



# news flash

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## India prepares to crack black money

The BJP led government made promises to curb the menace of black money in India during its electoral campaign in March last year. True to its promises, the government in March 2015 through the Finance Minister Mr. Arun Jaitley announced the introduction of Undisclosed Foreign Income and Assets (Imposition of Tax) Act 2015 (“UFIA Act”) to tax foreign undisclosed income and assets of tax residents of India. The UFIA Act has now been passed by both the houses of the Parliament and has received the President’s assent on 26<sup>th</sup> May 2016. The Act provides for separate taxation of any undisclosed income in relation to foreign income and assets with effect from 1<sup>st</sup> April 2015. Such income will henceforth not be taxed under the Income-tax Act, 1961 (“IT Act”) but under the stringent provisions of the UFIA Act.

### Applicability of the UFIA Act

The provisions of the UFIA Act applies to a person who is a tax resident of India (other than ‘not ordinarily resident’) as per the tests contained in IT Act by whom tax is payable under the UFIA Act on undisclosed foreign income and assets or any other sum of money and includes every person who is deemed to be an assessee in default under the provisions of the UFIA Act. The term ‘person’ is not defined in the UFIA Act so its definition under the IT Act must be adopted. A person is said to be ‘not ordinarily resident’ in India in a financial year if such person has been a non-resident in India in 9 out of 10 financial years preceding that year or has stayed for a period(s) amounting to 729 days or less during 7 financial years preceding that year.

To determine the residential status of individuals, the IT Act provides for a day-count test of physical stay in India, for companies, however, with effect from 1<sup>st</sup> April 2015 the test of ‘place of effective management’ (“POEM”) in India applies to determine its residential status.

Accordingly, a foreign company will be considered tax resident in India if its POEM is in India at any time in the relevant financial year. POEM has been defined to mean “a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made”. Thus, it will be important to analyze whether the activities carried by a foreign company (viz holding board meeting in India, having Indian directors etc) would create POEM of foreign company in India. If a POEM of a foreign company is created in India, it will be required to comply with the provisions of the UFIA Act.

The scope of applicability of provisions of the UFIA Act is further expanded by the provisions imposing personal liability on manager (including a managing director) of a company to pay any amount due under the UFIA if the amount is not recoverable from the company. Furthermore, partners in a partnership, members of an Association of Persons (AOPs) or of a body of

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Individuals (BoI) have also been made liable to pay any amount due under the UFIA Act along with the partnership, AoP or BoI.

## Scope of the UFIA Act: Nature of Assets and Income included

The UFIA Act covers undisclosed foreign income and assets, which has been defined in section 2(12) of the UFIA Act to mean the total amount of undisclosed income from a source located outside India (“UPI”) and the value of an undisclosed asset located outside India (“UFA”).

Section 4 of the UFIA Act provides that the UFI encompasses foreign income: (i) which has not been disclosed under applicable tax returns under the IT Act or (ii) for which a tax return should have been filed under the IT Act but was not filed. Further, section 2(11) of the UFIA Act defines UFA to mean an asset (including financial interest in any entity) located outside India, held by a taxpayer in his name or in respect of which he is a beneficial owner and he has no explanation about the source of investment in such asset or his explanation is not satisfactory in the opinion of the Assessing Officer. The term ‘financial interest in any entity’ is not defined in the IT Act or the UFIA Act.

## Consequences of having UFIA

The total undisclosed foreign income and asset of an assessee will be chargeable to tax at a flat rate of 30% of such undisclosed income and asset without allowing any exemption, deduction or set off of carried forward losses regardless of whether those were allowable under the IT Act.

Tax is levied in the financial year, in which such asset comes to the notice of the Assessing Officer on the fair market value of UFA (as it stands in such financial year). Thus, tax would need to be paid on the unrealised appreciated value of the UFA. The manner of determination of the fair market value will be prescribed in the rules. However, while calculating the total undisclosed foreign income, income already assessed under the IT Act shall be deducted from the value of the UFA if the assessee furnishes satisfactory evidence of such prior assessment.

