Making it Harder for Multinational Businesses to Dodge Paying Tax
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Presentation by
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Economic Outlook

- Globalisation of economies
- Liberalisation in foreign exchange controls
- Huge surge in cross-border transactions
- Increased presence of multinational companies and their vast expansion in international operations
Challenges

- Illicit Financial Flows
- Tax base erosion and profit shifting (A G-20 project and OECD is working on this)
- Proliferation of double non-taxation among MNCs


- Flows of illicit money out of developing countries from tax evasion, crime and corruption was USD 5.9 trillion in the last decade 2001-2010

From India (at eighth place) cumulative outflow USD 123 billion in the period 2001-2010
Illicit Financial Flows

- By cross-border transaction of goods and services between related parties;
- By cross-border transaction of goods and services between unrelated parties;
- Hawala;
- Money earned out of illegal activities such as drug trafficking, terrorist financing etc.
Enormity of Illicit Financial Flows

- Media reports - Substantial money stashed in offshore banks in Tax havens.
- But no reliable estimate - claims are drastically varying (from USD 2 Billion to USD 1500 billion)
- Concerns over the GFI estimates:
  - What about illicit inflows - unrecorded?
  - How to measure money round tripped coming back in the form of FDI, P-Notes?
How MNEs Dodge

- Aggressive tax planning
- Multi layering of transactions
- Wrong characterisation of income
- Setting up shell companies in tax havens
- Trade mispricing
- Money laundering techniques
- Exploiting loopholes in laws
- Specific tax avoidance schemes
Five priorities advocated by the Task Force

- Curtailing Trade Mispricing
- Country-by-Country Reporting
- Transparency of Beneficial Ownership
- Automatic Cross-Border Exchange of Tax Information
- Anti-Money Laundering
Indian scenario

- Tackling dodging of tax by MNEs
  - Rationalisation of tax structure and legislative clarity
  - Transparent and fair tax administration
  - Strict disclosure norms, particularly for intra group transactions
  - Quick and effective exchange of information
  - Standardised global norms on taxation of e-commerce
India is following a five pronged strategy to tackle the menace of generation and outflow of illicit flow. It comprises of

- Joining the Global Crusade against black money
- Creating an appropriate legislative framework
- Setting up institutions for dealing with illicit money
- Developing systems for implementation
- Imparting skills to the manpower for effective action
Five Pronged Strategy

- Joining the Global Crusade against black money
  - Efforts to build consensus at G20 for global transparency and exchange of information for tax purposes including making of automatic exchange of information as part of international standards
  - Effective representation at Global Forum on Transparency – India vice chair of PRG
  - First country outside the block of OECD and EC to join the Multilateral Convention – vice-chair of coordinating body
  - Joining Financial Action Task Force
  - Joining other International Conventions
  - Actively engaged with the G-20 Project on Base Erosion and Profit Shifting – MNEs are not paying fair amount of taxes in the jurisdictions in which they are operating
  - Building Consensus in BRICS countries for strong action against IFF
Five Pronged Strategy

- Creating an appropriate legislative framework
- Strengthening of Direct Tax Laws and Administrative Practices
  - GAAR
  - Reporting mechanism of assets located outside India
  - Toolbox of countermeasures
  - Special courts for prosecution
- Large network of treaties
  - 85 DTAAs – 3 more signed – 12 under negotiation
  - 11 TIEAs – 2 more signed – 33 under negotiation
  - Bringing existing DTAAs to the International Standards
Five Pronged Strategy

- Prevention of Money Laundering Act.
- Prevention of Benami Transactions Act.
- Prevention of Bribery of Foreign Public Officials Act.
- Financial Intelligence Unit- India-(FIU-IND).
  - Suspicious Transactions Reporting
- Beneficial ownership norms.
Five Pronged Strategy

- Setting up institutions for dealing with illicit money
  - Directorate of Criminal Investigation (DCI)
  - Cell for Exchange of Information
  - Income Tax Overseas Units – two established – approval for eight more obtained
- Strengthening of FT&TR Division
- Goods and Services Tax Network
Five Pronged Strategy

- Strengthening internal structures by developing innovative systems.
  - Integrated Taxpayer Data Management System (ITDMS) and 360 degree profiling
  - Adoption of more data mining techniques
  - Strengthening the Systems Directorate – new initiatives- e-filing, CPC, CPC-TDS etc.
  - Cyber forensic Labs and Work Stations
  - Computer Aided Investigation Tool (CIAT) conceived by CBDT to assist the investigators in carrying out tax audits after conducting relevant enquiries
Five Pronged Strategy

