Trends in International Tax Planning - Way forward.

CA Rashmin Chandulal Sanghvi

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I. *Theme:*

You, I & professional institutions - together will make our own future.

I. *Theme & Summary of this Paper.*

I.1. We look at International Tax Planning:
A global view.
From India's perspective.

I.2. To look at the future,
A. We look – briefly at past & present; and then
B. Future.
C. SWOT analysis.
Strengths & Weaknesses; Opportunities & **Threats.**

I.3. Massive Changes / Attacks on Tax Avoidance.
"Disruption" is a small word.
What is happening is like series of Earthquakes.

I.3.1 **Legal: IT:** SAAR, TP, GAAR, BEPS, S.9 & S.56; Black Money Law, FEMA, PMLA, Benami Property Law.

I.3.2 **Technology** – Internet – Software – computerisation & digitalisation of finance. Big Data & Data Analytics. Artificial Intelligence can be used by tax payer as well as tax collector.

I.3.3 **Government Approach:** Information Exchange Agreements & collapse of banking secrecy. Hold the tax consultant & auditor responsible. Tax haven jurisdictions falling apart.

I.3.4 **Ethical Hackers** like Tax Justice Network, "Wikileaks" etc.

I.4 International Tax Practice in India.

I.4.1 Distant Past: Pre-1991/ Pre Liberalisation.

Almost no one cared for international tax. No one studied – whether CAs, Lawyers, CITs or Judges. Litigation was on elementary issues like – whether an item of expense is Royalty or FTS or business expense. Less than 5 consultants all over India knew International Tax & FEMA.

I.4.2 Near Past: 1991 to 2013 Liberalisation to BEPS.

In the year 1987, a small group of CAs under the leadership of **Shri Dilipbhai Thakker** started spreading knowledge on these subjects. Soon BCAS, ICAI, Chamber of Tax Consultants and other professional bodies started arranging lectures, conferences, RRCs and study courses. My dream in the year 1987 was: **100 Indians becoming experts** in International Tax & FERA/FEMA. Today more than 1,000 Indians

(professionals + CITs) are good at International Taxation. Some of them are also good at FEMA. World has taken note of India's knowledge base in the field. And India is the only country where CAs provide expert advice on taxation including international taxation. In other countries, International tax practice is the domain of lawyers.

Conferences organised in India on International Taxation have been noticed by the global community of international tax professionals. **Indian judgements** on the subject are considered well researched, logical and speaking decisions. These are being quoted by international courts. Today, Indian tax experts (whether a professional or a commissioner) can challenge the discussion with any other international tax expert. **We are equals** and not less than any other country experts.

I.4.3 Present: 2013-2018 Transition Stage. Implementation of BEPS, GAAR, Information Exchange Agreements. **Some Tax Avoidance Practice has been demolished.**

It is true that compared to **Indian tax**, International tax pays more. Compared to **tax compliance**, tax planning pays more. **International tax planning** pays maximum fees. This practice has been already given a series of blows by Indian Government as well as OECD-G20 Combine.

Loss of tax planning practice is a serious problem because –
Law & its implementation have become **harsh**. When a person does a planning, he & his client both may fall in the net of any of the several anti-avoidance provisions of Income-tax law. If he saves his skin from tax law, he may be trapped under FEMA/ PMLA etc.

If the tax payer hides his tax avoidance, he will be caught under one or more **information exchange agreements** or under **Tax Justice Network**.

This is a clear & present danger.

I.4.4 Future – 2018 & onwards.
This is the focus of today's talk.

*Now a **second phase of growth** in knowledge has to start. My main purpose of today's presentation is to initiate the second phase of knowledge. It should be, a truly just and fair system of international taxation. A system where the Countries of Market like India also get their legitimate share in taxation. This would be proper sharing of tax revenues amongst the Governments.*

I.5. Conclusion:
Past: *India has come long way between 1991 & 2018.*

Future: *Now there are new challenges. Government, ICAI & other professional institutions need to put in huge efforts to meet with these challenges. At individual level, every CA interested in International Taxation needs to put in huge efforts to remain up-to-date.*

Your future at individual level; and the profession's future at Institute level have to be built by us only. It will not be something that will fall in our laps.

Part I Summary completed, Theme stated.

Next: Part II

International Tax Planning (Global Position): Tax War?

II. International Tax Planning (Global Position):

(A) BEPS; & (B) Tax War

II.A BEPS: G20 & OECD together have developed steps against Tax Planning & Tax Evasion.

(i) Tax Planning:

Fifteen Action Points. Each individual Action report covers a different method of Tax Planning by abusing certain provisions of the DTA. The Reports suggest modifications in OECD Model Treaty to curb the abuse of DTA. For example, **Treaty Shopping** is an abuse of DTA. **Action Report No. 6** provides for elimination of Treaty Shopping.

Making so many amendments in a few thousand DTAs for all the countries that have signed DTAs would be a marathon effort spanning a decade or more. To avoid such bilateral negotiations, **Multilateral Instrument (MLI)** has been prepared by G20. When a country signs this MLI, its DTAs with other countries get automatically modified to BEPS amendments. However, each signatory has been provided freedom to accept certain BEPS amendments & not accept others. These options may be exercised qua individual countries.
By now 78 countries have signed BEPS MLI. USA had refused to sign MLI right from the beginning & has not signed it.

