Tax Controversy

Contributing editor
Jean A Pawlow

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GETTING THE DEAL THROUGH

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Overview

1 What is the relevant legislation and who enforces it?

The Income Tax Act 1961 (the Act), along with the Income Tax Rules 1962 (the Rules) made thereunder, form the main legislation that is enforced by the Department of Income Tax. For proceedings beyond the level of the assessing officer (AO) and the Commissioner of Income Tax (Appeals) (CIT(A)) (ie, the first two levels within the assessment and appellate hierarchy), separate rules govern the proceedings: the Income Tax (Appellate Tribunal) Rules 1963 are one example. The Central Board of Direct Taxes (CBDT) is charged with the general administration of the Act, and has powers to issue circulars and notifications for, among other things, the proper administration of the Act.

2 Other than legislation, are there other binding rules for taxpayers and the tax authority?

The CBDT has the authority to issue circulars, notifications and orders (which may be specific to certain cases under section 119) from time to time. These are binding upon all tax authorities but not the taxpayer, though the taxpayer can avail of any benefit conferred by such circulars. The circulars may also be used by the tax authorities against taxpayers (to the extent that the circular is adverse to the taxpayer); however, the taxpayer can challenge such a circular if it is contrary to any provision in the Act or the Rules or the Constitution of India. Tax treaties duly entered into by the government of India are binding, to the extent that taxpayers can choose to have the provisions of the relevant treaty or of the Act, whichever is more beneficial to them, to be applied.

3 How is the tax authority organised?

The tax authorities under the Act consist of the following authorities:

- CBDT;
- Director General of Income Tax or Chief Commissioner of Income Tax CIT (Admin);
- Director General of Income Tax or Chief Commissioner of Income Tax CIT (Appeals);
- Director of Income Tax;
- Additional or Joint Commissioner of Income Tax;
- Additional or Joint Director of Income Tax;
- Assistant or Deputy Commissioner of Income Tax;
- Assistant or Deputy Director of Income Tax (ADIT or DDIT);
- Income Tax Officer or Tax Recovery Officer; and
- Income Tax Inspector.

The hierarchy of these authorities is in the order provided above. The highest authority is the CBDT. This authority has powers of administration, supervision and control that extend over the whole department of income tax; it can also make rules and issue orders, instructions and directions to all authorities and persons employed in the execution of this Act.

Enforcement

4 How does the tax authority verify compliance with the tax laws? What is the typical procedure for the tax authority to review a tax return and how long does the review last?

A tax authority may make an assessment of and determine the tax payable by the taxpayer by any of the following methods.

Returns filed by the taxpayer (under section 139 of the Act)

In this situation, the AO may, even in the absence of the taxpayer or the production by him or her of any evidence, make an assessment solely on the basis of returns filed after making prescribed adjustments, if any.

Evidence adduced under section 142

If the taxpayer objects to an assessment under section 139, or where the AO considers it expedient to verify the correctness and completeness of a return filed by the taxpayer, the AO may serve a notice upon the taxpayer requiring him either to attend the AO's office or to produce any evidence on the basis of which the taxpayer wants to rely in support of his or her returns. After weighing all such evidence that is produced, the AO may assess the total income, or make a fresh assessment if the assessment already made is found to be incorrect, adequate or incomplete.

Where returns have been filed under section 139 or evidence has been adduced under section 142, the AO proceeds to make an assessment in a manner prescribed by section 143 of the Act. This provision governs the powers of the AO to make inquiries and assessments of returns under the Act; the proceedings conducted by him are not judicial proceedings in the strict sense, however, they are governed by general judicial principles.

On the basis of best judgement under section 144 of the Act

Where there are no returns of income filed by the taxpayer under section 139, or where there have been no proceedings under section 142 or section 143, the AO is bound to make an assessment to the best of his or her judgement and determine the sum payable by the taxpayer on the basis of such assessment. Before doing so, the AO is to issue a notice to the taxpayer to show cause to the taxpayer as to why a 'best judgement' assessment should not be proceeded with.

The word 'assessment' as used in the Act has a very comprehensive meaning and includes computation, reassessment, review, etc.

The time limit for completion of an assessment pursuant to the rules under section 153 is two years from the end of the assessment year in which the income was first assessable.

5 Are different types of taxpayers subjected to different reporting requirements? Can they be subjected to different types of review?

All companies and firms are required to file returns, whereas individual persons are not required to file returns unless they exceed the threshold limit (which for the year 2015–2016 is 250,000 rupees). Previously, for individuals, crossing the threshold limit used to be the sole criterion for filing a tax return; however, in a bid to curb the circulation of unaccounted money, as of the financial year 2011–2012 return of income must be filed electronically by every individual who may be characterised as resident and ordinarily resident for tax purposes, if the individual has any asset (including a financial interest in any entity) located outside India or has signing authority in any account located outside India, irrespective of whether such individual has earned taxable income in the relevant assessment year.

Certain entities, such as trusts, are not considered to be taxable persons under the Act. Many mutual funds, securitisation trusts and venture capital funds (most of which are organised as trusts) are allowed the benefit of an exemption from tax in respect of their investment or securitisation-related activities. Therefore, they rarely cross the threshold limit for taxation. Consequently, they are typically not required to furnish a tax return of their income, but merely a statement giving details of the nature of the income paid or credited during the previous year and other such relevant details. The Finance Act 2014 introduced a change in this regard – it provided that where the total income in respect of which a mutual fund, securitisation trust, venture capital company or venture capital fund is assessable, without giving effect to the specific exemptions, exceeds the threshold limit for taxation, they should file returns, even if they may file nil returns. Further, business trusts (with effect from 1 April 2015) and any investment fund, which has been registered as a Category-I or Category-II Alternate Investment Fund with the Securities Exchange Board of India (SEBI) (with effect from 1 April 2016), are now required to furnish returns even in case of loss.

