

Chapter 1

Introduction and Background

- 1.1 Reading about real world cases on alleged tax evasion can match the best of the fictional thriller stories, especially when we hear of cases like:
- ♦ A group of French aristocrats who passed more than 80 billion Euros through Bermuda, then to Singapore finally landing in a Canadian trust¹.
 - ♦ A scion of one of Guatemala's most powerful families stashing more than \$13 million in a secrecy-shaded trust in the Great Plains of the United States².
 - ♦ The world's most valuable company - Apple Inc. – which established an offshore subsidiary - Apple Operations International – through which it reported net income of \$30 billion from the period of 2009 to 2012, but declined to declare any tax residence, filed no corporate income tax return, and paid no corporate income taxes to any national government for five years.³
 - ♦ An Indian family which was beneficiary to almost \$45 million through a trust in Switzerland.
- 1.2 The above are just a few examples of how taxpayers hide huge wealth outside their own country of residence thereby escaping tax and scrutiny of governments
- ♦ with the assistance of unscrupulous advisors,
 - ♦ who use legal loopholes or even dubious laws, and
 - ♦ along with financial institutions and banks,

1 Roch c. Doron, 2023 QCCS 344 (CanLII), dated 26th January 2023.

2 “Offshore havens and hidden riches of world leaders and billionaires exposed in unprecedented leak” by ICIJ, October 3, 2021.

3 United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.), May 21, 2013

- ♦ devise strategies enabling the holding of funds offshore,
 - ♦ which are passed through layers of entities and structures
 - ♦ housed conveniently in tax havens and offshore financial centres.
- 1.3 A 2021⁴ report which analysed OECD data stated that the world is losing over USD 483 billion in tax a year to international tax abuse of which nearly USD 312 billion is lost to multinational corporations shifting profit into tax havens. The balance USD 171 billion is lost to wealthy individuals hiding undeclared assets and incomes offshore, beyond the reach of the law. India is estimated to lose around USD 16 billion, or more than 4% of its annual tax revenue, every year!

Exchange of Information under treaties:

- 1.4 With the rapid move towards globalisation, there was a need to ensure the tax authorities have information required to combat tax evasion and harmful tax practices. For that, it was important that the tax authorities have the relevant information about the income of the taxpayers in other countries. This resulted in the Exchange of Information article in the Model Tax Convention. This has been of equal importance along with the allocation of tax rights of income between the Contracting States to a tax treaty. This is evident from the fact that the first OECD Model Tax Convention of 1963 had a clause on Exchange of Information between the tax authorities.
- 1.5 Article 26 of the OECD Model Tax treaty provides that the competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out administration of taxes under the treaty or the domestic tax laws. The OECD Model Commentary provides that only specific information requests which are foreseeably relevant for the tax authorities should be covered and not ‘fishing expeditions’.

⁴ The State of Tax Justice 2021, published 16th November 2021 by Tax Justice Network.

1.6 Para 9 of the OECD Model Commentary on Article 26 provides,

“The rule laid down in paragraph 1 allows information to be exchanged in three different ways:

(a) on request, with a special case in mind, it being understood that the regular sources of information available under the internal taxation procedure should be relied upon in the first place before a request for information is made to the other State;

(b) automatically, for example when information about one or various categories of income having their source in one Contracting State and received in the other Contracting State is transmitted systematically to the other State;

(c) spontaneously, for example in the case of a State having acquired through certain investigations, information which it supposes to be of interest to the other State.”

1.7 Paras 7 and 8 of the OECD Model Commentary on Article 26 provide the instances wherein information can be exchanged between the competent authorities, which include information from financial institutions which are a part of a specific investigation by the tax authorities in the country which possesses the information.

1.8 Further, Para 8.1 also provides instances of certain situations, wherein the competent authorities are not required to exchange information as it may be considered as fishing expedition. It includes situations where the competent authorities of State A simply ask for names of all account holders in a bank situated in State B in respect of tax residents of State A, without any further information.

1.9 The result was that while there was a mechanism for sharing of information, there were enough stumbling blocks towards full transparency as far as exchange of information goes. But all this changed post 2008.

Global developments:

1.10. The tax world changed in the period after 2008 with the American Economic Crisis which affected the world

economy and especially the USA. The US Government turned its focus on systemic evasion and avoidance of tax by its own residents.

- 1.11 In 2010, the USA enacted “Foreign Account Tax Compliance Act” (FATCA) with the objective of tackling tax evasion by obtaining information in respect of offshore financial accounts maintained by the US residents and citizens. In 2014, the G20 and OECD countries working together, developed a Common Reporting Standard (CRS) on Automatic Exchange of Information (AEOI) wherein the onus was on financial institutions to share the information to their respective tax authorities, of taxpayers resident of other countries. India is said to have played an instrumental role in this initiative. A Multilateral Competent Authority Agreement (MCAA) was entered into, to enable this automatic exchange of information, to which India is also a signatory.
- 1.12 Until the advent of AEOI, information was exchanged largely on a request basis which affected the free flow of relevant information. Today, around 110 countries around the world have adopted AEOI. Information on 111 million financial accounts, covering total assets of nearly EUR 11 trillion, was automatically exchanged in 2021⁵.
- 1.13 The last decade has also been witness to effective investigative journalism whereby massive leaks have been made of client data held by firms in tax havens. Such leaks have brought to attention the massive amount of tax loss and numerous taxpayers who sought to evade tax. This also brought about political will to ensure that tax evaders do not get out of the clutches of the tax department.
- 1.14 All the above reasons led to many countries around the world bringing in voluntary disclosure schemes for undisclosed incomes and assets. These were a precursor to strengthening of the disclosure norms and bringing in stringent consequences for tax evasion in the form of undisclosed offshore assets.