(ii) Tax Evasion:

Even before BEPS Actions, G20 had started working on abolition of **Banking Secrecy and Tax Havens.** The term used by OECD is: **"Harmful Tax Practices"**. Under the combined pressures of G20 & OECD, most Tax Havens have agreed to collect specific information from any person opening tax haven SPVs. This covers identity of the promoter and beneficial owner and his Country of Tax Residence. This information is automatically shared by the countries that signed these agreements. Staunch tax havens like Panama refused to join G20 BEPS arrangements. However, exposure of **Panama Papers** in the year 2015 by an anonymous source; and its publication by ICIJ (**International Consortium of Investigative Journalists)** demolished its resolve not to join BEPS. Panama surrendered and signed agreement to share information. Similarly, almost all the tax havens popular with Indians – have agreed to sign MLI. This list includes UAE, BVI, Singapore, Mauritius, Panama etc. People who had used these tax havens in any manner in the past, are now suddenly exposed. Several countries started sharing the information in September 2017; and some have started later. Very soon all Tax Havens of any importance will be covered.

(iii) **Ethical Hackers** have proved to be even more effective terror in the hearts of tax evaders & money launderers. **Mossack Fonseca**, the **Panamanian** company whose documents were disclosed went bust. Several politicians and businessmen holding criminal money and black money through Mossack Fonseca are in deep trouble now. **HSBC paper leaks, Paradise Papers leak, Wikileaks,** etc. have established that no transaction on the internet; or on anything connected with internet is now free from exposure. We may conclude that Tax Haven banks, solicitors and Secretaries are in deep troubles. Their tax avoidance business may get reduced significantly.

II.B International Tax Planning (Global Position): Tax War?

In Part II.B, I am submitting that: International Taxation System has been designed to benefit a few dominant countries at the cost of other countries. Now circumstances have changed and there seems to be a tax war between yesterday's friends. To explain this, I will share with you an illustration of possible tax war. While sharing this illustration, simultaneously **fundamentals** of international taxation become clear. Let us see certain terminology used in this paper.

II.1 Terms:

(i) **BEPS:** Base Erosion & Profit Shifting = Tax Planning.

(ii) **COR** - Country of Residence of the tax payer.
(iii) **COS** - Country of Source of income.
(iv) **COM** - Country of Market.
(v) **DTA -** Double Tax Avoidance Agreement / Treaty/ Convention.
MLI - Multilateral Instrument.

(vi) **Tax Avoidance** now (after BEPS & GAAR) includes Tax Planning without substance; as well as Tax Evasion. Both are almost at par.

(vii) **Taxation Vs. Tax Planning:** The term Taxation is neutral. It covers everything – Tax Compliance, Tax regulation & the Tax law itself. Tax Planning covers only the plans by Tax Payer to reduce taxes.

II.2 The Issue stated briefly:

In case of international business & investment, income arises because of the economies & governments of two or more countries. Hence the tax on the income arising out of international business & investments should be shared by all countries contributing to the profits. In the existing international tax system, a country acquires right to tax any income only

when that country has a **nexus.** COR has the nexus – residential status of the assessee. It is relatively simple to determine residential status.

Which country is the **Country of Source**? There is a controversy on this particular issue. The way **OECD model** of tax treaty is interpreted, that country is COS in which the **tax payer makes value addition and earns profits**. Normally, for most incomes, COR itself will be the COS. The country in which the goods and services have been sold (Country of Market) is not considered as Country of Source.

In **my view**, a Country of Market is also a Country of Source. Because, the market contributes to the value of the product being sold. However, as per the current OECD commentary a Country of Market is not considered a Country of Source unless the assessee has a **permanent establishment** (PE) in that country. PE is defined to be a geographical, fixed location within the COS, outside the COR. E-Commerce defies geography. In E-Commerce, the assessee does not require a PE in the COM. Hence, under OECD model, the COM does not get any right to tax the revenue of Non-Residents collecting market revenues.

This is an abstract hypothesis and needs to be explained with illustrations.

II.3 Illustration:

Consider a British company manufacturing high technology chemicals. This company may purchase the raw materials from several countries at low prices. Using the technology available, it will convert the raw materials into finished products – specific chemicals. Production is completed within Britain. Indian customers go to Britain and purchase the chemicals. Sales also completed within Britain.

When an Indian customer wants to utilise these chemicals and make further finished products in India, the British company gives technology and charges **royalty**. For explaining the technology, the British company charges Fees for technical know-how **FTS.** When India was starved of finance, banks from the rich western countries would supply capital and charge **interest**. In India, because of conservative policies on FDI, import of loan has been restrained. However, in several developing countries capital had been imported on a very large scale.

Now, Britain would be the Country of Residence for the company that manufactured chemicals, that provided technical know- how and licence to produce goods; and the banks that provided capital. As per the OECD model all these revenues can be taxed only in Britain, COR and cannot be taxed in India, COS. (TDS on interest is available to COS in case of loans given by persons other than banks.)

There have been four large western economies for last several decades: USA, Britain, France and Germany. I call them **G4 (Group of four countries).**

This G4 always believed that they are the COR and they will remain COR. They also dominate the OECD. Hence, OECD Model for last few decades is in favour of COR. Most of the tax revenue would go to COR. COS would get only residual revenues. (It is only under UN Model that COS is granted TDS on Royalty, FTS, etc.)

In other words, the tax base in case of international trade would be with COR. Countries like India and other developing countries would have no tax base. Until the second world war, most of the developing countries were ruled by a few European countries. The developing countries had no voice in drafting of the OECD Model. Hence, the model treaty favoured tax right to the COR.