In addition to the above-mentioned statutory requirements to file returns, the CBDT announced in a circular that all non-residents, to the extent that they do business in India and would like to claim benefits under a tax treaty, would also have to mandatorily file tax returns on their income.

Other differences (eg, in the form of audit reports) may also exist and depend on the type of taxpayer and the amount of income earned. Separate reporting requirements exist in the case of international transactions that are or may be subject to transfer pricing regulations.

The recently enacted Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015 (the Black Money Act) provides for disclosure of undisclosed foreign income and assets by resident taxpayers who are ordinarily resident in India and imposition of tax on the undisclosed income and assets held outside India. This legislation also provides for personal liability of a manager (including a managing director) of a company to pay any amount due under this act if the amount is not recoverable from the company. Partners in a partnership, members of an Association of Persons (AoPs) or of a Body of Individuals (BoI) have been made liable to pay any amount due under this Act along with the partnership, AoP or BoI.

6 What types of information may the tax authority request from taxpayers? Can the tax authority interview the taxpayer or the taxpayer's employees? If so, are there any restrictions?

Pursuant to sections 133 and 142 of the Act, the AO may require a taxpayer to furnish certain accounts, documents and information in cases either where the return has been made or where the time allowed for filing the return has expired. Such powers enable the AO to serve a notice directing the taxpayer to produce or cause to be produced any evidence to verify the correctness of the return filed. Such evidence may include the business books and financial records of the taxpayer, copies of transaction documents, and any other evidence that the officer finds necessary to test the veracity of returns filed. All proceedings under the Act are judicial proceedings and the powers to demand information under the above provisions are analogous to that of a judicial court. Subject to the rules of evidence, any material evidence may be required to be submitted.

The income tax authorities do have the power to request information from trustees, guardians or agents, employers, dealers, brokers and banking institutions that they have reason to believe would be relevant to an inquiry or proceeding under the Act. However, as explained in question 30, the tax authorities cannot make a roving or fishing inquiry or call for general information that does not pertain to specific cases or to a specific class of persons.

Wilful failure to produce evidence as required by the AO is punishable under section 271(1)(b) of the Act. Failure on the part of the taxpayer to comply with such a notice also gives the AO the right to enter the taxpayer's premises and search for and seize accounts. Furthermore, having regard to the nature and complexity of accounts of the taxpayer and the interests of the department, the AO may direct the taxpayer to have its accounts audited by an accountant nominated by the commissioner of income tax.

The tax authorities cooperate with tax authorities of other countries under a tax information exchange agreement. India has entered into extensive agreements of such a nature, especially in the recent past. However, for exchange of information to be permitted there are certain requirements, such as foreseeable relevance to enforcement of domestic laws and basic details about the information requested in order to prevent fishing enquiries by the authorities.

The Finance Act 2015 has introduced new provisions dealing with indirect transfers. One of these provisions provides that if any company or entity registered or incorporated outside India holds, either directly or indirectly, through or in an Indian concern, assets located in India which exceed 10 million rupees (1 crore rupees) in value and represent more than 50 per cent of the value of the total assets held by the foreign company or entity, the Indian concern must furnish information or documents in respect of any offshore transaction undertaken by such foreign entity to the tax authorities. In the event of failure of the Indian concern to furnish such information or documents, a penalty will be imposed to the tune of 2 per cent of the value of the transaction if it has the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern or 0.5 million rupees (5 lakhs rupees) if it does not affect the right of management or control of the Indian concern. (Note that these provisions will be applicable from 1 April 2016.)

A taxpayer who is ordinarily resident in India is required to disclose his or her foreign assets as per schedule FA of the Act. He or she is required to mention the details of foreign bank accounts, financial interest in any entity, details of immoveable property or other assets located outside India, including details of any account located outside India in which he or she has signing authority, and details of trusts created outside India in which he or she is the settlor, beneficiary or trustee.

7 What actions may the agencies take if the taxpayer does not provide the required information?

In a situation where the taxpayer fails to furnish the return of income or information as required by the AO, pursuant to section 271(1)(b) of the Act the AO has the power to levy a penalty of 10,000 rupees, in addition to tax (if any) for each such failure. There has been an amendment in section 271(1)(c) to provide the AO with the power to levy a penalty of an amount up to three times the summation of tax sought to be evaded under the general provisions and the tax sought to be evaded under section 115JB or 115JC (the minimum alternate tax provisions).

Under the Black Money Act, taxpayers can be punished with rigorous imprisonment for a minimum period of six months, which may extend to seven years along with a fine, for furnishing any false information in any verification with respect to foreign income and assets. The same penalty has been provided for those found to be abetting the above and this poses a serious risk to tax advisers, financial advisers, banks and financial institutions.

8 How may taxpayers protect commercial information, including business secrets, from disclosure?

All privileged communication between an attorney and a client is protected by the overarching principles enshrined in the Indian Evidence Act 1872 (Evidence Act) under sections 126–129. As regards protections afforded to commercial information, including business secrets and confidential information, that is not otherwise protected by the Evidence Act, the powers under the Act to procure and review information are rather broad and subject to few safeguards. The safeguards are illustrated in some provisions such as section 133 for requisitioning information from banks in that information may be requested only to the extent that it would be useful towards proceedings against the taxpayer under the Act.