## Penalties and Prosecution

The UFIA Act provides for penalties and prosecution in case of default of certain acts and omissions. A summary of the same has been provided below:

Applicable provision of the UFIA Act	Default	Consequences
Section 41	Failure to disclose foreign income and asset	Penalty of a sum equal to three times the tax assessed
Section 42	Failure to furnish return in relation to foreign income and assets	Penalty of INR 1 million
Section 49	Wilful failure to furnish returns in due time in relation to foreign income and assets	Rigorous imprisonment for 6 months, may extend upto 7 years and fine

Section 43	Failure to furnish information or furnishing inaccurate asset particulars in a return of income, in relation to foreign income and assets	Penalty of INR 1 million
Section 50	Wilful failure to furnish information relating to a foreign asset or disclose any foreign income in a return	Rigorous imprisonment for 6 months may extend upto 7 years and fine
Section 44	Default in payment of tax arrears	Penalty equal to the amount of tax arrears
Section 45	Other defaults such as failure to sign legal statements, provide accounts etc.	Penalty of INR50,000 may extend to INR 200,000
Section 51(1)	Wilful attempt by a resident other than a 'resident who is not ordinarily resident' to evade tax, interest or penalty chargeable under the UFIA Act	Rigorous imprisonment of 3 years may extend upto 10 years and fine
Section 51(2)	Wilful attempt by any person to evade payment of any tax, interest or penalty chargeable under the UFIA Act	Rigorous imprisonment for 3 months, may extend upto 3 years and fine
Section 52	Making a false statement in verification which is known or believed to be false	Rigorous imprisonment for 6 months, may extend upto 7 years and fine
Section 53	Abetting or inducing another to make and deliver a false account or statement or declaration relating to tax payable or to wilfully attempt to evade tax, interest or penalty	Rigorous imprisonment for 6 months, may extend upto 7 years and fine
Section 58	Second and every subsequent offence	Rigorous imprisonment of 3 years may extend upto 10 years and fine of INR 0.5 million which may extend upto INR 10million

It is however important to note that, penalties for failure to disclose foreign income and asset and file return in respect of such income and asset under section 41 and section 42 of the UFIA Act, are not applicable to a UFA being one or more bank accounts having a maximum aggregate balance (at any time during a financial year) of INR 500,000. (approximately USD 8,000)

### One Time Compliance Window

Section 59 of the UFIA Act offers a one-time compliance window for a limited duration of time (period yet to be notified by the Government) for persons to declare any UFA outside India and acquired from income chargeable to tax under the IT Act for any financial year prior to financial

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year 2015-16. Such person would be required to pay tax at the rate of 30% of the value of the UFA along with penalty (equal to the tax).

It is worth noting that the UFIA Act does not provide any amnesty scheme. The onetime compliance window provided under the UFIA Act protects an assessee only from prosecution for failing to declare the foreign asset however such person would still be subject to penalty of a sum equal to 100 % of such tax. The declaration under section 59, however, can only be made once, subsequent declaration (if any) made by a person in respect of his asset or as a representative assessee of any other person is void under section 62(3) of the UFIA Act.

## Other related amendments

The UFIA Act has amended the Prevention of Money Laundering Act, 2002 (PMLA) by including the offence of tax evasion as a predicate offence under the PMLA, thus enabling the confiscation of foreign assets unaccounted for and prosecution of persons involved.

The Finance Act 2015 has inserted section 37A in the Foreign Exchange Management Act, 1999 (FEMA) to provide that foreign assets held in contravention of the provisions of FEMA may trigger seizure and confiscation of assets of equivalent value in India.

## Conclusion

The UFIA Act is comprehensive in its reach, and intends to cover a broad spectrum of individuals and corporations. The only criterion under the UFIA Act is the non disclosure of the foreign asset and income in the return of income furnished under section 139 of the IT Act and it does not seem to matter if the UFA was legally acquired or not. As it stands now, it appears that the UFIA Act imposes its strict consequences even where the structure has been set up in a legally compliant manner, if there has been a non-disclosure. Furthermore, lack of distinguishing factors or guiding principles in the UFIA Act to distinguish legal and illegal structures increases the likelihood of harassment of taxpayer. It would have been an efficacious legislation if the UFIA Act would have contained adequate checks and balances to avoid harassment of taxpayers.

It would be interesting to see the form and manner of declaration under one time compliance window, once the government notifies the rules for implementation of the provisions contained in the UFIA Act. Furthermore, the government must clarify certain important aspects such as availability of treaty benefits under existing DTAA's, and availability of credit for taxes paid in the source country where the undisclosed foreign asset and income is located.

The provisions of the UFIA Act raises further concerns in respect of the following:

- The UFIA Act is applicable to resident taxpayers (as defined under the IT Act) who have undisclosed foreign income/assets. Thus, expatriate employees, including their family members, qualifying as residents would also fall within the ambit of the UFIA Act.
- The UFIA Act seems to focus on bringing back black money stashed abroad; it however, does not deal with controlling the creation of black money in India.

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- In order to be outside the purview of the Act, a person having UFA may transfer their UFAs in favour of a person not resident in India, thus defying the purpose of the UFIA Act.

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