II.4 E-Commerce Taxation:

4.1 It was in the **year 2000** that **High Powered Committee on E-commerce** taxation set up by Government of India presented a report stating that the existing **OECD Model and the international tax system was inadequate to deal with E-commerce taxation**. The committee did feel that in addition to E-commerce taxation, even the regular taxation was in favour of COR / developed countries. However, the brief given to the committee was only "E-commerce taxation". Hence the report was restricted to E-commerce taxation. The committee concluded that this is a matter of global taxation. Unless OECD Model is amended, India cannot take unilateral steps.

The G4 were confident that they will continue to be COR for E-commerce also. In the year 2005, **OECD** came out with a report stating that the existing **system of international taxation** was good. E-commerce was too small a business. There was no justification to change the existing international tax system.

4.2 **God loves playing games.** Some historical developments turned the tables. **Google, Apple, Amazon** etc. all American MNCs used E-commerce for their business. They set up their subsidiaries in Ireland & sold goods & services to the whole world outside USA from Ireland. Irish Government issued special Rulings under which these MNCs paid less than 0.01% taxes to Ireland. They earned substantial revenues from Europe without setting up PE in Europe (except for the presence in Ireland, a Tax Haven). They paid negligible taxes to Europe. Suddenly, **G3** – Britain, France & Germany realised that they had become **Countries of Market** and USA was the only COR. At the same time, USA is not the

COM for MNCs of G3. In other words, there are no European giant MNCs selling goods & services to US customers.

4.3 **Britain** was the first country to realise that she was losing legitimate share of tax revenue. British Government came out with **Diverted Profits Tax Act.** However, this was not adequate to deal with the issue. France, Germany & European Union also realised that they were losing their legitimate share of tax revenue. G3 caused OECD to start a process of rewriting international tax system. In the year 2013, **OECD** came out with a statement accepting the fact that existing **system of international taxation was not adequate to deal** with E-commerce taxation. (Full reversal of stand taken in the year 2005.) To seek support from all the major economies, they devised an **inclusive programme. G20** – a Group of 20 largest economies was formed in the aftermath of the **American Economic Crisis** that erupted in the year 2007-08. OECD & G20 together started the exercise on Base Erosion & Profit Shifting (**BEPS**).

Please note that for the G3 E-commerce taxation was the most important issue of tax losses. Hence, E-commerce taxation was made the first Action Plan. They now call it Digital Economy instead of E-Commerce. Instead of the common word "committee", they call it "Task Force". A Task Force was constituted to give a report on Action 1 – Digital Economy Taxation.

There were several other actions to be taken including Transfer Pricing reports, Artificial Avoidance of Permanent Establishment, etc. These issues covered Action 2 to Action 15.

4.4 It was surprising that in **November, 2015** OECD & G20 published final reports for Action 2 to Action 15. However, the most important issue – Action 1 could not be concluded. They only published an interim report and promised that in the next five years (!?) the Group will come out with a tax system for digital commerce.

OECD has been discussing E-commerce taxation since **1997**. Even in the year **2018** (after full twenty years), it has not been able to give final report on E-commerce taxation. What is it that prevents OECD from a solution for E-commerce taxation? Frankly, E-commerce taxation is not nano technology which would require research for 20 years. I have right now a complete model of E-commerce taxation which can be implemented today. There are great experts in OECD & G20. Why are they not able to come out with a solution? I am giving some more facts before you. You may draw your own conclusion.

4.5 **Main Reason** why Task Force 1 could not give report. (Please note that following is an over simplified statement of the crux of the issue.)

Under the present system of international taxation, the E-commerce Giants who are mainly **American MNCs** cannot be taxed in any country other than USA. If the model treaty is amended, then all the countries of market (COM) will get a right to tax the American MNCs. Then, under the Article 23 for Elimination of Double Taxation, COR – USA will have to give credit for the taxes paid by American corporations in the countries of market. That would mean a big loss of tax revenue by American Government. This probably is the reason why US Government has strongly protested against any modifications in the existing system of international taxation for E-commerce.

II.4.6 Another fact may be shared here. USA **participated** in all the 15 Task Forces. Some people say USA did not just participate, it actually dominated the discussions. However, USA had made it clear right in the beginning that it is not going to sign the Multilateral Instrument (MLI). By now, 78 countries have signed MLI. USA has not signed and clearly said that it will not sign the MLI.

How can a Government participate in the discussions with a clear statement that it shall not sign the treaty?

Even before the MLI would become truly effective, US Government has **changed its domestic taxation**. It has made it attractive for the US MNCs to shift their tax base into USA. All the profits being parked in tax havens like Ireland will now be brought into USA.

This is the present system of international taxation for you. Please note that this is not exceptional. USA leads the discussion in many other matters. Nuclear Non-proliferation Treaty, Environment protection agreements and several such agreements have been drafted by global bodies. US Government leads the discussions. However, US will do only that which is profitable to USA. It will not comply with restrictions under those agreements. Rest of the world is expected to do what is profitable to USA.

II.5. Unilateralism / Exceptionalism:

US Government considers itself to be exceptional. It will make unilateral laws which rest of the world has to follow. For example, under **FATCA**, every country of the world is expected to report to US Government, any financial interest held in that country by a US tax payer. At the same time, US Government has refused to give comprehensive information to other Governments. Some adhoc information is shared, but not complete information.

Animal Farm:

George Orwell wrote the book "Animal Farm" in the year 1944. He has given a nice story of animals in a large farm revolting against human owners of the farm. Animals started ruling the farm in a democratic manner. When the democracy started, the pigs wrote seven commandments on the wall: The most important command was: "All animals are equal".

Soon, the ruling power went in the hands of the pigs. As the pigs became accustomed to power and the luxuries that go with power; democracy and equality were given a go by. The pigs were exceptional. They could enjoy the luxuries while other animals were expected to work. So, the 7th commandment was changed as under:

"All animals are equal, but some animals are more equal than others."