However, when tax authorities seek to retrieve information on taxpayers from other countries, all the circumstances given in the tax information exchange agreement are required to be met. These conditions are introduced to prevent fishing expeditions by the authorities and establish some reasonable basis or show the relevance of the information sought to enforce domestic laws.

9 What limitation period applies to the review of tax returns?

The time limit for completion of assessment by the AO:
- where the taxpayer enters into international transactions and the case is referred to the transfer pricing officer, the assessment is to be completed within three years from the relevant assessment year; or
- where no such reference has been made, the assessment is to be completed within two years from the end of the relevant assessment year.

In the case of income that has escaped assessment, section 147 of the Act empowers the AO to assess such income, subject to a limitation period of:
- four years from the end of the relevant assessment year;
- six years from the end of the relevant assessment year where the amount of income that has escaped assessment amounts to 100,000 rupees (1 lakh rupees) or more for that particular year; or
- 16 years, where the assets in relation to which income tax is to be paid are located outside India.

If the taxpayer has failed to deduct the required amount of tax at source pursuant to section 201, no order may be passed against him or her for such failure after the expiry of:

- two years from the end of the financial year in which a statement to the effect of such deduction is made; or
- six years from the end of the financial year in which any payment is made, or credit given.

10 Describe any alternative dispute resolution (ADR) or settlement options available.

There are two major alternative means of dispute resolution under the scheme of the Act, the Authority for Advanced Rulings (AAR) or a settlement commission.

Chapter XIX-B of the Act deals with the AAR, which was instituted in 1993 to enable non-residents to obtain an advance ruling on specific issues that could arise in determining their tax liability. Any question relating to the tax liability of a non-resident may be presented to the AAR and the AAR is statutorily mandated to give a ruling on such question within six months. The conditions precluding it the jurisdiction to try cases include:

- parallel proceedings by another authority under the Act;
- determination of the fair market value of property; and
- if it relates to transactions that are prima facie designed to avoid tax.

The AAR initially had only one bench that sits in New Delhi. Due to the backlog of pending matters before the AAR it has, over the years, been unable to meet the statutorily prescribed period of six months for passing rulings on questions referred to it. Therefore, approval has been given to set up two additional benches of the AAR in Mumbai and New Delhi. Since 2014 the AAR option has also been made available to resident parties. As per the Finance Act 2015 an application may be made to the AAR by a resident or a non-resident to determine whether a proposed arrangement is an impermissible avoidance arrangement under the Indian General Anti-Avoidance Rules (GAAR). (Note that GAAR will be applicable from 1 April 2017.)

Settlement of cases in the interests of the swift collection of dues by the tax department is permitted pursuant to Chapter XIX-A of the Act. Under this chapter, a settlement commission (the Commission) is constituted as a statutory authority with quasi-judicial powers for the settlement of cases. Upon an application for 'settlement' by the taxpayer under section 245C of the Act, subject to fulfilment of conditions therein, the Commission is empowered to facilitate the settlement of matters covered by the application. To this end, the Commission may call for a report from the Commissioner of Income Tax on the basis of which, having regard to the nature and circumstances of the case, or the complexity of the investigation involved, the Commission can either allow or reject the application.

The jurisdiction of the Commission is confined to matters covered by the application before it, and in making an order pursuant to such application it is neither bound by the report of the Commission nor limited to taking into consideration material not covered by the application. As far as possible, such an order must be passed by the Commission within 18 months from the end of the month in which the application was made The order passed by the Commission must contain the terms of settlement (including any demands by way of tax, interest or penalties), the manner of payment, and any other matter that is required to make the settlement effective. The order of settlement under this chapter is conclusive as to the matters stated therein, and no matter that is covered in such an order can be reopened in any proceeding, subject to constitutional remedies. The Finance Act 2014 had enlarged the scope of the Commission, by including the proceedings for assessment or re-assessment under section 147 on issue of notices under section 148 for the relevant years.

With a view to providing rapid disposal for cases involving foreign companies or transfer pricing disputes, the Dispute Resolution Panel (DRP) was also introduced as an ADR mechanism within the existing appellate structure. The DRP comprises a collegium of three Commissioners of Income Tax. Under this mechanism, in cases of taxpayers eligible for challenge before the DRP, a draft order must be supplied by the AO to the taxpayer. The taxpayer must file objections before the DRP within one month of receipt of the draft order; otherwise, the final order shall be passed. If objections are raised before the DRP, after giving a reasonable opportunity of hearing to the taxpayer it must give directions to the AO within nine months for completion of assessment. These directions are binding on the AO, who has to complete the assessment in conformity with the directions within one month from the end of the month in which such directions are received. An appeal against an assessment order passed in pursuance of the directions of the DRP can only be filed before the Income Tax Appellate Tribunal (ITAT or Tribunal). The orders of the Tribunal passed in this regard can be challenged before the High Court and Supreme Court as in respect of other orders of the Tribunal.

More recently, in 2012, in a bid to address the rise in transfer pricing litigation in India, the Advance Pricing Agreement (APA) scheme was also introduced to allow taxpayers and the income tax authorities to enter into pricing arrangements relating to specified transactions. The APA mechanism has had moderate success since its introduction. As per the annual report issued by the Ministry of Finance for the year 2014–2015, 329 unilateral APA and 57 bilateral APA applications were filed by 31 December 2014. The union budget speech for the year commencing on 1 April 2014 and ending on 31 March 2015 sought to make this mechanism more attractive by introducing a 'rollback' provision, so that the price determined by an APA can be applied to international transactions undertaken by a taxpayer in the previous four tax years from the date of the APA, thus providing clarity even on past disputes. On 3 August 2015 the CBDT signed the very first APA with a rollback provision where the APA will be applicable to four previous years in addition to the next five years.