5 2022 Annual Report by Global Forum on Transparency and Exchange of Information for Tax Purposes

Developments in India:

- 1.15 Indians, over centuries, have ventured out of their home and country to seek prosperity and make their own fate in the international arena. Today we live in a truly globalized world and cross-border asset holdings are quite the norm as far as India is concerned. It is quite likely that someone you know is either working outside India, has an investment outside India, or has income from a source outside India.
- 1.16 This has been true even before the enactment of the Income-tax Act ('the Act' or 'ITA') in 1962. However, post liberalisation in outbound investment rules (under the Liberalised Remittance Scheme and Overseas Investment Rules of FEMA), quite a few Indians today are active in foreign business and hold properties or assets outside India.
- 1.17 In line with global concern over tax evasion and concerted efforts for bringing in AEOI, India too enacted the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act in 2015. ('BMA') This brought in provisions levying not just penalty but also prosecution where Indian residents were found to have stashed undisclosed incomes in the form of assets outside India. At the same time amendments were made in FEMA and PMLA to ensure there is no escape for tax payers who have undisclosed assets outside India. These are discussed in detail in Chapter 9 later.
- 1.18 After the promulgation of the AEOI, in a sense the first successful multilateral agreement dealing with tax issues, Indian tax authorities are automatically and periodically receiving information on the offshore accounts of all Indian tax residents in overseas jurisdictions. This has enabled the Indian tax authorities to keep a check of all unaccounted income and assets of Indian residents outside India.
- 1.19 Recently the department has also constituted Foreign Asset Intelligence Units (FAIUs) around India to sift through the data with a focus on cases of undisclosed assets held abroad by Indians and black money stashed abroad. The new units will also probe cases of Indian entities named in global tax document leaks like the Panama and Pandora Papers, etc.

- 1.20 Considering the above background, it is important for resident taxpayers to ensure full compliance with the disclosure requirements under the ITR Form. However, even today there are taxpayers who believe information about their tax shelters would remain secret. With the fall of banking secrecy and effective and automatic exchange of information, it is no longer possible for taxpayers to shift incomes or create assets outside India without a high possibility of getting caught by the tax department.
- 1.21 However, for more than two decades post liberalisation there were no disclosure requirements under the tax return forms for foreign assets and action was taken by the tax officers only during the assessment proceedings. This all changed when Schedule FA dealing with disclosure of Foreign Assets was introduced as part of the Income-tax Return Form (ITR) Form in AY 2012-13. It is now more than a decade since the requirement of disclosure of foreign assets and foreign incomes was brought into the income-tax return (ITR) forms. Much has changed since then, especially with an increase in the scope of the disclosures required, as also the consequences of non-disclosure thereof.

Legal basis or the lack of it:

- 1.22 Schedule FA was introduced, quite innocuously, through the amended ITR Forms for AY 2012-13, relevant for FY 2011-12. While the ITR Forms are introduced through Section 139 and Rule 12 of the Income Tax Rules, 1962 ('the Rules'), the amendments in the forms themselves do not require a separate legislation. This is because it is understood that the Forms are meant for filing of the incomes that a taxpayer has earned for the concerned previous year and hence enable such taxpayers to correctly submit the details towards the same. General information apart from the income computation and tax details contain details which are otherwise available with the department and are essentially linked to the Permanent Account Number or to determine the tax liability, for example, residential status, type of person, etc.
- 1.23 However, over the years, a lot of disclosure requirements have been brought into law indirectly through the income

tax returns. The trend started with the Schedule FA which required details of Foreign Assets, whether or not such disclosures were connected to the taxpayer's incomes for the year or not. The Schedule, as introduced, did not even ask for foreign sourced incomes as those already formed part of the tax return form itself, under schedules meant for various heads of income. It is well understood that under the Income-tax Act, the ITR Form can ask for any details or information that would be required to compute the taxpayer's incomes correctly. Details in the tax return form should necessarily have a nexus with requirements under the Act. Any detail that is required beyond computation of incomes may be considered as an overreach without necessary amendment in the main law, i.e., ITA.

- 1.24 The issue gets compounded with the fact that non-disclosure leads to penal consequences under Section 43 of the BMA where, in practice, tax officers tend to levy a flat penalty of ₹ 10 lakhs even for innocent errors. This leads to a situation of a disproportionately high penalty being levied against the non-disclosure made. In such a case, requiring every resident holding a foreign asset to report under the Schedule FA without a substantive provision under the ITA seems unfair. A better position would have been to first enact a provision linking the non-disclosure of assets to a possible reason for assessment of such tax return (with suitable thresholds). A requirement under the tax forms then to report all such assets would be in line with the law. This would also enable the taxpayers to access the memorandum and notes to clauses laying down the intent and objective of the provisions, which is generally provided for amendments in law, but are missing for amendments in the forms, howsoever substantive they may be in determining income or leading to severe penal consequences as in this case.
- 1.25 Further, instructions to these disclosure requirements have remained bereft of helpful guidance and largely focus on reiterating what is already stated in the headings of Schedule FA of the ITR Form. The gap in guidance is quite alarming, especially with the fact that even a mistake in the asset disclosure could lead to initiation of penal

consequences. This is all the more concerning as there is a lot of material including commentaries, guidance notes, rules, etc., related to disclosure of this information by the reportable financial institutions under the CRS/FATCA norms.

- 1.26 The attempt in the following chapters is to demystify the reporting requirements for foreign assets and incomes. At the same time, the focus of the book is kept on disclosure requirements alone and hence there is no debate on taxability of such incomes or consequences under the BMA for undisclosed assets. The idea is to explain the basic concepts and analyse open issues - with the aim to provide clarity as far as compliance with the disclosure requirements is concerned.