This whole novel was directed as an allegory to **Russia.** Russian public revolted against Tsar (The King of Russia). In the year 1917 when the revolutionaries took over, they talked of equality. Eventually, **communist party became more equal than the others.**

God loves to show irony of life. United Nations and other global bodies were started on the theme that: "All countries are equal". But now **USA is more equal than all other nations.**

II.6 Tax War between USA & EU?

6.1 **European Union** has worked out its own plan for E-commerce Taxation. EU wants to tax Google, Apple, etc. based on the principle of **Significant Economic Presence (SEP)**. EU has borrowed the concept of Significant Economic Presence (SEP) from USA. Within USA, several State Governments tax - companies from outside the State selling goods & services within the State. This tax is based on SEP. However, USA refuses to permit this principle to BEPS Action 1 Task Force & to OECD.

Significant Economic Presence or SEP is a concept of virtual PE. When the non-resident has no fixed place within the geography of the COM, some criteria other than "Fixed Place of Business" may be considered for establishing a PE. Different countries have considered different specific criteria, or a set of criteria. India has introduced S. 9 (1)(i) explanation 2A to provide for SEP. Payments from India exceeding a threshold or number of users exceeding a threshold (as may be prescribed) will be the SEP. Once there is an SEP, India will consider it a Business Connection, a Nexus. This will give right to India to tax the income of the non-resident.

India has accepted the position that DTA overrides Income-tax Act. DTA provides for PE. OECD model of DTA, & all existing DTAs do not include SEP as a form of PE. Hence under DTA, these MNCs in E-Commerce will escape Indian & even EU tax based on SEP. Indian amendment to S. 9 will apply only where the assessee is not entitled to any DTA. India will not override DTA. She will wait till the global community accepts SEP as a form of PE. Similarly, EU also does not plan to override the OECD model. They are trying their best to include SEP in Action One report by the BEPS Task Force. Let us see how God again turns the tables so that the only COR in the E-Commerce world – USA accepts the demands of the rest of the world.

6.2 In the years 2016 & 2017, EU commission's investigation on **Apple & Ireland** was in the news. Apple resorted to aggressive tax planning. Apple sold its goods & services from a tax haven – Ireland. Sold to several countries in Europe – Britain, France, Germany, etc. However, Apple did not set up any PE within these countries & hence did not pay any income-tax to EU countries – Countries Of Market.

EU commission could not do anything under its tax laws. Because existing system of international taxation is inadequate to deal with E-Commerce. EU found a new way to deal with the matter.

EU has a **Treaty on functioning of the European Union**. Under the Treaty, free competition is to be encouraged. EU Competition Commission ruled that – Ireland had given illegal State Aid to Apple Group. Hence, ordered Apple Corporation to pay Euro 13 billion to Irish Government in back taxes and pay interest on the same. Apple has paid up the tax "under protest" with a right to appeal.

Now EU commission is taking action against other MNCs avoiding taxes of EU member states.

Some columnists have called this an open Tax War between USA & EU. Both of them refuse that there is any war.

II.7 BEPS – Action 7 - Artificial Avoidance of PE:

FIIs investing in India had dual claims. (i) They claimed that: "They are in the **business of trading** in shares and securities. They have no PE in India. Hence under the Double Tax Avoidance Treaty (Article 7), they are not liable to tax in India. (ii) Their another claim is that they are investors in capital assets – shares and securities. On sale of such shares and securities, in case of **capital gain**, they claim exemption under India – Mauritius or India – Singapore DTA - Article 13.

How do FIIs avoid permanent establishment in India?

(i) They have **researchers** in India. These researchers may be exclusively working for a particular FII. Still, they would not be on the pay rolls of the FII. They would claim to be independent consultants. The FII will get research information from the consultant and take decisions outside India.

(ii) Shares and securities buy and sell transactions will be undertaken through **brokers** who would be independent agents. Hence, they will not form PE.

(iii) **Bank** account will be in India. A bank does not become agent of the FII.

(iv) **Custodians** will be in India. They do not become a PE.

(v) There will be a team of managers who will be sitting outside India. They will take buy & sell **decisions outside India**.

Consider the whole business by FIIs. They buy & sell shares and securities within India. Make payments and receive sale proceeds within India. Their stock in trade (shares & securities) is stored in India. Thus, almost entire business is done in India. However, they have divided the functions amongst several different agencies and **artificially avoided permanent establishment.**

OECD & G20 under BEPS programme worked for curbing tax avoidance. Action 7 is directly against artificial avoidance of PE.

I studied the Action 7 report several times with a great hope. Since, the focus of this task force was to curb artificial avoidance of PE, I was hoping that the tax avoidance by FIIs as discussed above would have been covered. Unfortunately, the massive tax avoidance conducted by FIIs is not covered in Action 7. You may form your view on whether the BEPS programme is planned for favoured few countries or planned for all the signatories to MLI.

II.8 Far Analysis Vs. Farm Analysis:

A stark illustration of the fact that **markets** contribute to the revenue as well as profitability of a business is – **cricket**. As you are aware, cricket originated in Britain. But today, India has the largest number of cricket fans. (For those who want statistics: British population is less than seven crores. In India, cricket fans are estimated to be thirty crores.) For any cricket match – whether test match or IPL, largest revenue –by sale of

tickets and by advertisement is generated in India. ICC, the International Cricket Council (ICC) was always ruled by Britain. Mr. Sharad Pawar made the Britishers realise that the market power rests with India. And hence the president of ICC should be an Indian. A complete monopoly of Britishers over ICC was demolished, and India acquired the right purely because of market. India is the Country of Market. Indian market is the largest market for cricket. And hence India should get a significant portion of rights. Apply same principle to taxation.