11 How may the tax authority collect overdue tax payments following a tax review?

Any charge or transfer effected by a taxpayer during the pendency of any assessment or reassessment proceeding (or after the completion of such proceedings but before the receipt of a notice from the Tax Recovery Officer (TRO) to initiate recovery proceedings) shall be considered to be void as against any claim in respect of any tax or other sum payable by the taxpayer pursuant to such proceedings.

Recovery proceedings can be taken against a taxpayer that is regarded as a taxpayer in default or any other person deemed to be an taxpayer in default due to non-payment of tax or any other sum in accordance with the provisions of the Act. The modes of recovery of tax payable as a result of an assessment are set out in sections 222 and 223 of the Act and include:

- attachment and sale of the taxpayer's moveable property;
- attachment and sale of the taxpayer's immoveable property;
- the arrest of the taxpayer and his or her detention in prison; or
- appointing a receiver for the management of the taxpayer's moveable and immoveable property.

The modes of recovery specified above are not exhaustive or mutually exclusive and the authorities may proceed to pursue any or all of them concurrently. They are operative not only for recovery of tax but also as against interest, fines, penalties or any other sum payable under this Act. It is also possible for the tax authority to require a taxpayer's debtor to pay the debt due to the taxpayer to the tax authority instead. Compliance with such a request is considered to be a discharge of the debt.

12 In what circumstances may the tax authority impose penalties?

Penalties may be imposed by the tax authorities for the default in payment of tax, or for default in payment of interest. Such a penalty may be imposed pursuant to section 221 of the Act, in the form of an order specifying the exact sum that the taxpayer is required to pay by way of penalty. In addition to the above, penalties may also be imposed:

- on legal representatives for default in paying tax under an assessment of himself or herself, or of the deceased;
- for a delay in deposit of tax regardless of the fact that the business of the taxpayer is in loss; and
- for default in payment of advance tax.

The preconditions to the imposition of a penalty for the above are the application of judicial discretion, giving the parties a reasonable opportunity of being heard, serving notice for default, and the consequent default in payment of tax. Such an order for payment of penalties can be appealed against under section 246 of the Act, and there are also provisions under section 293 for the issuance of writs, directions or orders quashing an order of penalty.

The Act also provides for a scheme of penalties for furnishing inaccurate returns, failure to comply with notices and for concealment of income that is provided for under section 271 of the Act. In case of a failure to comply with notices issued (under section 142 or section 143 of the Act), the amount of the penalty, in addition to the tax, is the sum of 10,000 rupees for each failure. If details regarding income are concealed or inaccurate details of such income are furnished, in addition to the tax payable, a sum not less than but not exceeding three times the amount of tax sought to be evaded may be imposed as a penalty.

Similarly there are various other circumstances provided for in the statute under which penalties may be imposed on the taxpayer, such as:

- failure to keep and maintain or retain books of accounts, documents;
- failure to keep and maintain information and documents and respect of international transactions or specified domestic transactions;
- failure to have accounts audited;
- failure to deduct or to collect tax at source;
- failure to furnish return of income; and
- false estimate of, or a failure to state, advance tax.

The Black Money Act provides for a penalty up to 90 per cent of the value of any undisclosed assets held abroad by a person who is a resident in India, after levying tax at the rate of 30 per cent of the value of such assets, and also provides for rigorous imprisonment of three to 10 years for wilful attempt to evade tax in relation to a undisclosed foreign income or asset.

13 How are penalties calculated?

An exhaustive list of the circumstances under which penalties may be imposed has been provided in the Act. Such provisions contemplate situations such as the concealment of income or fringe benefits, providing inaccurate particulars of income or fringe benefits, specific procedural defaults and non-payment of taxes, etc. There are also provisions to deal with penalties in cases of one-time default, as well as those that relate to repeat defaulters. However, the amount of the penalty levied may or may not be dependent on the period of default.

All penalties leviable are provided for under the Act and the provisions relating thereto must necessarily be strictly construed.

14 What defences are available if penalties are imposed?

Pursuant to an amendment brought about in 1986, in certain circumstances, no penalties imposable for any 'failure' as referred to in the specified provisions, if the taxpayer proves that there was 'reasonable cause' for the failure. The amendment shifted the initial burden on the taxpayer to prove that he or she had reasonable cause for the failure referred to in the specified provisions as against the tax authorities having to prove the opposite. Consequently, it is at the discretion of the authority to consider whether the explanation offered by the taxpayer as regards reasons for failure was an account of reasonable cause. The burden of proof, however, is predicated on the nature of penalties. In civil proceedings under the Act, it would be based on the preponderance of probabilities while in criminal proceedings, the same would have to be established beyond all reasonable doubt. Frequently, in transactions involving larger amounts, one of the methods to establish bona fides for the purposes of mitigating the risk of penalties would be to seek legal opinions from legal advisers in respect of certain issues where the interpretation of the law may be subject to some dispute.

15 In what circumstances may the tax authority collect interest and how is it calculated?

Interest may be collected by the tax authorities on the amount of tax payable in case of the failure on the part of the taxpayer to deduct tax or a failure to pay the same after deduction. For instance under section 201(1A) any person who fails to deduct or pay tax as required by the Act is liable to pay simple interest at the rate of 1 per cent for every month in the case of failure to deduct tax, and at the rate of 1.5 per cent for every month for a failure to pay tax after collection at source, leviable from the date on which such tax should have been paid under the Act.