- Imparting skills to the manpower for effective action
  - Regularly upgrade the skills of officers and staff and to provide exposure to them to the international experience and global best practices
  - Human Resource Management System (HRMS) to identify officers who require specialized training, as also the training requirements of all personnel.
  - Makes proactive efforts to regularly upgrade the skills of employees by providing them opportunities for training on anti-money laundering, terrorist financing and related economic issues.
Future Roadmap

- Preventing Generation of Illicit Money
- Reducing Disincentives against Voluntary Compliance
  - Rationalization of Tax Rates
  - Reducing Transaction Costs of Compliance and Administration
  - Further Economic Liberalization
- Identification and Reforms in Sectors Vulnerable to Generation of Black Money
Future Roadmap

- Effective Credible Deterrence and Detention
  - Integration of Databases Leading to Actionable Intelligence by Monitoring Agencies
  - Coordination amongst various Intelligence Agencies
- Strengthening of Direct Taxes Administration
- Strengthening of Prosecution Mechanism
- Enhanced Exchange of Information with Foreign Jurisdictions (including Automatic Exchange)
COMMENTS ON SPECIFIC TOPICS
Exchange of Information

- TIEAs with 22 priority jurisdictions
  - Negotiations completed with 17 countries/jurisdictions
  - 9 TIEAs signed (Argentina, Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Isle of Man, Jersey, Guernsey, and Liberia)
  - 5 entered into force (Bahamas, Bermuda, British Virgin Islands, Cayman Islands, and Isle of Man)
- New jurisdictions for TIEAs identified
- India will have one of the largest networks of DTAAs and TIEAs
Exchange of Information

- In the beginning of 2009, 78 DTAAs
- In 3 DTAAs Article 26 was as per International Standards
- Renegotiation started in other 75 DTAAs
  - Negotiation finalized in 26 cases
  - 7 signed, 4 entered into force
- Negotiation of 19 new DTAAs
  - New DTAAs - Article 26 as per International Standards
  - 9 signed, 4 entered into force
Anti Avoidance Provisions in DTAAs

- **Residence:**
  - rule generally provide that only residents of the India or other contracting state are entitled to the benefits of the treaty.
  - “tie-breaker” rule to determine residence when an individual, company or other person initially may be considered a resident of two contracting states.

- **Beneficial ownership:** requires that the person claiming treaty benefits with respect to an item of income be the “beneficial owner” of such income.

- **Arm’s length rules:** authorize tax authorities to adjust the transfer pricing based on an arm’s length price.
Anti Avoidance Provisions in DTAAs

- Fiscally transparent entities: prevent the use of fiscally transparent entities to claim treaty benefits when the entity is not subject to tax on the income in residence state.
- Anti-conduit rules: treat benefits are denied to income passed through a conduit arrangements.
- LOB:
  - deny treaty benefits if main purpose of creation of an entity is to obtain treaty benefit that would not otherwise be available, or
  - deny treat benefits to a legal entity not having bonafide business purpose, or
  - allow application of domestic provision to prevent tax evasion.
Base Erosion and Profit Shifting (BEPS)

- Source based taxation
- Place of effective management should be the place where economic activities of MNEs take place.
- Threshold for PE needs to be changed to take care of technological advancement and increasing mobility of cross-border businesses.
Base Erosion and Profit Shifting (BEPS)

- Artificial distinction between “liable to tax” and “subject to tax” should be removed.
- Details of MNEs not paying taxes should be highlighted in the report.
- The report is silent on misuse of multi-layered corporate structure, a popular vehicle to shift their profits out of the country of business operations.
Base Erosion and Profit Shifting (BEPS)

Transfer Pricing

- Undue emphasis on ‘risk’ and control of risk in TP matters.
- No internationally agreed standard on ownership of intangibles—legal ownership vs. economic which has lead to erosion of tax base of developed as well as developing countries.
- Payments for Intragroup Services—another means of profit shifting.
Base Erosion and Profit Shifting (BEPS)

- The artificial classification of the entrepreneurial work as low risk arrangement or limited risk arrangement has opened new avenues to shift profit from countries where all the core functions are being performed.
India supports Inter-Governmental Commission over the existing committee of experts.

India does not support the OECD Transfer Pricing Guidelines (TPG) to be followed by all countries including developing countries, as indicated by Group of Experts in the year 1999 (Para 3, Article 9 UN Model commentary).
Thank You