Consider Google, Face Book and Whatsapp. These are essentially American MNCs. They have a significant market in India. While, as a percentage, the Indian revenue is smaller than the US revenue, it is still a significant revenue. As per the current international taxation system prescribed by OECD, if these MNCs earn their business revenues without establishing a permanent establishment in India; India does not get right to tax them under the FAR analysis. If we want to have a just and fair system of taxation, India as a Country of Market should have a significant right to tax all revenue collected from India by these MNCs. We have to move to **FARM analysis – Functions, Assets, Risks & Market analysis.**

For this plan, India has already introduced the concept of **Significant Economic Presence** u/s. 9 (1) (i) – Explanation 2A.

II.9 Theme:

9.1 Some experts in India debate: "Whether OECD commentary is binding within India?" – as if OECD is preparing a just & fair commentary. Let us realise harsh facts of life. Every country & every such group of countries works for its own vested interests. Don't go by their words. Go by their actions. India has to protect its own interests. OECD commentary is not binding in India. Where ever India has noted reservations to the commentary, those issues have no effect in India. For the rest of the commentary also, one can consider the OECD commentary as a valuable commentary – like Late Mr. Palkhiwala's commentary or Late Prof. Klaus Vogel's commentary. Nothing more. Also note that OECD model treaty is just a model treaty. Not the law. India has to interpret its treaties based on the language of its treaties. Where the Indian Treaty & OECD model are at variance, the OECD commentary is of no significance.

9.2 As I have said separately, there are two phases of development of international tax practice in India. Because of sustained efforts by all professional bodies, between 1991 and 2018 there has been a tremendous progress within India. But that **is only a milestone**. It is not the ultimate target. Now the **second phase of development** should start where India gets its fair share of revenue. For this objective, Indian Income-tax commissioners are actively working through BEPS. A team of fair minded professionals should also join the effort, so that India gets its reasonable

share in tax revenue. We need Think Tanks at ICAI at Central & Regional levels on International Taxation to help Government of India.

Part II - Global Position on International Tax Planning completed.

Next: Part III
Indian Position on International Tax Planning

III. International Tax Planning – Indian Position. Attack on Tax Planning & Tax Evasion:

Government of India has started (i) Legal Attacks, (ii) Technological Attacks & (iii) Regulatory Attacks on Tax Planning and Tax Evasion = Tax Avoidance.

III.1 Summary of Legal Attack:

People have resorted to massive tax planning and tax evasion. There are several different ways of tax avoidance. Now India has come out with a massive **armoury of weapons** targeting tax **planning**. There is another set of weapons targeting tax **evasion**. Both of these are deadly weapons eliminating a lot of tax avoidance. For the purpose of this presentation, let us say that **tax avoidance** includes tax planning without substance and tax evasion. I am not trying to give a new meaning to terms normally used in the profession. My purpose is only to have a shortcut instead of repeating the phrases "tax planning" and "tax evasion".

The **Indian** legal weapons against **tax planning** are –

(i) SAAR – Specific Anti-Avoidance Regulations like Section 9, Section 64 etc. Indian Income-tax Act has more than thirty SAARs.

(ii) Transfer Pricing.
(iii) GAAR.

The Indian legal provisions against **tax evasion** are:

(i) Harsh provisions for penalty and prosecution.
(ii) Section 56 under ITA.
(iii) GST.
(iv) **Demonetisation.**

(v) **360 degrees profiling:**
Forcing everyone to obtain an **Aadhar** Number and then linking Aadhar Number with all financial transactions. Forcing **Digital payments** rather than cash payments.

(vi) **Black Money Law**, FEMA.

Internationally Governments all over the world have collaborated in attacking tax avoidance.

(i) **BEPS.** This is a large weapon covering several kinds of tax planning. Mainly, most of the reports help COR Governments.

(ii) **PMLA**. Under Prevention of Money Laundering Act (PMLA), several Governments have signed agreements to share information on suspicious transactions. Primary aim is to prevent money laundering. However, the system also throws up movement of large money even if its is simply black money and not criminal money. Once the information is available with a Government they use it for tax purposes also.

(iii) **Information Exchange** Agreements under DTA.

(iv) Automatic Exchange of Information under BEPS forcing a **Collapse of Banking Secrecy and** system of **Tax Havens.**

III.2 Technological Attack.
Technology has changed the way of business & investigation:

It has been a popular subject of discussion in the media: "Technology Disruption will take away many jobs". The media reports further state that even doctors, tax consultants and lawyers are likely to lose their practice because of technology. In my submission, technology disruption is a mild term. Actually, there is a **technology earthquake**. Past methods of tax avoidance are almost totally exposed to regulators' knowledge. Technologies have developed tremendously and have become intrinsic part of doing business. Even if someone wants to avoid technology, it is not practical to do a global business of high volume without technology. The same technology makes everything transparent for the regulators.

2.1 Today, **global banking** has become digitalised. Remember, those years when computers were first introduced in the Income-tax departments and in the banks. Unions went of strike in India fearing loss **of employment**. It has been "fait accompli. Now Income-tax department makes best use of computerisation, big data and data analytics. Almost all banking has been digitalised. It is because of computerisation that cheques are cleared within 24 hours and not within a fortnight (as used to happen before computerisation.)