Default in payment of advance or for deferment of advance tax would also attract interest as per the provision of section 234C.

16 Are there criminal consequences that can arise as a result of a tax review?

Criminal consequences can arise in the case of failure to comply with certain provisions of the Act. These are provided for under Chapter XXII of the Act and are listed as follows:

- failure to comply with any orders for search and seizure;
- fraudulently removing, concealing, transferring or delivering to any person, any property or interest therein, intending thereby to prevent such property or interests from being taken in execution of recovery proceedings under the Act;
- failure to give notice of appointment as a receiver or liquidator of a company under liquidation; a failure to set aside the amount required by an order of the tax authorities in case of liquidation of the assets of the company; or any disposal of the assets of the company in contravention of the provisions of the Act;
- failure to comply with the restrictions on transfer of immoveable property provided for under section 269UC of the Act, property vested in the central government under section 269UE, or the contravention of the provisions of section 269UL of the Act dealing with restrictions on registration of documents in respect of the transfer of immoveable property;
- failure to pay tax collected at source to the credit of the central government;
- wilful attempt to evade tax, penalties or interest chargeable or imposable under the Act;
- wilful failure to furnish returns of income in due time;
- failure to produce accounts and documents pursuant to any notice served upon the taxpayer under section 142;
- wilfully made false statements regarding the verification of returns of income filed under the Act;
- where a taxpayer wilfully and with the intent to enable any other person to evade tax or interest or penalty chargeable or imposable, makes any statement that is false and suppresses any books of accounts or documents that may be used against the taxpayer; or
- abetting or inducing the taxpayer in any manner to make and deliver false statements with the intent to deceive the tax authorities.

The Black Money Act also provides for criminal consequences for non-compliance with its provisions. Many of the offences under this Act are similar to the ones above. A new feature has been the introduction of criminal liability for tax advisers, consultants, wealth managers, banks and financial institutions if they are found to abet the making of false statements during verification of foreign assets.

For every second and every subsequent offence by a taxpayer under the Black Money Act there is a penalty in the form of rigorous imprisonment between three and 10 years and fine between 0.5 million rupees (5 lakhs rupees) to 10 million rupees (1 crore rupees).

17 What is the recent enforcement record of the authorities?

The past decade was marked by an increasingly aggressive approach of the income tax authorities to enforce the compliance of taxpayers with increasingly stringent and retroactively applicable provisions of the Act, to the point that the stance of the previous government with respect to taxation had been dubbed 'tax terrorism'. The recent controversy over tax demands being sent to foreign portfolio investors (FPIs), requiring them to pay minimum alternative tax (MAT) is another example of the use of retrospective amendments being used by the AO. In recent years, major national banks have had their bank accounts with the Reserve Bank of India attached, and multinationals have had their Indian assets frozen and suffered multiple losses as a consequence. More than 900 entities have been banned from capital markets recently by SEBI and it has also referred these cases to the tax authorities for further investigations.

In the budget speech for the year 2015–2016, however, there has been an effort to reverse the aggressive approach and a slew of reliefs have been announced including deferral of GAAR and grandfathering of existing structures, more clarity on taxation of overseas indirect transfers phased reduction in corporate tax rates, pass-through status for alternate investment funds and relief against MAT for FPIs.

In accordance with the statement made by the Finance Minister in the budget speech for 2014–2015, a High-Powered Committee has been constituted by the Central Board of Direct Taxes under section 119 of the Income Tax Act 1961 for dealing with references made by AOs on the application of amendments introduced with retrospective effect on income arising from indirect transfer of assets.

Third parties and other authorities

18 Are third parties involved in the authority's review of tax returns and what rights do taxpayers have with respect to their involvement?

The Act has conferred upon the tax authorities various powers with respect to recovery of information from both the taxpayer and third parties. For instance, pursuant to section 133 of the Act, tax authorities have the power to:

- require any firm to furnish names and addresses of partners of the firm with the respective shares;
- require any Hindu undivided family to furnish details regarding the members of the family;
- require any trustee, guardian or agent to furnish details of persons of whom he or she is a trustee, guardian or agent;
- require any taxpayer to furnish details of all persons to whom he or she has paid any rent, interest, commission, royalty or brokerage, any annuity, or any other such payments;
- require any dealer, broker or agent or any such person concerned and management of stock or commodities to furnish details of all persons with whom he or she or the exchange has paid any sum in connection with the transfer of assets on whose behalf he or she or the exchange transacts; and
- require any person, including any bank to furnish information in relation to statements of accounts and affairs that in the opinion of the specified authorities are useful for any inquiry or proceeding under the Act.

Such information can be sought even when no proceeding is pending under the Act, and the tax authorities have wide powers to enforce compliance in this respect. The only safeguards that persons being surveyed have in such cases are that the tax authorities should on no account remove or cause to be removed any cash, stock or other valuable article or thing from the place being surveyed, and that where an ADIT, DDIT, AO, TRO or Income Tax Inspector are surveying the premises, the prior approval of the Joint Director of Income Tax or the Joint Commissioner of Income Tax (as the case may be) must be obtained.

19 Does the tax authority cooperate with other authorities within the country? Does the tax authority cooperate with the tax authorities in other countries?

There are some provisions under the Act whereby the authorities can direct requisition of information pertaining to any proceedings under the Act from any other officer under any other law prevailing in the country. Even regardless of such provisions, there is some level of exchange of information between various regulatory authorities that is not statutorily codified.

