake this task. However, it is difficult to ascertain who is a recognised valuer in the country in question. Further, there are many issues and practical complications pertaining to valuation of assets like bank accounts, unlisted shares. In regard to bank accounts, as per Rule 3(1)(e) of the Black Money Rules, all accretion and withdrawals have to be taken into account since the time the account has been opened for arriving at the closing balance. But most banks generally do not maintain records beyond a certain period, and therefore providing such information can be a challenging task for the declarant.

Furthermore, if the applicants are from West Asian countries where there is no tax requirement, it is very likely that such records have not been maintained. An equally arduous task would be to value the shares of an unlisted company within such limited duration. As per the Black Money Rules, the applicant has to obtain the "book value of all the assets of the company," irrespective of his share of holding in that company. This is a

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cumbersome process which has to be concluded at any cost within three months—that is by 30 September 2015.

However, the challenges are not only for the declarant, but even for the tax administration which theoretically speaking can reject an understated valuation on the ground of misrepresentation. However, it seems highly unlikely that the department has the resources to match the market value with the stated value, cross verify the validity of the declaration made under various countries, when the designated officer has to notify the applicant within a one month period, that is, by 31 October 2015. Moreover, a major ground of dispute could be pertaining to the subjective nature of valuation which may differ on several instances.

So what happens if the valuation declared by the declarant is not in consonance with the declaration made by the applicant? Is the department going to per se accept the valuation declared by the applicant based on the report provided by the valuer recognised in a given country? It must also be noted that a genuine difference of interpretation leading to differences in the valuation report is common and cannot be ruled out. What would be the consequences upon such an eventuality remains uncertain.

Further, there could be a situation where the person has bought an asset abroad with loans taken outside India. As per the valuation rules, the declarant has to declare the market value of such assets, but there is no provision for factoring in the loan amount. For example, if A has bought a home worth Rs 100, out of which the loan amount was Rs 70, only Rs 30 was actually used from his own income. The scheme is not clear whether the valuation of assets can be reduced by the amount of loan availed.

There are further complications when it comes to valuation of interest in the discretionary trust, where the beneficiary is not certain about his share. The Black Money Rules are also not clear about how to treat a contribution to social security fund like pension funds. Is there a possibility of seeing such contribution as an enforceable vested right that should have been disclosed? These are some of the many questions that still remain unanswered by the FAQs and are constantly bothering the professionals and consultants who have to advise their clients who may be contemplating declaration under the scheme.

Chargeability of Interest

Chapter VI of the Black Money Act is silent on the chargeability of interest, unlike penalty and prosecution which have been expressly excluded. However, if one looks at Form VI, it requires a declarant to mention the exact date of acquisition of assets. Therefore, the information regarding the period from which the interest can be levied is clearly available before the department, in other words, there is a possibility of levy of the same. Furthermore, there is another aspect which is more essential from the perspective of the tax administration. This is the possibility of the Comptroller and Auditor General (CAG) raising an objection on the non-chargeability of such interest by the Income Tax Department, when the exact date of acquisition of asset out of undisclosed income was available and interest

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could have been charged for the disclosed duration.

Extension of Payment Deadline

A practical complication that needs to be factored in by the authorities under the scheme is a situation where the applicant has duly declared the undisclosed assets but due to certain unavoidable genuine financial hardships, he is unable to pay the tax within the deadline, that is, 31 December 2015. There could also be situations where a son has inherited property from his father whose source is not clear, a beneficiary to some bank account or trust who was not aware of such interest, etc. In these situations, the person may not be in a financial condition to immediately pay off the taxes, considering the entire valuation would be have to be done on the current date which increases the monetary liability.

Section 61 of the act clearly states that the tax and penalty shall be paid on or before the date notified by the CBDT but if the applicant fails to do so, the declaration shall be deemed never to have been made. So, the question arises whether the revenue authorities have the discretion or power to grant an extension in such a situation? The answer is no. A similar situation arose in the Voluntary Disclosure Scheme (VDIS), 1997 where the petitioner (Hemalatha Gargya) sought an extension of the payment date of the tax under the scheme.

The matter reached the Supreme Court,[5] which held that it is not open to the revenue authorities to alter or modify the explicit terms of the scheme, that is, no extension of the last payment date of tax can be granted. With such binding precedent of the apex court, the only possible relief for an applicant would be that the CBDT issues a circular extending the last date of payment of tax and penalty under the scheme, perhaps with compensatory interest chargeable for such an extended period. Certainly, such a measure can be expected only if there are multiple cases which merit extension of the payment date.

Broadening the Horizon

The definition of “assessee” under the Black Money Act includes resident other than not “ordinarily residents.” If one looks at Chapter VI, Section 59 states that any person may make a declaration under the one time compliance window. However, the circular states that the scope of the scheme is to cover only residents. The FAQ circular (FAQ no 23) states that a non-resident may make a declaration under the scheme, if he had acquired foreign assets as a resident out of the income, that is, tax chargeable in India but not disclosed in the income tax return. Interestingly FAQ no 32 also clarifies that a non-resident person in India who was employed in a foreign country may make a declaration of his assets if it was acquired out of income which had a connection with India and was tax chargeable. The impression one may derive from reading Section 59 and some of the aforementioned FAQs is that the litmus test for applicability of the scheme is whether the undisclosed foreign assets acquired out of income was chargeable to tax in India or not, and not the residential status of the person. In a nutshell, the possibility of confusion or conflicting interpretation cannot be completely ruled out since circulars issued by CBDT are also statutory in nature.