Similarly, all the important **stock exchanges** are fully computerised. All share market transactions are available as a big data. Investigation into manipulations of share market as well as use of share market for converting **black money into white** – can we done online through the computers. The manipulators are now caught within a few days of their operation. This is a great improvement over the past when the operators manipulated the markets and the regulators came to know about it after a few years.

Massive developments in computers (hardware as well as software), internet communications, satellite communications, mobile phones etc. have made **communication** as well as **transaction of business** easy and efficient. At the same time, all the information is now available to the regulators for their scrutiny.

Let me give an illustration of how transparency in financial transaction is affecting tax avoidance. Consider an illustration.

2.2 Hypothetical Illustration of Tax Avoidance based on Banking Secrecy:

Mr. X, an Indian resident is a senior manager in ABC Ltd. He is entitled to large remuneration as the senior manager. His tax consultants devised a plan. His remuneration was divided into two parts: (i) About 60% remuneration was paid in India on which he paid Indian tax. (ii) Balance 40% was paid in a tax haven on which he did not pay any Indian tax. The consultant incorporated a company in BVI. The company opened bank account with a Swiss bank's Singapore branch. Company invested in securities through London Stock Exchange. Mr. X was assured that his information will remain completely confidential and Government of India will never come to know about it.

Now with three different kinds of information sharing agreements, **BVI Government** would write to Indian Finance Ministry giving full details of the company incorporated and its beneficial shareholders. **Singapore Government** would also send information to Indian Finance Ministry for the bank accounts opened and operated in a Singapore branch of a Swiss Bank. The **British Government** would write to Indian Finance Ministry about investments made on the London stock exchange by a tax haven company which is owned by an Indian citizen, Indian tax payer.

All the **promises** and assurances given by the **tax consultants** have become useless. When the Government of India gets information from three different Governments, it will be fairly easy for the Income-tax department to levy penalty and to prosecute Mr. X under **Black Money Law** & under **FEMA**. If, in this hypothetical illustration, Mr. X is an Indian politician or civil servant transferring funds abroad; he would be covered under **PMLA** also**.**

Anybody dreaming of tax avoidance should be careful. There is a very good chance that he will be caught, and he will go to jail.

III.3 Regulatory Attack:

In the past, we complained that "Income-tax department takes harsh steps". Now they have become even more harsh. Prosecution was a matter of exception in the past. Now it has become the norm. Earlier, tax

consultants and auditors were not questioned except in case of their fraudulent involvement. Now, tax consultants and auditors are clearly targeted. **Section 278 on abetment** of tax violation was there for last several decades. It was rarely used. Now tax professionals are being prosecuted for abetment. Probably, Government wants to give a message to the tax consultants: "Do not advise tax avoidance. Or you also may be prosecuted like the tax payer himself".

Thus, there are three different major changes in tax practice: technology, legal & regulatory changes. The past is no longer a guide to the future. "**As per last year**" will no longer work. We have to study the law. We have to be alert in advising our clients. If we find understanding of BEPS, GAAR, etc. difficult; then it may be better not to advise the client.

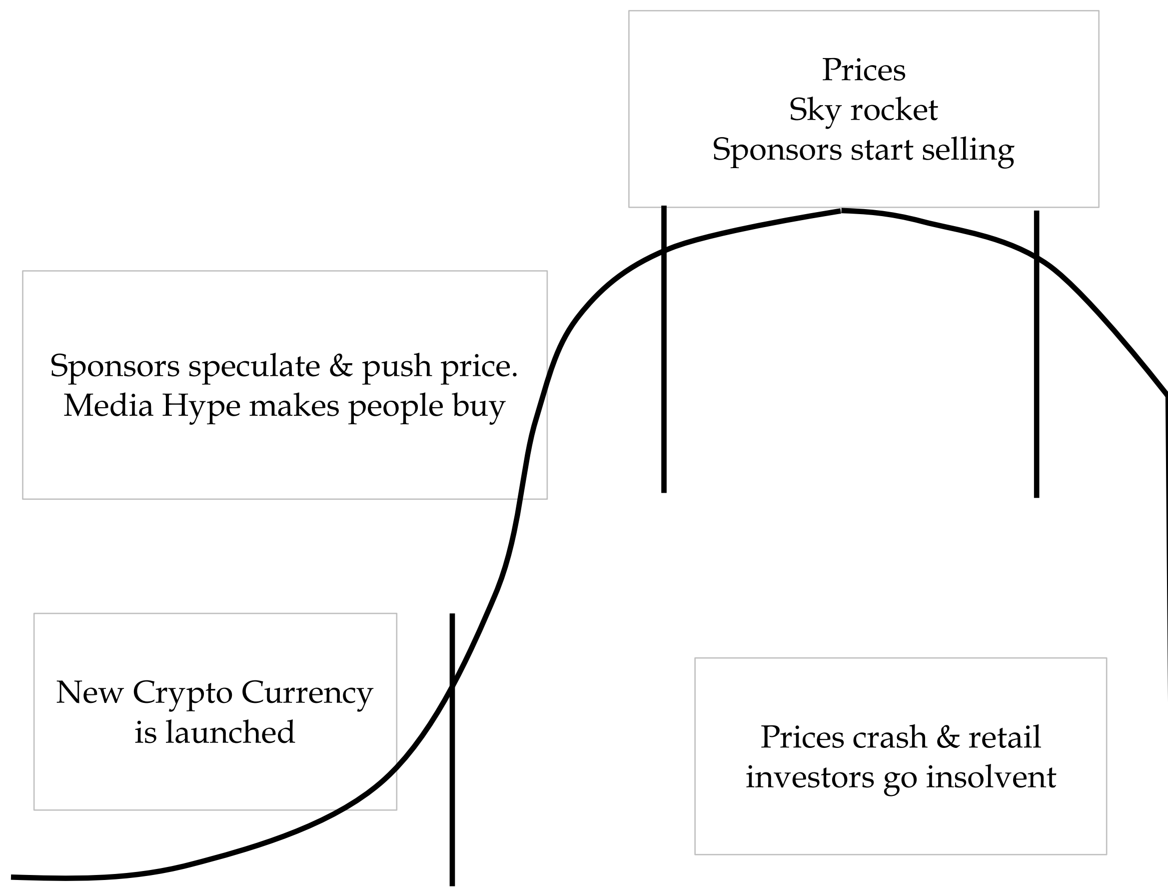
III.4 Crypto Currencies:

God loves to play games. Just when people thought that tax evasion is now impossible, Bitcoin and other crypto currencies have become very popular. One can buy a crypto currency in black money and transfer the money outside India. He can hold the money outside India for a long period. It is fairly difficult for any regulator to find out the holders of crypto currencies.

I have made separate presentation establishing my view that many of the crypto currencies are bogus and a person holding white money (tax paid money) should not invest in crypto currencies. However, people go ahead with substantial investment in crypto currencies. Main attraction is avoiding regulators. However, black money is always a risky business. There are ways in which regulators may catch the black money holder.

Whoever promoted the Bitcoin did a very smart thing. He has written a paper which very few people understand. Very few people can prove or disprove the merits of a Bitcoin. Just as we have formulae for successful Hindi films, there are **formulae for successful cheating** of large number of people. Make a strategy which no body understands. Make it attractive. It should sound very intelligent. Then show potential for huge gains and or escaping from the regulators. All this put together is a deadly formula for cheating the greedy investors. They may be thinking that they are avoiding Indian Government. However, in the process they are exposed to big losses in their fortunes.

Crypto Currency - Scandal Chart



These games will probably go on forever. There are people who do not want to pay tax. There are armies of tax consultants and more than 50 **tax haven Governments** who are ready and keen to help tax avoidance for a fee. New technologies keep coming up helping the Government as well as tax evaders. Smart tax avoiders approach the Government itself and get the law amended to suit their plans. So the game will go on. However, the game has become very difficult.

I would love to say that now tax compliance has become almost compulsory. Hence, tax avoidance practice will go down. **Honest tax consultants will now have a fair chance for their practice.**

III.5 Why have we reached a danger Zone?

5.1 Tax Payers' & Tax consultants' Role.

Indian Income-tax act 1961 (ITA)was reasonably simple in the year 1961. Today, it has become extremely complex. In addition to ITA, the

Black Money Law, FEMA & other provisions have created such a serious confusion that even if a person wants to pay proper tax; he would not know whether he will be hit by any deeming provisions of the law. **The process by which ITA has become complex may be explained as under.** Tax consultants went on devising new and aggressive plans to avoid taxes. Government of India (GOI) came out with Anti-Avoidance Provisions. The tug of war has brought tax law to the current position.

Consider a few illustrations.

A tax payer giving gifts to his spouse and children is a most normal matter. However, this was resorted to, to create additional tax files and to benefit by basic tax exemptions & lower slab rates. Hence, GOI brought in **Section 64** under which income earned by the donee is taxable in the hands of the donor. Then, tax payers resorted to indirect gifts. Hence, Section 64 was amended to cover indirect gifts. In the process, the Section became difficult.

A simple matter of **partnership and HUF** – popular forms of doing business in India have been abused for tax avoidance. Tax consultants drafted partial partition deeds in such a way that a family of four could have ten different HUFs. Each HUF would file separate income-tax & wealth tax returns. Hence, **Section 171** has been amended to curb partial partition of HUFs. **Section 45** of the Income-tax Act has been amended to prevent artificial admissions and retirements to the partnership. Similarly, **Section 164** has been amended several times to prevent artificial trusts.

Then Government of India reduced tax rates from the maximum **marginal rate of 97.75% to 34%.** Wealth-tax, Estate Duty and Gift Tax Acts have been abolished. Today, Indian direct tax rates are quite reasonable. And yet, the tax avoidance games have not stopped.

Consider the tax avoidance by MNCs. Hutchison sold its shares in Hutchison – ESSAR Ltd. through a Cayman Island Co. The tax haven company with $ 1 share was supposed to have transferred Indian shares worth $ 11 bn. A prima facie absurd statement by the tax payer. Yet, under the existing law, the tax avoidance game was approved by the Honourable Supreme Court. GOI had no option but to amend Section 9 (1)(i) and bring in explanations 5 & 6 to tax **indirect transfer**.

Authorities accepting bribes and converting black money into white became bold and used corporate structure for this purpose. This forced GOI to bring in **Section 56 (2) (x).** Now even innocent issues of shares and any transfers of shares are exposed to the rigours of Section 56. Under Section 56 a transfer or issue of shares should be at book values as adjusted for market values of immovable properties etc. Under FEMA, the share valuation could be different. In USA, Discounted Cash Flow is the

accepted method. This creates serious problems for even genuine acquisitions and investments.

My humble submission is that the law has become complex because tax payers have resorted to aggressive tax planning.

5.2 Indian Government's Role.

(i) Through India - **Mauritius** treaty, India permitted treaty shopping. Then signed treaties with several tax havens – **UAE, Malta, Cyprus, Luxembourg** & so on. For **Singapore**, made special amendments in the treaty to permit treaty shopping.