Under a tax information exchange agreement, the tax authorities cooperate with tax authorities of other countries. India has entered into extensive agreements of such a nature, especially in the recent past. However, for exchange of information to be permitted, there are certain requirements such as foreseeable relevance to enforcement of domestic laws and basic details about the information requested in order to prevent fishing enquiries by the authorities. The tax authorities have enjoyed recent success in obtaining information from Swiss authorities on undisclosed accounts of Indians in Swiss banks.

Under the Black Money Act, the CBDT on a certificate from the TRO that a taxpayer has property in a country can take any action it may deem appropriate to recover tax, having regard to the terms of the agreement.

The Black Money Act also empowers the central government to enter into agreements with other countries for the exchange of information for the prevention of evasion or avoidance of tax on undisclosed foreign income chargeable under that Act as well recovery of tax on the same.

India signed a reciprocal version of Model 1 Inter-Governmental Agreement with the United States on 9 July 2015. Due to this, financial institutions in India are now required to make disclosures (through the CBDT) to the US Internal Revenue Service under the Foreign Account Tax Compliance Act (FATCA). This primarily relates to investments by account holders liable for tax in the United States. Financial institutions in India will be required to be registered with US authorities and obtain a global intermediary identification number. FATCA compliance would be effective upon India's written notification to the United States, confirming completion of the required internal procedures for compliance. Compliance with the OECD's common reporting standards becomes mandatory from 1 January 2016.

Special procedures

20 Do any special procedures apply in cases of financial or other hardship, for example when a taxpayer is bankrupt?

As discussed in question 27, financial hardship can be a ground for the waiver of the pre-deposit of the tax amount before appellate authorities. Further, under the Sick Industrial Companies Act 1985 the Board of Industrial and Financial Reconstruction (BIFR) has the ability to recommend or direct certain relief in respect of income tax proceedings as well. To this extent, the CBDT has issued an order under section 119(2)(a) that BIFR 'recommendations' will also be considered binding on the tax department, as long as the tax authorities have been heard by the BIFR before passing orders. Therefore, any relief directed by the BIFR to be given to a party under the Act would have to be given effect immediately. However, under the provisions of the Act, any losses incurred by an entity may be carried forward to the subsequent year and offset against any profits that the entity may make, meaning that they may be leveraged against subsequent tax liabilities.

21 Are there any voluntary disclosure or amnesty programmes?

The Indian government has, in the past, attempted to bring back unaccounted money held abroad through amnesty programmes, such as the Voluntary Disclosure of Income Scheme 1997 (which was closed on 31 December 1998), which gave income tax defaulters an opportunity to disclose their undisclosed income at prevailing tax rates. However, these programmes were not successful enough in achieving their aims, and the government has since been very conservative about floating such schemes. The Black Money Act has provided a one-time compliance opportunity to those who have undisclosed assets situated overseas. Such persons now can declare their undisclosed assets in the prescribed form with the prescribed authorities and by paying 60 per cent as tax and penalty thereon, they can ensure that no prosecution will be launched against them under the following legislation:

- Income Tax Act 1961;
- Wealth Tax Act 1957;
- Foreign Exchange Management Act 1999;
- Companies Act 2013; and
- Customs Act 1962.

For the purposes of the Black Money Act, a person is barred from voluntary declaration under the one-time compliance window if any information has been received by the central government under such an agreement with another country.

Rights of taxpayers

22 What rules are in place to protect taxpayers?

A Citizens' Charter of the Income Tax Department, which declares the mission, vision, values and standards of delivery of various services to citizens and lays down indicative timelines for the tax authorities to provide various services (eg, the issue of refund along with interest) has been issued and regularly updated. It must be displayed in English and Hindi in all offices of the department.

The principles of natural justice generally run through all proceedings under the Act. To this extent, the various rights afforded to the taxpayer, either under certain provisions or otherwise, are:

- the right to be afforded a hearing before any action taken against him or her under the Act;
- the right to be given notice of proceedings under the Act;
- the right to examine all evidence procured and used against him for any proceedings under the Act; and
- the right to cross-examine witnesses.

23 How can taxpayers obtain information from the tax authority? What information can taxpayers request?

The Act and all authorities under it are within the purview of the Right to Information Act 2005. Accordingly, any taxpayer may request and obtain information held by the authorities that is in the public domain. There are, however, certain restrictions on the obtaining of information pertaining to other taxpayers, which unless deemed to be in public interest, will be protected.

24 Is the tax authority subject to non-judicial oversight?

The only statutorily instituted non-judicial oversight under the Act is by the CBDT. However, even the CBDT's functions do not extend to review of assessments and are limited to framing and execution of policies, and administrative aspects of the functioning of tax authorities.

Court actions

25 Which courts have jurisdiction to hear tax disputes?

The scheme of appeals under the Act confers jurisdiction upon specialised tribunals such as the ITAT, as well as the High Court and the Supreme Court, to hear tax disputes. The ITAT is a quasi-judicial body specially

Update and trends

One of the core promises made by the current ruling party before the general elections of 2014 was that it would endeavour to retrieve the undisclosed money stashed abroad by Indian residents as well as clamp down on domestic black money. In furtherance of this objective, the Black Money Act has been enacted with overwhelming support from the opposition. Recently, the Swiss government has shared information with India on Indian account holders in Swiss banks, giving a boost to the government's claim that it is focused on fulfilling this promise. In addition, the regulatory authorities are acting in concert with the government on this issue and this is evidenced by the recent banning of more than 900 entities from capital markets by SEBI on suspicion of money laundering and referring these cases to the tax authorities for further investigations.