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Moreover, whatever the case may be, a clarification does no harm if it allows a willing not-ordinarily-resident to come forward and go out clean.

Another practical scenario could be where the assessment has been left open because the assessing officer could not obtain certain information and therefore, there is always a possibility of scrutiny or reopening of such assessment. The question that arises is whether such an assessee is eligible to make declaration under the scheme. The act does not allow such an assessee to declare undisclosed foreign assets since his income is now the subject matter of assessment. This situation is quite likely to occur and therefore, requires an immediate clarification. It would be advisable to cover such assessees under the scheme which will not only augment the revenue kitty, but also provide immunity to the declarant.

To sum up, the government should contemplate allowing an assessee to avail the declaration under the scheme, if he has undisclosed foreign assets acquired out of income pertaining to the period up to 31 March 2015, which has escaped assessment or the assessing officer has left the assessment open due to lack of information. Further, this eligibility to declare should be accorded, irrespective of his residential status. After all the sole objective of any voluntary disclosure scheme is to encourage the maximum number of persons to come forward to regularise past instances of tax evasion and avoid any future prosecution.

The Deterrent Effect

The experience of disclosure schemes in other jurisdictions usually shows that only when such schemes offer concessional rates and the authorities have relevant information, do tax evaders come forward to declare. This applies not only to tax compliance programmes but also to the domain of competition laws where cartel members are lured to come forward to avail the leniency schemes. The threat of being pulled up has to be palpable and mere speculation and strict laws in letter would not drive the tax evaders to come home. The rate of prosecution of tax evaders in India remains dismal. Further, the scheme does not offer any concessions in terms of reduced tax liability or penalty, but only immunity from prosecution. Not only this, it is riddled with several unexplained areas, practical complications which makes it an unchartered territory. This implies that the cost–benefit analysis decision becomes all the more difficult for the prospective declarants. Some experts have opined that this scheme is another form of amnesty scheme. During the VDIS episode, the Government of India had filed an affidavit before the Supreme Court saying that it would not come out with another amnesty scheme in the future. In other words, although the black money scheme aims to garner revenue for the nation, the possibility of someone challenging its constitutionality cannot be completely ruled out.

The FAQ circular clearly shows that the success of the scheme greatly hinges upon the forthcoming regime of Automatic Exchange of Information (AEOI). It must be understood that the AEOI is yet to become operational and the tentative date is around 2017–18. The

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membership to the AEOI regime is voluntary, although the Organisation for Economic Co-operation and Development (OECD) is putting all possible pressure on nations to embrace its membership. However, how much the errant and notorious tax havens oblige the OECD and join the AEOI regime is yet to be seen. Further, it is true that the 16 years' cap of reopening of assessment as given in the Information Technology Act is not applicable under the Black Money Act. But the moot question is whether it is sufficient when the information that would be shared under the regime of the AEOI will be only prospective and not of the past.

Another crucial aspect which requires mention is that under the present Common Reporting System (CRS) of AEOI, a pre-existing account will be reported only when the account has $2,50,000.[6] Therefore, it would be at the discretion of a sovereign nation to report an account whose value does not match this threshold. This threshold can be avoided by spreading the money over several accounts with value less than $2,50,000.

The situation becomes all the more grim because under the Financial Action Task Force (FATF)[7] recommendations, a person can be considered to hold beneficial interest only when he has more than 25% controlling interest.[8] In other words, unless A (an Indian resident) holds more than 25% shares in a company in country A (a member of the FATF) which follows the CRS under the AEOI regime, country A is not obligated to share with India any information about A. This high threshold is a potential ground for avoidance of reporting under the AEOI.

One good recommendation would be to adopt the threshold of 10% as prescribed under the Foreign Account Tax Compliance Act signed between the US and other countries. However, since the developing countries have been hardly consulted in the process of framing of corporate social responsibility norms, it is unlikely that India stands much of a chance in lobbying for its recommendations for plugging the loopholes of the AEOI structure.

Notes

1 Notification No 56/2015, dated 1 July 2015. Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act (Removal of Difficulties) Order, 2015.

2 CBDT circular No 12/2015, dated 2 July 2015. Explanatory Notes on provisions relating to tax compliance for undisclosed foreign income and assets as provided in Chapter VI of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

3 Circular No 13/2015, dated 6 July 2015. Clarifications on Tax Compliance for Undisclosed Foreign Income and Assets.

4 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Rules, 2015 (Black Money Rules).

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5 *Hemalatha Gargya vs CIT* 2002-TIOL-548-SC-IT (2003) 259 ITR 1 (SC).

6 See "The Full Picture of OECD's AIE Standard Is Unveiled: Catering to Tax Havens at the Expense of Developing Countries," Tax Justice Network, 20 June 2014.

7 FATF is an intergovernmental organisation founded to harmonise the legal and regulatory approach of its member countries to combat against money laundering and terrorism financing. India is a member of FATF since 2012.

8 See, Andres Knobel and Markus Meinzer, "The End of Bank Secrecy"? Bridging the Gap to Effective Automatic Information Exchange: An Evaluation of OECD's Common Reporting Standard (CRS) and its alternatives, Tax Justice Network, 24 November 2014.