In the year 2000, a **Mumbai CIT** passed an adverse order against certain FIIs that invested in India from Mauritius. There was a lot of protest by these **FIIs** with veiled threats that Indian share market will collapse – if FIIs withdrew their investment. CBDT came out with Circular No. 789 dated 13th April, 2000 to assure the market that treaty shopping will not be objected to. Then Azadi Bachao Andolan filed a suit stating that this circular was illegal and contrary to the interests of the country. Honourable Delhi High Court held the circular to be null & void. If this decision were accepted, Indian Government's revenue would go up. But Government succumbed to blackmail and became party to the suit and opposed Azadi Bachao Andolan. Rest of the history is well known. Honourable Supreme Court ruled that India – Mauritius Treaty & the circular 789 were valid.

Recently Government amended the treaty and stopped such Tax Planning with a Grand Fathering clause. No one made any noise. When a Government is firm, such Tax Payers fall in line.

(ii) **Indian DTA with UAE** was challenged on the grounds that: "There is no income-tax in UAE. Hence there is no Double Tax. Then why give relief to UAE residents under Double Tax Avoidance Agreement?" Government went out of its way to protect UAE investors in India. Special amendment was carried out in the year 2003, in section 90 (1) (a) (ii) and the purpose: "to promote mutual economic relations, trade and investment" was brought in.

Government of India at the highest level and the CBDT gave clear signal: "You can use Tax Havens & resort to treaty shopping."

(iii) Participatory Notes (PNs): It was widely believed that the PNs were being used for clearly illegal Round Tripping. Indian black money was going abroad by hawala. It was invested in PNs issued by most reputed FIIs having their subsidiaries in Mauritius or Singapore. That

money was then invested in Indian share market. Despite these allegations, Government continued PN investment in India with substantial tax benefits and secrecy for the beneficial owner.

I am just bringing out these illustrations to show that Government of India itself permits certain specific kinds of tax avoidance. Thereafter, for people resorting to tax planning, Income-tax department cracks down upon them. This is **confused implementation of tax law.**

(iv) When situation is full of contradictions, what do you do? We will discuss below.

III.6 Future International Taxation Practice:

If we were to project the future tax practice in the International Taxation field, then probably the scene may be as under:

Anti-Avoidance provisions have increased compliance requirements tremendously. For any medium size tax payer, it is very difficult to comply with all the provisions – TP, GAAR, SAAR & BEPS. It is possible that even when the tax payer has absolutely no plan to avoid any tax, he may still be hit by anyone of these deeming provisions. Tax payers now need really good experts who **are masters in all the** above referred **anti-avoidance provisions** and **information exchange agreements**. It is possible that compliance practice will be the bread and butter for the future. Tax planning or tax avoidance will go down drastically.

A good consultant should also understand the use of **computer hardware and software**. The tax managers as well as tax consultants of MNCs should be able to understand massive data base, their analysis and use of artificial intelligence.

We have seen earlier that data analytics and artificial intelligence will be good weapons in the hands of Income-tax department to catch the tax avoider. At the same time, these technologies will be excellent instruments in the hands of tax payer for good compliance with law.

I believe we have a bright future. The **scope** of our work is expanding. There will be a lot of work for chartered accountants to handle. However, those people will benefit who can master the technology and actually help the client in compliance with law. We have to now be the **master of the law as well as master of technology**. I would like to emphasise that all this can be done by an individual chartered accountant also. There is no tax work which an Indian chartered accountant cannot do. Even small firms of sole proprietors or a few partners are good enough to do the best of the practice. Just to list out the opportunities available for a chartered accountant:

(i) Income-tax compliance, accounts writing, internal audit, statutory audit, TP audit, tax audit. Consolidation of global accounts and common reporting. (CBCR).

Mastering Double Tax Avoidance Agreement in line with BEPS; GAAR, etc. is a big part of the practice.

(ii) GST.

(iii) FEMA. Advising on proper corporate structuring in compliance with FEMA and Company Law.

(iv) Formation of company/ LLP/Partnership.

(v) Estate Planning independent of taxation. Wealthy families need proper planning.

We are the only profession where a person can simply pay Rs. 8,000 per year annual fee and then conduct his practice. We have opportunities in practice, in jobs and for going abroad.

Indian economy is growing better than most other economies. Indian economy is globalised. Hence, international taxation and compliance with international law is bound to be increasing. So Indian chartered accountant's practice is bound to grow. Since it will be more difficult and there are more risks, we have to increase our fees substantially.

Technology is helping the profession in **spreading the knowledge**. Now our conferences are held as webinars. All the information is kept on institute's website and other sister NGOs' websites. If chartered accountants want to acquire knowledge, they have tremendous opportunities to acquire the knowledge irrespective of where they are located.

IV. Conclusion: The Threat & the solution may be:

We, the CAs of India have entered a chaotic period. This chaos affects us directly. CAs have been prosecuted. This never happened in the past. Signals are, this can be a trend & not an exception. Hence, we need to examine this chaos & protect ourselves. At the same time, same Government is continuing PNs. When the situation is full of contradictions, Government appears to be confused, what are we supposed to do?

A professional is expected to be stable like a solid rock. Any amount of waves of tax planning or tax evasion plans may become popular. The CA will not be moved by such waves. He will advise in keeping with substance & spirit of law. He will not advise aggressive planning.

Wherever he feels that his **audit** report needs qualification; he will qualify his report. This will be made clear to his clients in advance, so the client also knows what to expect from the CA. The CA will be prepared to lose a few clients.

This is not idealism. This is the need of the hour today.

For a CA, who keeps himself abreast with the latest law;
And advises in keeping with the law
The future is always better.

Thank you,

Rashmin Chandulal Sanghvi.