While the government has displayed its resolve to tackle the issue of black money strongly by enacting stringent legislation, no distinction has been made under the Black Money Act between legal and illegal structures. This does not provide reference points for taxpayers, tax advisers and AOs and there is a possibility that this could lead to unjustified tax demands and penalties in some cases. The CBDT has come out with clarification on the Black Money Act, but greater clarity on some of its provisions is needed and we expect further developments on this front.

The current government has as a stated goal the promotion of foreign investment into India. Hence there has been a marked departure from the adversarial posture of the previous decade. For instance, the decision to appoint a panel headed by Law Commission Chairman AP Shah to examine the issue of the applicability of MAT on foreign portfolio investors is a step in the right direction. This committee has very recently submitted its report to the government after taking the views of the industry as well as consulting firms. Thus there is an expectation that the aggressive postures displayed by the revenue department in the previous decade will not be adopted by the current dispensation, and enforcement of tax claims will be conducted with an eye on the impact on investor confidence.

constituted to deal with tax disputes appealed from the lower tax authorities. However, while the ITAT has jurisdiction to hear any appeals from the lower authorities (including the DRP), the jurisdiction of the High Court and the Supreme Court is restricted to matters that involve a 'substantial question of law'.

Jurisdiction to hear cases also lies with the AAR. However, these are not disputes in the strict sense and the AAR only hears matters on application by the taxpayer on questions of tax liability.

If tax authorities act without jurisdiction, remedies may also be available directly before the High Court through writ petitions under article 226 of the Constitution of India.

26 How can tax disputes be brought before the courts?

The ITAT is constituted by the central government as a quasi-judicial body to hear appeals from decisions of the lower tax authorities. Every appeal before the ITAT must be filed within 60 days of the date on which the order sought to be appealed against was passed by the tax authority, and may be filed by any party aggrieved by the order. There is no minimum threshold amount for claims brought before the ITAT. However, only orders from which substantial questions of law arise may be referred to the High Court. Similarly, only in instances of significant questions of law, or on account of a conflict in the decisions of various High Courts in respect of particular questions of law, would an appeal lie from the decision of the High Court to the Supreme Court.

27 Must the taxpayer pay the amounts in dispute into court before bringing a claim? Can the costs of a dispute be recovered?

A demand notice is issued under section 156 of the Act to initiate tax recovery proceedings. The tax amount specified in a notice of demand must be paid within 30 days of the receipt of such notice. The tax recovery proceedings are separate from the main appeal to the CIT(A); therefore, the mere fact that the taxpayer has preferred an appeal to an order does not automatically stay the recovery proceedings under the Act. A stay on the demand may be sought before the AO first of all, then appealed to the CIT (Admin) and then before the High Court via writ petition if rejected.

It is generally standard practice that at least 50 per cent of the demanded tax amount is requested by the authorities pending appeal before the CIT(A). This occurs after a stay of the demand notice is requested before the AO or the CIT (Admin) (on appeal against the AO's stay verdict). If full or partial stay is granted at the CIT(A) stage, at least 50 per cent of the tax amount (or a larger percentage of the tax amount if 50 per cent was already deposited) may be requested before the tribunal stage if the CIT(A) passes an adverse order and further stay is sought.

Where a full stay is not obtained, the AO or the CIT (Admin) may allow for partial stay by asking for part-payment of the tax amount pending disposal of the main appeal pending before the CIT(A). The taxpayer should be able to claim a refund under the Act if the assessment is set aside by the appellate authorities.

Tribunals may waive the pre-deposit of tax amount in certain circumstances (eg, undue financial hardship, prima facie lack of case and public interest).

28 Who is the decision maker in the court? Is a jury trial available to hear tax disputes?

The Indian judiciary does not permit jury trials for any cases and tax disputes are no exception to this rule. The decision maker in the ITAT or the High Court and Supreme Court is typically a bench consisting at least of two members. Before the ITAT, such a bench would necessarily be constituted of one judicial member and one technical member. However, in exceptional cases, pursuant to authorisation by the central government, the bench may also consist of a single judge, or three judges or more based on the circumstances. Appeals before the High Court and the Supreme Court must necessarily be decided by a bench consisting of at least two judges.

29 What are the usual time frames for tax trials?

At the first level, where an appeal has been preferred against assessment by the AO, while there is no mandatory time limit for disposal of the appeal, wherever and to the extent possible, such appeal is to be heard and decided within one year from the end of the financial year in which such appeal is filed.

Under the revisionary powers of the Commissioner of Income Tax, any order of the AO, if erroneous or prejudicial to the interests of the Revenue, may be revised, subject to a limitation period of two years from the end of the financial year in which the order sought to be revised was passed.

As regards appeals to the ITAT, while there is no mandatory time limit, every appeal, wherever possible, is to be heard and disposed of within a period of four years from the end of the financial year in which such appeal is filed. However, due to a backlog of cases, the time taken for disposal of the cases is inordinately high.

The AAR is required to pass rulings on questions referred to it within a statutorily prescribed period of six months. However, this has not been adhered to so far, with the AAR having a significant backlog of cases. The setting up of two additional benches is thus, a welcome step in this regard. The Commission is required to pass the settlement order within 18 months from the end of the month in which the application is made. As regards objections raised before the DRP, it must give directions to the AO within nine months for completion of assessment,

30 Describe the discovery process for a tax trial.

There is no discovery process in tax trials in India. However, tax authorities, in their quasi-judicial capacity, may exercise certain powers, subject to application of mind, such as calling for accounts even of a period beyond three years preceding the relevant accounting year; sending for books and documents seized by a magistrate in other proceedings; or requiring any person, including a banking company or any officer thereof, to furnish such points or matters, or to furnish statements of accounts and affairs and other information as would be relevant or useful to any inquiry under the Act. However, the tax authorities cannot make a roving or fishing inquiry or call for general information that does not pertain to specific cases or to a specific class of persons.

31 What testimony is permitted in a tax trial?

As per the Rules of the ITAT, any facts contrary to, or that cannot be borne out by the facts on record, may be admitted by way of an affidavit. Such affidavits may be submitted by any party as evidence purporting to support their claim, and such affidavits may be submitted on behalf of expert witnesses, and other third parties. However, the extent of the relevance of testimony of the taxpayer is very limited in the absence of evidence on record support his or her claim. The ITAT typically relies on documentary evidence; cross-examination of witnesses is not common at the level of the ITAT.

32 Who can represent taxpayers in a tax trial? Who represents the tax authority?

Under the Act, every taxpayer is entitled to represent himself or herself before any income tax authority, or the ITAT in connection with any proceeding under the Act relating to him or her. Additionally, the taxpayer is also permitted to attend through an 'authorised representative', specifically defined under the provisions of the Act as including, inter alia, lawyers, accountants, any person regularly employed by the taxpayer, officers of banks dealing with the taxpayer, or any other person acquiring such qualifications as may be prescribed by the CBDT from time to time. Before the High Courts or the Supreme Court, only duly qualified lawyers may represent the taxpayer (unless the taxpayer appears in person).

The tax authority is typically represented by lawyers or accountants, as appointed by the government based on prescribed qualifications and experience. Currently under the Act and the rules framed thereunder, there are no provisions for taxpayers who cannot afford legal representation for themselves.

33 Are tax trial proceedings public?

While tax assessment proceedings are privately conducted, the situation is different for appellate proceedings.

Typically all tax trial proceedings are conducted by way of public hearings. However, in exceptional circumstances as determined under the Code of Civil Procedure or the rules of the High Court and Supreme Court, as the case may be, certain proceedings may be conducted as in camera proceedings.

34 Who has the burden of proof in a tax trial?

The general rule in this regard is that it is for the tax authorities to show any income being accrued by, or arising from, the taxpayer. This shifts the burden to the taxpayer to either dispute the claims of the authorities per se, or to show that such income is exempt under the provisions of the Act. Furthermore, certain presumptions operate with respect to unexplained money, undisclosed investments and unexplained expenditure under the provisions of the Act that are for the taxpayer to disprove, as given under sections 69A, 69B and 69C. Also, under section 96 of the Act, the burden of proof in cases being scrutinised under the GAAR (to be effective from 1 April 2017) shall be on the taxpayer.

Furthermore, the burden of proof in a tax trial, pursuant to an assessment under section 142 of the Act, is upon the taxpayer to not only establish the veracity of the returns filed by him, but also to disprove allegations of default, concealment etc, made by the tax authority in this regard.

Section 54 of the Black Money Act provides that for criminal prosecutions under this act there is a presumption that the accused has the required culpable mental state for an offence. Thus it is presumed that the accused had the intention, motive or knowledge of a fact or belief in, or reason to believe, a fact to commit an act considered an offence under this act and the accused must prove his or her innocence beyond a reasonable doubt. This is a matter for concern as the burden of proof has been shifted to the accused, despite the fact that penal consequences are being sought to be imposed.

35 Describe the briefing process for a tax trial.

In India, tax trials are governed by procedures prescribed under the Act, and the accompanying Rules, as well as the rules of procedure of the ITAT and the AAR, which as such have the power to frame their own rules.

Tax trials at the level of the ITAT and the AAR are the final stage at which evidence may be appreciated, and at which determination of facts by the AO and the CIT(A) may be controverted. There is no system of summary proceedings under Indian law for tax trials, and all matters at this level typically involve disputing determinations of facts by the lower authorities. As such, questions of law and fact are taken together during such proceedings, with the parties having the right to submit additional evidence in terms of documentation and affidavits as testimony. After an appreciation of all evidence, all questions presented to the authorities are ruled upon. Equal opportunity of being heard, and of responding to claims of the other side, is afforded to both the taxpayer and the Revenue.

The rulings of the ITAT and the AAR are binding upon all authorities subordinate to them. With regard to the AAR, lower authorities are bound only to the extent of the specific case being dealt with and the specific questions answered.

Beyond the ITAT and the AAR, the rules of the High Court and the Supreme Court govern the appellate proceedings, and the proceedings here are restricted to adjudication on significant questions of law. Whether a case is fit to be appealed before the High Court from the ITAT depends on, for example, if a significant question of law has arisen, or if it is subject to determination in 'admission proceedings'. Only cases 'admitted' by the court are taken up for adjudication on the merits.

36 Can a court decision be appealed?

Yes, a court decision can be appealed subject to certain conditions as specified above. All decisions from the CIT(A) may be appealed before the ITAT within a specified time frame of 60 days from the date of the order that is sought to be appealed. However, appeals from the decision of the ITAT to the High Court will be permitted only in circumstances where the order of the ITAT presents substantial questions of law. Similarly, only decisions of the High Court, which present substantial questions of law, or deal with questions upon which there are conflicting decisions of the High Court, may be appealed against before the Supreme Court.

The statutorily prescribed time frame for disposal of cases by the ITAT is four years from the end of the financial year in which such appeal is filed. There is no such time frame prescribed for appeals before the High Court or the Supreme Court.

As discussed earlier, if tax authorities act without jurisdiction, remedies may also be available directly before the High Court through writ petitions under article 226 of the Constitution of India.

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